

Guidewire Software, Inc.
Form 10-Q
November 30, 2017
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 October 31, 2017

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

1001 E. Hillsdale Blvd., Suite 800	94404
Foster City, California	
(Address of principal executive offices)	(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," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer

Non-accelerated filer (do not check if a smaller reporting company) Smaller reporting company

Emerging growth company ..

Table of Contents

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

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

On October 31, 2017, the registrant had 75,362,109 shares of common stock issued and outstanding.

Table of Contents

Guidewire Software, Inc.
Index

Part I – Financial Information

Item 1.	<u>Financial Statements (unaudited):</u>	<u>3</u>
	<u>Condensed Consolidated Balance Sheets as of October 31, 2017 and July 31, 2017</u>	<u>3</u>
	<u>Condensed Consolidated Statements of Operations for the Three Months Ended October 31, 2017 and 2016</u>	<u>4</u>
	<u>Condensed Consolidated Statements of Comprehensive Loss for the Three Months Ended October 31, 2017 and 2016</u>	<u>5</u>
	<u>Condensed Consolidated Statements of Cash Flows for the Three Months Ended October 31, 2017 and 2016</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>24</u>
Item 3.	<u>Quantitative and Qualitative Disclosures about Market Risk</u>	<u>36</u>
Item 4.	<u>Controls and Procedures</u>	<u>37</u>
	<u>Part II – Other Information</u>	<u>38</u>
Item 1.	<u>Legal Proceedings</u>	<u>38</u>
Item 1A.	<u>Risk Factors</u>	<u>38</u>
Item 6.	<u>Exhibits</u>	<u>55</u>
	<u>Signatures</u>	<u>56</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, results of operations, 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,” “continue,” 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;
- the developing market for subscription services and uncertainties attendant on emerging sales and delivery models;
- trends in future sales, including the mix of licensing and subscription models and seasonality;
- our competitive environment and changes thereto;
- competitive attributes of our software applications and delivery models;
- challenges to further increase sales outside of the United States;
- our research and development investment and efforts;
- expenses to be incurred, and benefits to be achieved from our acquisitions;
- our gross and operating margins and factors that affect such margins;
- our provision for tax liabilities and other critical accounting estimates;
- the impact of new accounting standards and any contractual changes we have made in anticipation of such changes;
- our exposure to market risks, including geographical and political events that may negatively impact our customers;
- 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. together with its subsidiaries 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

(in thousands)

	October 31, 2017	July 31, 2017
	(unaudited)	
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$255,399	\$263,176
Short-term investments	305,685	310,027
Accounts receivable	78,408	79,433
Prepaid expenses and other current assets	28,142	26,604
Total current assets	667,634	679,240
Long-term investments	92,388	114,585
Property and equipment, net	13,806	14,376
Intangible assets, net	66,538	71,315
Deferred tax assets, net	146,005	37,430
Goodwill	141,924	141,851
Other assets	21,853	20,104
TOTAL ASSETS	\$1,150,148	\$1,078,901
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable	\$14,233	\$13,416
Accrued employee compensation	24,579	48,882
Deferred revenues, current	86,661	91,243
Other current liabilities	9,959	10,075
Total current liabilities	135,432	163,616
Deferred revenues, noncurrent	24,519	19,892
Other liabilities	1,796	2,112
Total liabilities	161,747	185,620
STOCKHOLDERS' EQUITY:		
Common stock	8	8
Additional paid-in capital	850,705	830,014
Accumulated other comprehensive loss	(6,567)	(5,796)
Retained earnings	144,255	69,055
Total stockholders' equity	988,401	893,281
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$1,150,148	\$1,078,901

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 shares and per share amounts)

	Three Months Ended	
	October 31,	
	2017	2016
Revenues:		
License and other	\$ 30,093	\$ 38,721
Maintenance	18,930	16,532
Services	59,148	38,874
Total revenues	108,171	94,127
Cost of revenues:		
License and other	6,715	2,430
Maintenance	3,467	3,325
Services	52,712	36,264
Total cost of revenues	62,894	42,019
Gross profit:		
License and other	23,378	36,291
Maintenance	15,463	13,207
Services	6,436	2,610
Total gross profit	45,277	52,108
Operating expenses:		
Research and development	35,711	30,750
Sales and marketing	23,610	25,500
General and administrative	18,671	14,160
Total operating expenses	77,992	70,410
Loss from operations	(32,715)	(18,302)
Interest income	1,908	1,342
Other expense, net	(262)	(681)
Loss before income taxes	(31,069)	(17,641)
Benefit from income taxes	(22,155)	(9,783)
Net loss	\$(8,914)	\$(7,858)
Net loss per share:		
Basic	\$(0.12)	\$(0.11)
Diluted	\$(0.12)	\$(0.11)
Shares used in computing net loss per share:		
Basic	75,187,437	73,293,467
Diluted	75,187,437	73,293,467

See accompanying Notes to Condensed Consolidated Financial Statements.

Table of Contents

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

	Three Months Ended October 31,	
	2017	2016
Net loss	(8,914)	(7,858)
Other comprehensive loss:		
Foreign currency translation adjustments	(696)	(851)
Unrealized losses on available-for-sale securities, net of tax benefit of \$45 and \$134 for the three months ended October 31, 2017 and 2016, respectively	(90)	(196)
Reclassification adjustment for realized losses (gains) included in net loss	15	(27)
Other comprehensive loss	(771)	(1,074)
Comprehensive loss	(9,685)	(8,932)

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)

	Three Months Ended October 31,	
	2017	2016
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	\$(8,914)	\$(7,858)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	6,634	3,074
Stock-based compensation	19,623	17,877
Deferred income tax	(23,708)	(10,502)
Amortization of premium on available-for-sale securities, and other non-cash items	210	467
Changes in operating assets and liabilities:		
Accounts receivable	855	8,682
Prepaid expenses and other assets	(3,575)	191
Accounts payable	1,868	902
Accrued employee compensation	(23,953)	(21,300)
Other liabilities	(356)	(1,251)
Deferred revenues	68	(3,192)
Net cash used in operating activities	(31,248)	(12,910)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of available-for-sale securities	(66,843)	(200,893)
Sales of available-for-sale securities	93,039	157,163
Purchases of property and equipment	(1,899)	(2,474)
Capitalized software development costs	(517)	—
Acquisitions of business, net of acquired cash	—	(33,593)
Net cash provided by (used in) investing activities	23,780	(79,797)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from issuance of common stock upon exercise of stock options	365	1,112
Net cash provided by financing activities	365	1,112
Effect of foreign exchange rate changes on cash and cash equivalents	(674)	(924)
NET DECREASE IN CASH AND CASH EQUIVALENTS	(7,777)	(92,519)
CASH AND CASH EQUIVALENTS—Beginning of period	263,176	223,582
CASH AND CASH EQUIVALENTS—End of period	\$255,399	\$131,063
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid for income taxes, net of tax refunds	\$1,283	\$1,062
SUPPLEMENTAL DISCLOSURES OF NONCASH INVESTING AND FINANCING ACTIVITIES:		
Accruals for purchase of property and equipment	\$374	\$188

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. The Company’s technology platform 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 are primarily insurance carriers for property and casualty (“P&C”) 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, 2017. 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, 2017 included in the Company’s Annual Report on Form 10-K except changes to the income taxes and stock based compensation policies resulting from the adoption of Accounting Standards Update (“ASU”) 2016-09.

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 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 primarily 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 classified as available-for-sale.

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.

7

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.

One customer individually accounted for 10% of the Company's revenues for the three months ended October 31, 2017. No customer accounted for 10% or more of the Company's revenues for the three months ended October 31, 2016. One customer individually accounted for 11% of the Company's total accounts receivable as of October 31, 2017, and another customer individually accounted for 11% of the Company's total accounts receivable as of July 31, 2017.

Revenue Recognition

The Company enters into arrangements to deliver multiple products or services (multiple-elements). For a substantial majority of its sales, the Company applies software revenue recognition rules and allocates the total revenues among elements based on vendor-specific objective evidence ("VSOE") of the 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 software subscriptions;
- (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 from professional services related to the implementation of the Company's software, reimbursable travel and training expenses.

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. Fees from term licenses are invoiced in advance in annual or quarterly installments over the term of the agreement beginning on the effective date of the license and represent extended payment terms. A significant majority are invoiced annually. As a result, term license fees are not considered to be fixed and determinable until they become due or payment is received. Perpetual license fees are generally due between 30 and 60 days from delivery of software. We offer extended payment terms in limited cases.

• Collectability is probable or reasonably assured. 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 reasonably assured, 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.

8

Table of Contents

Substantially all of the Company's professional services engagements are billed on a time and materials basis. Services are typically not considered to be essential to the functionality of the software, and the related revenues and costs are recognized in the period incurred.

In select situations, the Company will contract its professional services on a fixed fee basis. In these situations, if reliable estimates of total project costs are available, the Company recognizes services revenues on a proportional performance basis as the 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 the limited 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 revenue recognition is measured based on 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.

If reliable estimates of total project costs cannot be made, the zero gross margin or the completed contract method is applied to revenues and direct costs. Under the zero gross margin method, revenues recognized are limited to the direct costs incurred for the professional services. Under the completed contract method, revenues and direct costs are deferred until the project is complete. When the zero gross margin method is applied for lack of reliable project estimates and subsequently project estimates become reliable, the Company switches to the percentage-of-completion method, resulting in a cumulative effect adjustment for deferred license revenues to the extent of progress toward completion, and the related portion of the deferred professional service margin is recognized in full as revenues. The Company also sells its software on a subscription basis, and the related revenues are recognized ratably over the term of the arrangement typically upon provisioning the products.

As noted above, the Company generally invoices fees for licenses and maintenance to its customers in annual or quarterly installments payable in advance. Deferred revenues represent amounts, which are billed to or collected from creditworthy 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. All deferred tax assets and liabilities are classified as non-current on its condensed consolidated balance sheets. 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.

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 tax audits, changes 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 accounts for stock-based compensation using the fair value method, which requires the Company to measure the stock-based compensation based on the grant-date fair value of the awards and recognize the compensation expense over the requisite service period. The Company recognizes compensation expense net of actual forfeitures. To date, the Company has granted stock options, time-based restricted stock units (“RSUs”), performance-based restricted stock units (“PSUs”), and restricted stock units that may be earned subject to the Company’s total shareholder return ranking relative to the software companies in the S&P Software and Services Select Industry Index (“S&P Index”) for a specified performance period or specified performance periods, service periods, and in select cases, subject to certain performance conditions (“TSR PSUs”).

Table of Contents

The fair value of the Company's RSUs and PSUs equals the market value of the Company's common stock on the date of grant. These awards are subject to time-based vesting, which generally occurs over a period of four years. The Company recognizes compensation expense 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 that contain either a performance condition, market conditions, or both using the graded vesting method.

The fair value of the Company's TSR PSUs are estimated at the grant date using a Monte Carlo simulation method. The assumptions utilized in this simulation require judgments and estimates. Changes in these inputs and assumptions could affect the measurement of the estimated fair value of the related compensation expense. Compensation expense associated with these TSR PSUs will be recognized over the vesting period regardless of whether the market condition is ultimately satisfied, however, the expense will be reversed if a grantee terminates prior to satisfying the requisite service period. For TSR PSUs containing an additional performance condition, a portion of the expense may fluctuate depending on the achievement of the performance conditions. All TSR PSUs will vest at the end of a three-year period.

Business Combinations

The Company uses its best estimates and assumptions to assign fair value to the tangible and intangible assets acquired and liabilities assumed at the acquisition date. Goodwill is calculated as the difference between the acquisition-date fair value of the consideration transferred and the values assigned to the assets acquired and liabilities assumed. The Company's estimates of fair value are based upon assumptions believed to be reasonable, but which are inherently uncertain and subject to refinement and, as a result, actual results may differ from estimates. During the measurement period, which may be up to one year from the acquisition date, if new information is obtained about facts and circumstances that existed as of the acquisition date, the Company may record adjustments to the fair value of these assets and liabilities, with the corresponding offset to goodwill. Upon the conclusion of the measurement period or final determination of the fair value of assets acquired or liabilities assumed, whichever comes first, any subsequent adjustments are recorded to the Company's consolidated statements of operations.

Software Development Costs

For qualifying costs incurred for computer software developed for internal use, the Company begins to capitalize its costs to develop software when preliminary development efforts are successfully completed, management has authorized and committed project funding, and it is probable that the project will be completed and the software will be used as intended. These capitalized costs are amortized to expense over the estimated useful life of the related asset, generally estimated to be three years. Costs incurred prior to meeting these capitalization criteria and costs incurred for training and maintenance are expensed as incurred and recorded in research and development expense on the Company's consolidated statements of operations. Capitalized software development costs are recorded in property and equipment on the Company's consolidated balance sheet.

Impairment of Long-Lived Assets, Intangible Assets and Goodwill

The Company evaluates its long-lived assets, consisting of property and equipment and intangible assets, for indicators of possible impairment when events or changes in circumstances indicate that the carrying amount of certain assets may not be recoverable. Impairment exists if the carrying amounts of such assets exceed the estimates of future net undiscounted cash flows expected to be generated by such assets. Should impairment exist, the impairment loss would be measured based on the excess carrying value of the assets over the estimated fair value of the assets. The Company has not written down any of its long-lived assets as a result of impairment during the periods presented. The Company tests goodwill for impairment annually, during the fourth quarter of each fiscal year and in the interim whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. The Company evaluates qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test. In performing the qualitative assessment, the Company considers events and circumstances,

including but not limited to, macroeconomic conditions, industry and market considerations, cost factors, overall financial performance, changes in management or key personnel, changes in strategy, changes in customers, changes in the composition or carrying amount of a reporting unit's net assets and changes in the price of the Company's common stock. If, after assessing the totality of events or circumstances, the Company determines that it is more likely than not that the fair value of a reporting unit is greater than its carrying amount, then the two-step goodwill impairment test is not performed. There have been no goodwill impairments during the periods presented.

Recent Accounting Pronouncements

Share-Based Payment Accounting (Topic 718): Improvements on Employee Share-Based Payment Accounting

10

Table of Contents

In March 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2016-09, “Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting” (“ASU 2016-09”), which simplifies several aspects of the accounting for employee share-based payment transactions for both public and nonpublic entities, including the accounting for income taxes, forfeitures, and statutory tax withholding requirements, as well as classification in the statement of cash flows. The Company adopted ASU No. 2016-09 on August 1, 2017.

This ASU requires excess tax benefits and tax deficiencies related to share based payments to be recorded as income tax expense or benefit in the income statement when awards vest or are exercised. Cash flows associated with excess tax benefits are no longer classified as cash flows from financing activities but will be classified as operating activities, consistent with other income tax cash flows. The ASU also requires recognition of a windfall tax benefit at the time of settlement, instead of delaying recognition until it reduces current taxes payable; subject to normal valuation allowance considerations. Previously unrecognized excess tax benefits of \$85.7 million have been recorded as deferred tax assets net of valuation allowances of \$0.6 million, on a modified retrospective basis with a net cumulative effect adjustment to opening retained earnings of \$85.1 million. For the three months ended October 31, 2017, the benefit from income taxes included \$4.4 million in tax effects related to stock based awards settled in the period.

The Company elected to account for forfeitures based on actuals, as they occur, and using a modified retrospective transition method, recorded a cumulative-effect adjustment of \$1.0 million to decrease the Company’s opening retained earnings balance as of the adoption date.

The Company has prospectively classified excess tax benefits and deficiencies as operating activities on the condensed consolidated statement of cash flows, these were previously classified as financing activities.

The Company prospectively excluded excess tax benefits and deficiencies from assumed future proceeds in the calculation of diluted shares when using the treasury stock method. The effect of this change on the fully diluted net income per share was immaterial for the three months ended October 31, 2017.

Revenue from Contracts with Customers (Topic 606): Revenue Recognition

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606) (“ASU 2014-09”), 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.

In August 2015, the FASB issued ASU No. 2015-14, Revenue from Contracts with Customers: Deferral of the Effective Date, which deferred the effective date of this standard. As a result, the ASU and related amendments will be effective for the Company for its fiscal year beginning August 1, 2018, including interim periods within that fiscal year. Early adoption is permitted, but not before the original effective date of the ASU, August 1, 2017.

Subsequently, the FASB issued ASU No. 2016-08, Principal Versus Agent Consideration (or Reporting Revenue Gross versus Net) in March 2016, ASU No. 2016-10, Identifying Performance Obligations and Licensing in April 2016, and ASU No. 2016-12, Narrow-Scope Improvements and Practical Expedients in May 2016. These amendments clarified certain aspects of Topic 606 and have the same effective date as ASU 2014-09.

The Company will adopt these ASUs (collectively, Topic 606) on August 1, 2018. Topic 606 permits two methods of adoption: retrospectively to each prior reporting period presented (the “Full Retrospective Method”), or retrospectively with the cumulative effect of initially applying the guidance recognized at the date of initial application (the “Modified Retrospective Method”). The Company currently intends to apply the Modified Retrospective Method.

The Company has evaluated the potential impact of Topic 606 on its revenue recognition policy and practices and has concluded that Topic 606 will impact the pattern of its revenue recognition associated with its software licenses. The Company’s term licenses require payments to be made annually or quarterly in advance and are subject to extended payment terms. Currently, revenues associated with the payment for term software licenses are recognized in the earlier of the period in which the payments are due or are actually made. Under Topic 606, the Company will be

required to recognize the revenue associated with such payments not when they are made or due, but when control of the software license is transferred to the customer, which occurs at or near the time a contract with a customer is executed. As a result, under Topic 606, all contractually obligated payments under a term license that the Company reasonably expects to collect would be recognized upon delivery. In conjunction with its evaluation of this new standard, the Company began revising its contracting practices and amending existing agreements with certain customers primarily by shortening the initial, non-refundable term of its licenses. Since fiscal 2016, a substantial majority of new contracts feature a two-year initial term with subsequent one-year auto renewal options.

Table of Contents

The Company continues to evaluate the other potential impacts that Topic 606 will have on its consolidated financial statements, internal controls, business processes, and information technology systems including, for example, how to account for commission expenses, and the accounting for new subscription based offerings, including new revenue models acquired from recent acquisitions.

Financial Instruments (Topic 825): Recognition and Measurement of Financial Assets and Financial Liabilities

In January 2016, the FASB issued ASU No. 2016-01, Financial Instruments (Topic 825) (“ASU 2016-01”), which impacts certain aspects of recognition, measurement, presentation and disclosure of financial instruments. The standard will be effective for the Company beginning August 1, 2018. The Company is currently evaluating the effect the updated standard will have on its consolidated financial statements and related disclosures.

Share-Based Payment Accounting (Topic 718): Scope of Modification Accounting

In May 2017, the FASB issued ASU No. 2017-09, Scope of Modification Accounting (Topic 718) (“ASU 2017-09”), which amends the scope of modification accounting for share-based payment arrangements. ASU 2017-09 provides guidance on the types of changes to the terms or conditions of share-based payment awards to which an entity would be required to apply modification accounting under ASC 718. Specifically, an entity would not apply modification accounting if the fair value, vesting conditions, and classification of the awards are the same immediately before and after the modification. The new standard is effective for annual periods beginning after December 15, 2017 and interim periods within those years. Early adoption is permitted. The standard will be effective for the Company beginning August 1, 2018. The Company is currently evaluating the impact this update will have on its consolidated financial statements.

Leases (Topic 842): Accounting for Leases

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842) (“ASU 2016-02”), which requires lessees to put most leases on their balance sheets but recognize the expenses on their income statements in a manner similar to current practice. ASU 2016-02 states that a lessee would recognize a lease liability for the obligation to make lease payments and a right-to-use asset for the right to use the underlying asset for the lease term. The standard will be effective for the Company beginning August 1, 2019. The Company is currently evaluating the impact this update will have on its consolidated financial statements.

2. Fair Value of Financial Instruments

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

	October 31, 2017			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
	(in thousands)			
U.S. agency securities	\$21,652	\$ —	\$ (56)	\$21,596
Commercial paper	70,277	—	(14)	70,263
Corporate bonds	257,458	89	(221)	257,326
U.S. Government bonds	58,162	—	(172)	57,990
Certificates of deposit	28,976	14	(4)	28,986
Money market funds	183,467	—	—	183,467
Total	\$619,992	\$ 103	\$ (467)	\$619,628

Table of Contents

July 31, 2017

	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
(in thousands)				
U.S. agency securities	\$22,662	\$ —	\$ (66)	\$22,596
Commercial paper	147,371	2	(34)	147,339
Corporate bonds	258,334	157	(146)	258,345
U.S. Government bonds	67,164	—	(185)	66,979
Certificate of deposit	27,498	29	—	27,527
Money market funds	96,313	—	—	96,313
Total	\$619,342	\$ 188	\$ (431)	\$619,099

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:

October 31, 2017

	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)						
U.S. agency securities	\$16,059	\$ (34)	\$5,537	\$ (23)	\$21,596	\$ (57)
Commercial paper	18,079	(14)	—	—	18,079	(14)
Corporate bonds	174,857	(202)	12,973	(19)	187,830	(221)
U.S. Government bonds	45,301	(155)	12,690	(16)	57,991	(171)
Certificate of deposit	12,974	(4)	—	—	12,974	(4)
Total	\$267,270	\$ (409)	\$31,200	\$ (58)	\$298,470	\$ (467)

As of October 31, 2017, the Company had 110 investments in a gross unrealized loss position. The unrealized losses on its available-for-sale securities were primarily a result of unfavorable changes in interest rates subsequent to the initial purchase of these securities. The Company does not intend to sell, nor does it 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 October 31, 2017 to be other-than-temporarily impaired, nor are any unrealized losses considered to be credit losses. The Company has recorded the securities at fair value in its consolidated balance sheets, with unrealized gains and losses reported as a component of accumulated other comprehensive loss. The amount 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 material.

The following table summarizes the contractual maturities of the Company's investments measured at fair value:

October 31, 2017

	Less Than 12 Months		Total
	12 to 24 Months		
(in thousands)			
U.S. agency securities	\$21,596	\$—	\$21,596
Commercial paper	70,263	—	70,263
Corporate bonds	169,940	87,386	257,326
U.S. Government bonds	57,990	—	57,990
Money market funds	183,467	—	183,467

Certificates of deposit	23,984	5,002	28,986
Total	\$527,240	\$92,388	\$619,628

Table of Contents

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.

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 October 31, 2017 and July 31, 2017:

October 31, 2017

Level 1	Level 2	Level 3	Total
---------	---------	---------	-------

(in thousands)

Cash equivalents:

Commercial paper	\$—	\$38,088	\$	-\$38,088
Money market funds	183,467	—	—	183,467

Short-term investments:

U.S. agency securities	—	21,596	—	21,596
Commercial paper	—	32,175	—	32,175
U.S. Government bonds	—	57,990	—	57,990
Corporate bonds	—	169,940	—	169,940
Certificates of deposit	—	23,984	—	23,984

Long-term investments:

U.S. agency securities	—	—	—	—
Certificates of deposit	—	5,002	—	5,002
Corporate bonds	—	87,386	—	87,386
U.S. Government bonds	—	—	—	—
Total	\$183,467	\$436,161	\$	-\$619,628

Table of Contents

	July 31, 2017			
	Level 1	Level 2	Level 3	Total
	(in thousands)			
Cash equivalents:				
Commercial paper	\$—	\$98,174	\$—	-\$98,174
Money market funds	96,313	—	—	96,313
Short-term investments:				
U.S. agency securities	—	20,583	—	20,583
Commercial paper	—	49,165	—	49,165
U.S. Government bonds	—	47,105	—	47,105
Corporate bonds	—	170,654	—	170,654
Certificate of deposit	—	22,520	—	22,520
Long-term investments:				
U.S. agency securities	—	2,013	—	2,013
Certificate of deposit	—	5,007	—	5,007
Corporate bonds	—	87,691	—	87,691
U.S. Government bonds	—	19,874	—	19,874
Total	\$96,313	\$522,786	\$—	-\$619,099

3. Acquisitions

ISCS Acquisition

On February 16, 2017, the Company completed its acquisition of ISCS, Inc., a privately-held company that provides a cloud-based, all-in-one system for policy administration, billing and claims management to P&C insurers (“ISCS Acquisition”). The purchase price of the ISCS Acquisition was approximately \$160 million, subject to certain adjustments including a net working capital adjustment, which resulted in cash consideration paid of \$154.9 million. The fair value of all assets acquired and liabilities assumed will be finalized by the fiscal quarter ending April 30, 2018. A portion of the consideration has been placed into an escrow account as partial security to satisfy any potential claims, including the indemnification liability for state sales taxes. The ISCS Acquisition is intended to enhance the Company's ability to serve those P&C insurers that prefer a cloud-based, all-in-one platform that offers policy, billing, and claims management functionality. Total acquisition costs of \$1.1 million were expensed as incurred, and recorded as general and administrative expenses in the accompanying condensed consolidated statement of operations.

In connection with the ISCS Acquisition, the Company recorded an indemnification asset of \$1.6 million, which represents the selling security holders' obligation under the Agreement and Plan of Merger to indemnify the Company for unpaid state sales taxes. The indemnification asset was recognized on the same basis as the corresponding liability, which is based on its estimated fair value as of the date of acquisition.

The ISCS Acquisition was accounted for as a business combination. As part of the preliminary purchase price allocation, the Company determined that ISCS's separately identifiable intangible assets were developed technology, customer contracts and related relationships, and order backlog. The valuation method used was in accordance with the Company's policy, practice and experience as described above:

Table of Contents

	Total Purchase Price Allocation (in thousands)	Estimated Useful Lives (in years)
Acquired assets, net of assumed liabilities	\$ 4,551	
Developed technology	43,300	4
Customer contracts and related relationships	7,000	9
Order backlog	3,500	4
Deferred tax assets	171	
Goodwill	96,410	
Total preliminary purchase price	\$ 154,932	

The goodwill of \$96.4 million arising from the ISCS Acquisition consists largely of the acquired workforce, the expected company-specific synergies and the opportunity to expand the Company's customer base. The goodwill recognized is deductible for income tax purposes.

FirstBest Acquisition

In August 2016, the Company purchased all of the outstanding equity interests of FirstBest, Inc. During the three months ended October 31, 2017, the fair value of all assets acquired and liabilities assumed in the transaction, including acquired deferred tax assets, were finalized, and did not result in any additional adjustments to the preliminary purchase price allocation in the current quarter.

4. Balance Sheet Components**Property and Equipment, net**

Property and equipment consist of the following:

	October 31, 2017	July 31, 2017
	(in thousands)	
Computer hardware	\$21,537	\$21,408
Purchased software	3,884	3,855
Capitalized software development costs	1,520	1,065
Furniture and fixtures	3,404	3,253
Leasehold improvements	8,230	8,251
Total property and equipment	38,575	37,832
(Less) accumulated depreciation	(24,769)	(23,456)
Property and equipment, net	\$13,806	\$14,376

As of October 31, 2017 and July 31, 2017, no property and equipment was pledged as collateral. Depreciation expense was \$1.9 million and \$1.6 million for the three months ended October 31, 2017 and 2016, respectively.

During the third fiscal quarter of 2017, the Company began to capitalize software development costs for a cloud-based technology application that the Company will offer solely as a software subscription service. The amounts capitalized as of October 31, 2017 and July 31, 2017 were \$1.5 million and \$1.1 million, respectively, and comprised primarily of compensation and related headcount costs for employees who were directly associated with the software development projects.

Other Assets

The Company's other assets of \$21.9 million and \$20.1 million at October 31, 2017 and at July 31, 2017, respectively, include a strategic equity investment in a privately-held company of \$10.7 million, which was accounted for using the cost method of accounting. Strategic investments are non-marketable equity securities, in which the Company does not have a controlling interest or the ability to exert significant influence. These investments do not have a readily determinable market value. Under the cost method of accounting, the non-marketable securities are carried at cost and

are adjusted only for other-than temporary impairments, certain distributions and additional investments. Accordingly, if the Company were to disclose the fair value of the

16

Table of Contents

investment, the fair value measurement would be Level 3 in the valuation hierarchy. The Company assesses the investment for impairment when events or changes in circumstances indicate that its carrying amount may not be recoverable.

As of October 31, 2017 and July 31, 2017, there were no indicators that the investment with carrying value of \$10.7 million was impaired.

Goodwill and Intangible Assets

The following table presents changes in the carrying amount of goodwill for the period presented:

	(in thousands)
Goodwill, July 31, 2017	\$ 141,851
Changes in carrying value	73
Goodwill, October 31, 2017	\$ 141,924

The Company's intangible assets are amortized over the estimated useful lives. Intangible assets consist of the following:

	October 31, 2017 (in thousands)			July 31, 2017		
	Cost	Accumulated Amortization	Net Book Value	Cost	Accumulated Amortization	Net Book Value
Amortized intangible assets:						
Acquired technology	\$65,200	\$ 18,596	\$46,604	\$65,200	\$ 14,710	\$50,490
Customer contracts and related relationships	18,000	2,183	15,817	18,000	1,683	16,317
Partner relationships	200	35	165	200	30	170
Order backlog	5,500	1,548	3,952	5,500	1,162	4,338
Total amortized intangible assets	\$88,900	\$ 22,362	\$66,538	\$88,900	\$ 17,585	\$71,315

Amortization expense was \$4.8 million and \$1.4 million for the three months ended October 31, 2017 and 2016, respectively. As of October 31, 2017, the estimated aggregate amortization expense for each of the next five fiscal years is as follows:

	Future Amortization (in thousands)
Fiscal year ending July 31,	
2018 (remainder of fiscal year)	\$ 14,006
2019	17,541
2020	16,464
2021	9,995
2022	2,156
Thereafter	6,376
Total	\$ 66,538
Accrued Employee Compensation	

Table of Contents

Accrued employee compensation expense consists of the following:

	October 31, 2017	July 31, 2017
	(in thousands)	
Accrued bonuses	\$6,526	\$26,581
Accrued commission	403	5,228
Accrued vacation	11,509	10,873
Accrued salaries, payroll taxes and benefits	6,141	6,200
Total	\$24,579	\$48,882

Deferred Revenues

Deferred revenues, current and non-current, consist of the following:

	October 31, 2017	July 31, 2017
	(in thousands)	
Deferred license and other revenues	\$30,145	\$23,727
Deferred maintenance revenues	37,554	47,727
Deferred services revenues	43,481	39,681
Total	\$111,180	\$111,135

Accumulated Other Comprehensive Loss

Changes in accumulated other comprehensive loss by component during the three months ended October 31, 2017 were as follows:

	Foreign Currency (Loss) on Translation Adjustments (in thousands)	Unrealized Gain Available-for-Sale Securities	Total
Balance as of July 31, 2017	\$(5,630)	\$ (166)	\$(5,796)
Other comprehensive loss before reclassification	(696)	(135)	(831)
Amounts reclassified from accumulated other comprehensive loss to earnings	—	15	15
Tax effect	—	45	45
Balance as of October 31, 2017	\$(6,326)	\$ (241)	\$(6,567)

Table of Contents

5. Net Loss Per Share

The following table sets forth the computation of the Company's basic and diluted net loss per share:

	Three Months Ended October 31, 2017 2016 (in thousands, except share and per share amounts)	
Numerator:		
Net loss	\$ (8,914)	\$ (7,858)
Net loss per share:		
Basic	\$ (0.12)	\$ (0.11)
Diluted	\$ (0.12)	\$ (0.11)
Denominator:		
Weighted average shares used in computing net loss per share:		
Basic	75,187,430	73,293,467
Diluted	75,187,430	73,293,467

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 October 31, 2017 2016	
Stock options to purchase common stock	545,470	1,054,183
Restricted stock units	2,556,366	3,078,219

6. 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, 2017. See the Annual Report on Form 10-K for the fiscal year ended July 31, 2017 for additional information regarding the Company's contractual obligations.

Leases

The Company leases certain facilities and equipment under operating leases. Lease expense for all worldwide facilities and equipment, which is being recognized on a straight-line basis over terms of the various leases, was \$1.9 million and \$1.6 million for the three months ended October 31, 2017 and 2016, respectively.

Legal Proceedings

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 has not accrued for estimated losses in the accompanying condensed consolidated financial statements as the Company has determined that no provision for liability nor disclosure is required related to any claim against the Company because: (a) there is not a reasonable possibility that a loss exceeding amounts already recognized (if any) may be incurred with respect to such claim; (b) a reasonably possible loss or range of loss cannot be estimated; or (c) such estimate is immaterial. The Company has not recorded any accrual for claims as of October 31, 2017 or July 31, 2017. The Company expenses legal fees in the period in which they are incurred.

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.

19

Table of Contents

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 October 31, 2017 or July 31, 2017. 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.

7. 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 October 31, 2017 2016 (in thousands)	
Total stock-based compensation	\$19,614	\$18,104
Impact of capitalized stock-based compensation	9	(227)
Total stock-based compensation expenses	\$19,623	\$17,877

Stock-based compensation was charged to the following categories:

Cost of license and other revenues	\$174	\$51
Cost of maintenance revenues	455	413
Cost of services revenues	5,226	4,695
Research and development	4,912	4,467
Sales and marketing	4,217	4,223
General and administrative	4,639	4,028
Total stock-based compensation expenses	\$19,623	\$17,877

As of October 31, 2017, total unamortized stock-based compensation cost was as follows:

	As of October 31, 2017	
	Unrecognized Expense (in thousands)	Weighted Average Expected Recognition Period (in years)
Stock options	\$704	1.0
Restricted stock units	191,030	2.7
	\$191,734	

Table of Contents

Restricted Stock Units

A summary of the Company's RSU, PSU and TSR PSU, (collectively "Stock Awards"), activity under the Company's equity incentive plans is as follows:

	Stock Awards Outstanding		
	Number of Stock Awards Outstanding	Weighted Average Grant Date Fair Value	Aggregate Intrinsic Value (in thousands) ⁽¹⁾
Balance as of July 31, 2017	2,634,085	\$ 56.62	\$ 190,076
Granted	1,066,831	\$ 79.12	
Released	(332,100)	\$ 52.63	\$ 25,930
Canceled	(63,586)	\$ 61.08	
Balance as of October 31, 2017	3,305,230	\$ 64.20	\$ 264,352
Expected to vest as of October 31, 2017	3,305,230	\$ 64.20	\$ 264,352

Aggregate intrinsic value at each period end represents the total market value of Stock Awards at the Company's (1) closing stock price of \$79.98 and \$72.16 on October 31, 2017 and July 31, 2017, respectively. Aggregate intrinsic value for released RSUs represents the total market value of released Stock Awards at date of release.

Certain executives and employees of the Company received PSUs and TSR PSUs in addition to RSUs. The PSUs included performance-based conditions and vest over a four-year period. The TSR PSUs are subject to total shareholder return rankings relative to the software companies in the S&P Index for a specified performance period or specified performance periods, and vest at the end of three years. In select cases, certain TSR PSUs are also subject to performance-based conditions.

Stock Options

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

	Stock Options Outstanding			Aggregate Intrinsic Value ⁽¹⁾
	Number of Stock Options Outstanding	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (in years)	
Balance as of July 31, 2017	555,636	\$ 22.17	4.0	\$ 27,777
Granted	—			
Exercised	(22,384)	\$ 16.31		\$ 1,380
Canceled	—			
Balance as of October 31, 2017	533,252	\$ 22.42	3.8	\$ 30,696
Vested and expected to vest as of October 31, 2017	533,252	\$ 22.42	3.8	\$ 30,696
Exercisable as of October 31, 2017	493,449	\$ 20.34	3.6	\$ 29,429

Aggregate intrinsic value at each period end represents the difference between the Company's closing stock prices (1) of \$79.98 and \$72.16 on October 31, 2017 and July 31, 2017, 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

TSR PSUs

Table of Contents

The fair values of our TSR PSUs were estimated at the date of grant using the Monte Carlo simulation model which included the following assumptions:

	Three Months Ended	
	October 31,	
	2017	2016
Expected term (in years)	2.88	2.87-2.88
Risk-free interest rate	1.44%	0.89%-0.93%
Expected volatility of the Company	28.0%	31.5%
Average expected volatility of the peer companies in the S&P Index	34.7%	36.9%-37.0%
Expected dividend yield	-%	-%

The number of TSR PSUs that may ultimately vest will vary based on the relative performance of the Company's total shareholder return rankings relative to the software companies in the S&P Index for a specified performance period or specified performance periods. The Monte Carlo methodology incorporates into the valuation all possible outcomes, including that the Company's relative performance may result in no shares vesting. As a result, stock-based compensation expense is recognized regardless of the ultimate achievement of the plan's performance metrics. The expense will be reversed only in the event that a grantee is terminated prior to satisfying the requisite service period.

For a subset of TSR PSUs, the number of shares that may ultimately vest will vary based on the achievement of certain Company specific financial performance metrics in addition to the Company's total shareholder return condition noted above. As a result, the expense recognized will fluctuate based on the Company's estimated financial performance relative to the target financial performance metrics.

Common Stock Reserved for Issuance

As of October 31, 2017 and July 31, 2017, the Company was authorized to issue 500,000,000 shares of common stock with a par value of \$0.0001 per share and, of these, 75,362,109 and 75,007,625 shares of common stock were issued and outstanding, respectively. As of October 31, 2017 and July 31, 2017, the Company had reserved shares of common stock for future issuance as follows:

	October 31, 2017	July 31, 2017
Exercise of stock options to purchase common stock	533,252	555,636
Vesting of restricted stock units	3,305,230	2,634,085
Shares available under stock plans	17,450,429	18,453,674
Total common stock reserved for issuance	21,288,911	21,643,395

8. Income Taxes

The Company recognized income tax benefits of \$22.2 million and \$9.8 million for the three months ended October 31, 2017 and 2016, respectively. The increase in tax benefits for the three months ended October 31, 2017 was primarily due to the increase in the loss before taxes and an increase in tax benefits related to stock-based compensation from the adoption of ASU 2016-09 for the period, as compared to the same period a year ago. The effective tax rate of 71% for the three months ended October 31, 2017, differs from the statutory U.S. federal income tax rate of 35% mainly due to permanent differences for stock-based compensation, research and development credits, the tax rate differences between the United States and foreign countries, foreign withholding taxes, and certain non-deductible expenses including executive compensation.

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 October 31, 2017, U.S. income taxes were not provided for on the cumulative total of \$35.4 million undistributed earnings from certain foreign subsidiaries. As of October 31, 2017, the unrecognized deferred tax liability for these earnings was approximately \$10.6 million.

During the three months ended October 31, 2017, the increase in unrecognized tax benefits from the beginning of the period was \$0.5 million. Accordingly, as of October 31, 2017, the Company had unrecognized tax benefits of \$4.8 million that if recognized, would affect the Company's effective tax rate.

Table of Contents

9. 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. The Company's principal operations and decision-making functions are located in the United States.

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

	Three Months Ended October 31, 2017 2016 (in thousands)	
United States	\$69,834	\$46,849
Canada	10,195	14,494
Other Americas	4,742	5,224
Total Americas	84,771	66,567
United Kingdom	9,337	8,390
Other EMEA	6,624	8,941
Total EMEA	15,961	17,331
Total APAC	7,439	10,229
Total revenues	\$108,171	\$94,127

No country, other than those presented above, accounted for more than 10% of revenues during the three months ended October 31, 2017 and 2016, respectively.

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

	October 31, 2017	July 31, 2017
	(in thousands)	
Americas	\$219,679	\$224,667
EMEA	2,493	2,747
APAC	96	128
Total	\$222,268	\$227,542

Table of Contents

10. Subsequent Events

On November 1, 2017, the Company completed its acquisition of Cyence, Inc. (“Cyence”) for an aggregate consideration of approximately \$275 million, subject to customary transaction adjustments. The consideration consisted of net cash of approximately \$130 million and approximately 1.7 million shares of newly issued Guidewire common stock and options. Of those shares, approximately 250,000 are in the form of deferred equity consideration, which are subject to the achievement of certain retention and operating milestones. The Cyence acquisition is intended to provide the Company with a cloud-based data listening and risk analytics technology that enables the P&C insurance industry to grow by underwriting new and evolving risks such as cyber risk, that have gone underinsured or uninsured. The acquisition will be accounted for as a business combination. The Company has not yet completed its acquisition accounting for this transaction, and is in the process of evaluating the impact of the business combination on its consolidated financial statements.

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 assume no obligation to revise or update any forward-looking statements for any reason, except as required by law.

Overview

We are a provider of software products and subscription services for the global property and casualty (“P&C”) industry. Our software serves as a technology platform for P&C insurance primary carriers. Guidewire InsurancePlatform™ consists of applications to support core operations, data management and analytics, and digital engagement, and is connected to numerous data sources and third party applications. Our applications are designed to work together to strengthen our customers’ ability to adapt and succeed in a rapidly changing market. Guidewire InsuranceSuite™ and Guidewire InsuranceNow™ provide core transactional systems of record supporting the entire insurance lifecycle, including product definition, distribution, underwriting, policy holder services and claims management. Guidewire InsuranceSuite is a highly configurable and scalable system comprised primarily of three applications (ClaimCenter, PolicyCenter and BillingCenter) that can be licensed separately or together and can be deployed on-premise or in the cloud. Guidewire InsuranceNow is a cloud-based system that offers policy, billing, and claims management functionality to insurers that prefer an all-in-one solution. Our data and analytics applications enable insurers to manage data more effectively and gain insights into their business. Our digital engagement applications enable digital sales, omni-channel service and enhanced claims experiences for policyholders, agents, vendor partners and field personnel. The applications and services of Guidewire InsurancePlatform can be deployed on-premise, in the cloud or in a hybrid mode. To support P&C insurers globally, we have localized, and will continue to localize, our software for use in a variety of international regulatory, language and currency environments.

We sell our products to a wide variety of global P&C insurers ranging from some of the largest global insurance carriers or their subsidiaries to national and regional carriers. Our customer engagement is led by our direct sales model and supported by our system integrator (“SI”) partners. We maintain and continue to grow our sales and marketing efforts globally, and maintain regional sales centers in the Americas, Europe and Asia. Strong customer relationships are a key driver of our success given the long-term nature of our engagements 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. These evaluation periods can extend further if the customer purchases multiple products, which is common; or assesses the benefits of a cloud-based subscription in addition to our more traditional term licensing models. Sales to new customers also involve extensive customer due diligence and reference

checks. We must earn credibility with each successful implementation as we expand our sales operations, market products that have been acquired or newly introduced, and expand the ways we deliver our software. The success of our sales efforts relies on continued improvements and enhancements to our current products, the introduction of new products, and the continued development of relevant local content and the automated tools that we believe are optimal for updating that content.

To date, we have primarily licensed our software under term-license contracts. We generally price our licenses based on the amount of direct written premiums (“DWP”) that will be managed by our solutions. Our term licenses for both recurring term license and maintenance fees are typically invoiced annually in advance or, in certain cases, quarterly, and generally include extended payment terms. We assess whether a fee is fixed or determinable at the outset of the arrangement, primarily based on

Table of Contents

the payment terms associated with the transaction. As a result of our extended payment terms, our term license fees are not considered to be fixed and determinable until they become due or payment is received, resulting in a deferral of the related revenues until this revenue recognition criteria is met, assuming all other revenue recognition criteria are satisfied. In preparing for our adoption of the new revenue recognition standard, we began revising our contracting practices in fiscal 2016 by selling substantially all term-based licenses with an initial two-year committed term and optional annual renewals. We also began a program to amend existing long-term contracts to the same committed term of two-years with optional annual renewals. A small portion of our revenues are derived from perpetual licenses, for which license revenues are typically recognized upon delivery of the software, provided that all revenue recognition criteria have been met.

We also offer subscriptions to our cloud-based services. Currently, subscriptions may be for terms greater than two years, and we anticipate that a majority of our subscription arrangements will be billed annually or quarterly in advance, although in some instances additional fees may be assessed in arrears as customers increase their DWP. Revenues derived from subscriptions are recognized ratably over the contractual term beginning after the service is effectively provisioned, which is the date our service is made available to customers. We anticipate that sales of our subscriptions will increase as a percentage of annual sales as we sell more cloud-based services. As a result of the ratable recognition of revenues associated with subscriptions, a significant shift from term licenses to subscriptions may adversely affect our reported revenue growth. As this relatively new sales model matures, we may decide to change certain terms for future orders to remain competitive or otherwise meet market demands.

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. In certain cases we will also acquire skills and technologies to accelerate our time to market for new products and solutions.

Our track record of success with customers and their implementations is central to maintaining our strong competitive position. We rely on our services teams and leading SI partners to meet our customers' implementation needs. Our services organization is comprised of on-site, near-shore and off-shore technical experts. The services organization seeks to ensure that teams with the right combination of product and language skills are utilized in the most efficient way. Our partnerships with leading SIs allows us to increase 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. We continue to grow our services organization 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 or acquiring existing products successfully, migrating a portion of our business to a more ratable revenue recognition model as we bring to market more cloud-based solutions, 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. Our investments in services are designed to ensure customer success, both with on-premise and cloud-based solutions.

Acquisitions

On November 1, 2017, we completed the acquisition of Cyence, Inc. ("Cyence"), for an aggregate consideration of approximately \$275 million, including approximately \$130 million in cash and approximately 1.7 million shares of newly issued Guidewire common stock and options. Through the acquisition we gained a cloud-based data listening and risk analytics technology that enables the P&C insurance industry to grow by underwriting new and evolving risks

such as cyber risk, that have gone underinsured or uninsured. This acquisition will be accounted for as a business combination. We have not yet completed our acquisition accounting for this transaction, and we are in the process of evaluating the impact of the business combination on our consolidated financial statements.

In February 2017, we completed the acquisition of ISCS, Inc. (“ISCS”), for cash consideration, net of certain adjustments, of approximately \$154.9 million. Through the acquisition we gained a cloud-based, all-in-one transactional platform that combines policy, claims and billing management functionality for P&C insurers. Re-branded InsuranceNow, this platform enhances our ability to serve P&C insurers that have less complex businesses, require the functionality of a suite, and prefer cloud-based delivery. We will continue to invest in this platform, improving its scalability and performance, reducing its cost to implement and deliver,

Table of Contents

adapting it for international markets and integrating it to our data and analytics and digital products. The results of ISCS's operations have been included in our results of operations since February 16, 2017, the date of acquisition. In August 2016, we added Guidewire Underwriting Management through the acquisition of FirstBest, a provider of underwriting management systems and related applications to P&C insurers, for total consideration of approximately \$37.8 million. We believe that, over time, this acquisition will allow us to expand our insurance platform by providing insurers in the U.S. and Canada that write complex commercial, specialty, and workers' compensation lines greater support for their risk assessment and decision-making processes. The results of FirstBest's operations have been included in our results of operations since August 31, 2016, the date of acquisition.

Seasonality

We have historically experienced seasonal variations in our license and other revenues as a result of increased customer orders in our second and fourth fiscal quarters. We generally see a modest increase in orders in our second fiscal quarter, which is the quarter ending January 31, due to customer buying patterns. We also see significantly increased orders in our fourth fiscal quarter, which is the quarter ended July 31, due to efforts by our sales team to achieve annual incentives. This seasonal pattern, however, may be absent in any given year. For example, the timing of a small number of large transactions or the receipt of early payments may be sufficient to disrupt seasonal revenue trends. On an annual basis, our maintenance revenues which are recognized ratably, may also be impacted in the event that seasonal patterns change significantly. As we increase subscription sales, a concentration of such sales in our fiscal fourth quarter will reduce the revenues we can recognize in the fiscal year, which will impact the revenues reported in the fiscal year and our revenue growth.

Our services revenues are also subject to seasonal fluctuations, though to a lesser degree than our license revenues. Our services revenues are impacted by the number of billable days in a given fiscal quarter. The quarter ended January 31 usually has fewer billable days due to the impact of the Thanksgiving, Christmas and New Year's holidays. The quarter ended July 31 usually also has fewer billable days due to the impact of vacation times taken by our professional staff. Because we pay our services professionals the same amounts throughout the year, our gross margins on our services revenues are usually lower in these quarters. This seasonal pattern, however, may be absent in any given 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 four-quarter recurring revenues as well as operating cash flows and capital expenditures.

Four-Quarter Recurring Revenues

We measure four-quarter recurring revenues by adding the total term license and other revenues and total maintenance revenues recognized under GAAP in the preceding four quarters ended in the stated period. This metric excludes 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. In addition, growth in this metric will be adversely impacted during periods in which subscriptions increase as a percentage of total customer orders, as more of the revenue under those agreements will be deferred to future periods. This metric applies revenue recognition rules under GAAP and does not substitute individually tailored revenue recognition and measurement methods. Our four-quarter recurring revenues for each of the eight periods presented were:

	Four quarters ended							
	October 31, 2017	July 31, 2017	April 30, 2017	January 31, 2017	October 31, 2016	July 31, 2016	April 30, 2016	January 31, 2016
	(in thousands)							
Term license and other revenues	\$253,792	\$258,322	\$237,919	\$220,494	\$210,278	\$208,430	\$194,458	\$184,647
Maintenance revenues	71,041	68,643	66,958	64,776	62,451	59,931	56,103	53,610

Total four-quarter recurring revenues	\$324,833	\$326,965	\$304,877	\$285,270	\$272,729	\$268,361	\$250,561	\$238,257
---------------------------------------	-----------	-----------	-----------	-----------	-----------	-----------	-----------	-----------

Table of Contents

Operating Cash Flows and Capital Expenditures

We monitor our cash flows from operating activities and used for capital expenditures, 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 the timing of invoicing and collections of accounts receivable, the size of annual bonus payment, as well as payments of payroll and other taxes. As a result, our operating cash flows fluctuate significantly on a year over year basis. Cash used in operations were \$31.2 million and \$12.9 million for the three months ended October 31, 2017 and 2016, respectively. Additionally, cash used for capital expenditures were \$1.9 million and \$2.5 million for the three months ended October 31, 2017 and 2016, respectively. Our capital expenditures consisted of purchases of property and equipment, most of which was computer hardware, software and leasehold improvements. For a further discussion of our operating cash flows, see “Liquidity and Capital Resources-Cash Flows.”

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;

• Income taxes;

• Business combinations; and

• Long-lived assets, intangible assets and goodwill impairment.

There have been no changes to our significant accounting policies and estimates described in our Annual Report on Form 10-K that have had a material impact on our condensed consolidated financial statements and related notes, except for our election to change our accounting policy to account for the forfeitures and tax effects from stock-based compensation awards as they occur. The change was applied on a modified retrospective basis with a net cumulative effect adjustment of \$1.0 million recorded to our retained earnings balance as of August 1, 2017. 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 19, 2017 for a more complete discussion of our critical accounting policies and estimates.

Table of Contents

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 19, 2017.

	Three Months Ended October 31,					
	2017			2016		
	As a %		As a %			
	of total		of total			
	revenues		revenues			
	(in thousands except percentages)					
Revenues:						
License and other	\$30,093	28	%	\$38,721	41	%
Maintenance	18,930	18	%	16,532	18	%
Services	59,148	54	%	38,874	41	%
Total revenues	108,171	100	%	94,127	100	%
Cost of revenues:						
License and other	6,715	6	%	2,430	3	%
Maintenance	3,467	3	%	3,325	4	%
Services	52,712	49	%	36,264	38	%
Total cost of revenues	62,894	58	%	42,019	45	%
Gross profit:						
License and other	23,378	22	%	36,291	38	%
Maintenance	15,463	15	%	13,207	14	%
Services	6,436	5	%	2,610	3	%
Total gross profit	45,277	42	%	52,108	55	%
Operating expenses:						
Research and development	35,711	33	%	30,750	33	%
Sales and marketing	23,610	22	%	25,500	27	%
General and administrative	18,671	17	%	14,160	15	%
Total operating expenses	77,992	72	%	70,410	75	%
Loss from operations	(32,715)	(30)	%	(18,302)	(20)	%
Interest income	1,908	2	%	1,342	1	%
Other expense, net	(262)	—	%	(681)	—	%
Loss before income taxes	(31,069)	(28)	%	(17,641)	(19)	%
Benefit from income taxes	(22,155)	(20)	%	(9,783)	(11)	%
Net loss	\$(8,914)	(8)	%	\$(7,858)	(8)	%

Revenues

We derive our revenues primarily from licensing our software applications, providing maintenance support and professional services. Additionally, a growing portion of our revenues are derived from subscriptions to our cloud-delivered software.

We will adopt ASU No. 2014-09, "Revenue from Contracts with Customers (Topic 606)" on August 1, 2018. We currently intend to apply the Modified Retrospective Method. We have evaluated the potential impact of Topic 606 on our revenue recognition policy and practices and have concluded that Topic 606 will impact the pattern of our revenue recognition associated with our software licenses. Refer to Note 1 of the Notes to Condensed Consolidated Financial Statements included in this Form 10-Q for further details on our evaluation of the potential impact of Topic 606 and

our accounting policy related to revenue recognition.

Licenses and Other

A substantial majority of our license and other revenues are comprised of term license fees. We also recognize revenue from sales of perpetual licenses and software subscriptions. Our term license revenues are primarily generated through annual license fees that recur during the term of the contract. Since fiscal year 2016, a substantial majority of our term-based licenses have been sold with a contract of a two year committed term with optional annual renewals. Term-license revenues are generally recognized

Table of Contents

upon the earlier of when payment is due or cash is received from our customers. In a limited number of cases, we license our software on a perpetual basis or our 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. Perpetual license revenues are generally recognized upon delivery.

Cloud-delivered software subscription revenues are generally recognized ratably over the term of the arrangement typically beginning upon the provisioning of our service for each engagement, which is the point in time our provisioning process has been completed and access has been made available to the customer, assuming that all other revenue recognition criteria have been met. Such arrangements are not necessarily structured with a two year initial term and the initial term may be longer.

We generally price our software based on the amount of direct written premiums, or DWP, that will be managed by our software. We typically invoice our term-license customers annually or quarterly in advance. We invoice our perpetual license customers either in full at contract signing or on an installment basis. We currently anticipate billing our subscription customers annually or quarterly in advance, but terms may change as our cloud business matures and the market develops.

Maintenance

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. We typically invoice our customers annually or quarterly in advance.

Professional Services

Our professional services revenues are primarily derived from implementation services performed for our customers, reimbursable travel expenses and training 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.

Three Months Ended October 31,

	2017		2016		Change	
	Amount	% of total revenues	Amount	% of total revenues	(\$)	(%)
	(in thousands, except percentages)					

Revenues:

License and other	\$30,093	28 %	\$38,721	41 %	\$(8,628)	(22)%
Maintenance	18,930	18 %	16,532	18 %	2,398	15 %
Services	59,148	54 %	38,874	41 %	20,274	52 %
Total revenues	\$108,171	100 %	\$94,127	100 %	\$14,044	15 %

License and Other Revenues

The \$8.6 million decrease in our license and other revenues was primarily a result of: (i) the timing of early payments which operated to reduce recognized revenue, on a net basis, of approximately \$4.8 million, (ii) perpetual license orders received in the first fiscal quarter of 2017, and (iii) the prevalence of subscription agreements in the first fiscal quarter of 2018. Our license and other revenues are primarily comprised of term license revenues. Term licenses remain our predominant licensing model, although we anticipate subscription licenses to grow as a percentage of annual sales in future periods. Due to the delayed and ratable recognition of subscription revenues, growth in subscription revenues will lag behind the growth of subscription sales and will impact the comparative growth of our reported revenues.

Table of Contents

	Three Months Ended October 31,				Change	
	2017	2016	% of license	% of license	(\$)	(%)
	Amount revenues		Amount revenues			
	(in thousands, except percentages)					
License and other revenues:						
Term and other	\$29,970	100 %	\$34,500	89 %	\$(4,530)	(13)%
Perpetual	123	*	4,221	11 %	(4,098)	(97)%
Total license and other revenues	\$30,093	100 %	\$38,721	100 %	\$(8,628)	(22)%

* Not meaningful

The decrease in our term and other revenues was primarily a result of the timing of early payments received in the prior fiscal year's fourth quarter in advance of their due dates and, to a lesser extent, the impact from the ratable nature of subscription revenues and the concentration of transactions in the fourth quarter of the prior fiscal year.

Perpetual license revenues accounted for less than 1% and approximately 11% of total license and other revenue in the first quarter of fiscal 2018 and 2017, respectively. We anticipate that revenues from the sale and delivery of perpetual licenses will continue to represent a small percentage of our total license and other revenues. Nevertheless, we expect perpetual license revenues to remain volatile across quarters due to the large amount of perpetual revenue that may be generated from a single customer order.

Additionally, our license revenues may fluctuate based on the timing of large orders or if our customers pay their annual license fees in advance of the invoice due date either of which may cause an unexpected increase in revenues in one quarter which can reduce revenue growth rates in future periods. Finally, we anticipate that the small amount of our license and other revenues derived from cloud-delivered software services will increase over time. As a result of the delayed and ratable nature of subscription revenues, near-term revenue growth rates will be negatively impacted.

Maintenance Revenues

The increase in our maintenance revenues reflects our growing term and perpetual license customer base. Subscription arrangements include maintenance as part of the subscription service and are not priced or reported separately. As a result, an increase in the mix of subscription orders in the future will reduce the growth in maintenance revenues.

Services Revenues

The \$20.3 million increase in our services revenues was primarily a result of a net increase in billings from new and existing customer engagements performed during the three months ended October 31, 2017, including service revenues associated with InsuranceNow engagements, as well as the recognition of previously deferred amounts. Historically, we have relied on our network of third-party SI partners to facilitate new sales and implementations of our products. During the past several years we have undertaken a program which increased SI participation on our projects, causing growth in services revenues to moderate significantly. We believe this model will continue to serve us well and we intend, in the future, to continue to expand our network of SI partners and the number of trained consultants with whom we work.

We anticipate, however, that recent declines in services revenues growth rates will reverse as we increase our sales of cloud-based core, digital and data systems. While not essential to the functionality of the service, for a period of time implementations of InsuranceNow or InsuranceSuite Cloud will require significantly greater levels of participation by our services professionals than is currently necessary for on-premise versions of our products. At the time of our acquisition, ISCS had few third-party resources to assist with implementations of InsuranceNow. We intend to qualify and train consultants from existing and new partners. In the interim, we anticipate taking primary responsibility for InsuranceNow implementations. With respect to InsuranceSuite Cloud, our obligation to manage the platform in production requires us to have a much greater familiarity with its configuration and integrations. As a result, we intend

to control implementation work until effective processes have been established to reduce any risk we face in managing a production environment for a system we have not implemented.

As we gain experience with the deployment and maintenance of cloud solutions, we hope to leverage our SI partners more effectively and replicate more closely our current division of labor applicable with on-premise implementations. During this period, however, we anticipate higher levels of growth for our service revenues.

Table of Contents

We also expect modestly higher levels of variability of our service revenues. As we continue to expand into new markets and new product categories, we have, and we expect to, enter into contracts that may require us to delay the recognition of service revenues and associated costs until we are able to meet certain contractual obligations, including customer acceptance criteria or the delivery of new products. This has in the past, and may in the future, result in volatility in our reported services revenues and cost of revenues.

Deferred Revenues

	As of		Change	
	October 31, 2017	July 31, 2017	(\$)	(%)
	(in thousands, except percentages)			
Deferred revenues:				
Deferred license and other revenues	\$30,145	\$23,727	\$6,418	27 %
Deferred maintenance revenues	37,554	47,727	(10,173)	(21)%
Deferred services revenues	43,481	39,681	3,800	10 %
Total deferred revenues	\$111,180	\$111,135	\$45	*

* Not meaningful

Deferred License and Other Revenues

The \$6.4 million increase in deferred license and other revenues was primarily a result of the combined net impact from increases in deferrals of amounts associated with subscription contracts that are recognized on a ratable basis, increases in license billings related to new contracts executed during fiscal year 2018 which will be recognized when contractual obligations are met, partially offset by the recognition of billings recognized based on timing of payments and upon meeting certain contractual obligations.

Deferred Maintenance Revenues

The \$10.2 million decrease in deferred maintenance revenues was primarily driven by the impact from revenues recognized in excess of new billings during the three months ended October 31, 2017, and reflects the seasonal nature of the billings of maintenance revenues. Additionally, subscription arrangements include maintenance as part of the subscription service and are not priced or reported separately. As a result, an increase in the mix of subscription orders in the future will reduce the growth in deferred maintenance revenues.

Deferred Services Revenues

The \$3.8 million increase in deferred services revenues was primarily driven by a \$7.6 million increase in services billings associated with ongoing InsuranceNow implementations related to acquired contracts which are being deferred until go-live and then will be recognized ratably over the remaining contract term. This was partially offset by the net recognition of \$3.8 million in previously deferred billings.

Generally, 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 represent incomplete measures of the strength of our business and are not necessarily indicative of our future performance. However, we believe that as we transition to a greater mix of subscription revenues, the change in our deferred revenues will become a more meaningful indicator of our future performance.

Cost of Revenues and Gross Profit

Our total cost of revenues and gross profit are variable and depend on the type of revenues earned in each period. Our cost of license and other revenues is primarily comprised of compensation and benefit expenses for our cloud operations and Guidewire Production Services personnel, amortization of our acquired intangible assets and royalty fees paid to third parties. Our cost of maintenance revenues is comprised of compensation and benefit expenses for our technical support team. Our cost of services revenues is primarily comprised of compensation and benefit expenses for our professional service employees and contractors, travel-related costs and allocated overhead. In the instances we serve as a prime contractor, subcontractor fees are expensed as cost of service. In each case, personnel costs include stock-based awards and allocated overhead.

Table of Contents

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.

	Three Months Ended October 31,			
	2017	2016	Change	
	Amount	Amount	(\$)	(%)
(in thousands, except percentages)				
Cost of revenues:				
License and other	\$6,715	\$2,430	\$4,285	176 %
Maintenance	3,467	3,325	142	4 %
Services	52,712	36,264	16,448	45 %
Total cost of revenues	\$62,894	\$42,019	\$20,875	50 %

Includes stock-based awards of:

Cost of license and other revenues	\$174	\$51	\$123
Cost of maintenance revenues	455	413	42
Cost of services revenues	5,226	4,695	531
Total	\$5,855	\$5,159	\$696

The \$20.9 million increase in cost of revenues primarily resulted from increases in the costs of license and other revenues of \$4.3 million and cost of service revenues of \$16.4 million.

The increase in our cost of license and other revenues was primarily attributable to the combined impact from increases of \$2.8 million related to the amortization of acquired intangible assets and \$1.0 million related to increased headcount and related expenses as we grew our cloud operations and Guidewire Production Services staff. We anticipate higher cost of license and other revenue as we continue to grow the staffing for our cloud operations and Guidewire Production Services.

Cost of maintenance revenues remained primarily flat in line with term and perpetual license sales activities.

The increase in our cost of services revenues was primarily attributable to the combined impact of \$10.3 million in higher compensation and related headcount expenses and \$4.1 million in expenses for billable third-party consultants and sub-contractors.

We had 766 professional service employees and 94 technical support and licensing operations employees at October 31, 2017 compared to 610 professional services employees and 71 technical support and licensing operations employees at October 31, 2016. The increase in hiring included the 128 professional service, technical support and licensing operations employees hired on a permanent basis as part of the ISCS acquisition that we completed on February 16, 2017.

	Three Months Ended October 31,					
	2017		2016		Change	
	Amount	Margin %	Amount	Margin %	(\$)	(%)
(in thousands, except percentages)						
Gross profit:						
License and other	\$23,378	78 %	\$36,291	94 %	\$(12,913)	(36) %
Maintenance	15,463	82 %	13,207	80 %	2,256	17 %
Services	6,436	11 %	2,610	7 %	3,826	147 %
Total gross profit	\$45,277	42 %	\$52,108	55 %	\$(6,831)	(13) %

Our gross margin decreased to 42% during the first quarter of fiscal 2018, compared to 55% for the corresponding prior year period primarily attributable to lower license and other revenue, increased costs from amortization of acquired intangible assets, and increased costs associated with the growth in our staffing for our Guidewire Production Services and cloud operations. We expect gross margins will decrease for the full fiscal year 2018 compared to fiscal year 2017 as lower margin services revenues begin to increase more rapidly than higher margin license revenues and to a lesser extent, due to increases in our costs associated with the amortization of acquired intangible assets and the growth in staffing for our Guidewire Production Services and cloud operations.

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, and rent and facility costs. We allocate overhead such as IT support, facility, and other administrative costs to all functional departments based on headcount. As a result, general overhead expenses

Table of Contents

are reflected in cost of revenue and each functional operating expense.

	Three Months Ended October 31,				Change	
	2017	2016	% of total	% of total	(\$)	(%)
	Amount revenues	Amount revenues				
	(in thousands, except percentages)					
Operating expenses:						
Research and development	\$35,711	\$30,750	33 %	33 %	\$4,961	16 %
Sales and marketing	23,610	25,500	22 %	27 %	(1,890)	(7)%
General and administrative	18,671	14,160	17 %	15 %	4,511	32 %
Total operating expenses	\$77,992	\$70,410	72 %	75 %	\$7,582	11 %

Includes stock-based compensation of:

Research and development	\$4,912	\$4,467	\$445
Sales and marketing	4,217	4,223	(6)
General and administrative	4,639	4,028	611
Total	\$13,768	\$12,718	\$1,050

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 \$5.0 million increase in research and development expenses was primarily attributable to the net effect from increases in our compensation and related headcount expenses of \$5.9 million which included increased stock-based compensation costs of \$0.4 million, partially offset by the capitalization of internal use software development costs of \$0.5 million related to the development of a new cloud-based technology application.

Our research and development headcount was 592 at October 31, 2017 compared with 486 at October 31, 2016. The increase in headcount reflects our continued investment in InsuranceSuite, data management and analytics, digital engagement, and includes 56 employees gained through our acquisitions.

We expect our research and development expenses to continue to increase in absolute dollars as we continue to hire aggressively in research and development. Research and development expenses may also increase if we pursue additional acquisitions, such as the acquisition of Cyence which closed on November 1, 2017.

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 \$1.9 million decrease in sales and marketing expenses was primarily attributable to a decrease of \$1.8 million in marketing and advertising expenses resulting from the timing of expenses from our annual Connections User Conference which occurred in the second quarter of our current fiscal year compared to the first quarter in our prior fiscal year.

Our sales and marketing headcount was 295 at October 31, 2017 compared with 283 at October 31, 2016.

We expect our sales and marketing expenses to continue to increase as we continue to invest in sales and marketing activities to support our 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, legal functions and allocated overhead.

Table of Contents

The \$4.5 million increase in our general and administrative expenses was primarily a result of increases of \$4.0 million in fees from professional services and \$0.4 million in compensation and headcount related costs. The increases in costs for headcount and related expenses was required to support the growth of our business.

The increases in our costs for professional services were primarily a result of our continued investment in corporate infrastructure and support services and include license fees and fees for third-party consultants associated with the implementation of a new enterprise resource planning platform and a new product configuration and quoting system, and to a lesser extent, increased costs for third party consultants and professional services resulting from the acquisition of Cyence which closed on November 1, 2017. We expect to incur additional third-party costs related to consultants and professional services in the second fiscal quarter.

Our general and administrative headcount was 198 at October 31, 2017 compared with 169 at October 31, 2016. We expect that our general and administrative expenses will increase in absolute dollars as we continue to invest in personnel and corporate infrastructure and systems required to support our strategic initiatives, the growth of our business, and our compliance and reporting obligations. For example, in the second quarter, we will incur additional costs related to the acquisition of Cyence, and implementation of new accounting software applications.

Other Income (Expense)

	Three Months Ended October 31,			
	2017	2016	Change	
	Amount	Amount	(\$)	(%)
	(in thousands, except percentages)			
Interest income	\$1,908	\$1,342	\$566	42 %
Other income (expense), net	\$(262)	\$(681)	\$419	(62)%

Interest Income

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

Interest income increased \$0.6 million compared to the year ago period primarily due to higher yields on our cash equivalents and investments.

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.

Other income (expense), net increased by \$0.4 million primarily as a result of decreased realized losses in the current fiscal year from our receivables and payables denominated in currencies other than the U.S. dollar. Last year, we realized net currency exchange losses of \$0.7 million from transactions primarily denominated in the British Pound, Euro, Australian Dollar, Canadian Dollar, and Japanese Yen.

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 October 31,

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

	2017	2016	Change	
	Amount	Amount	(\$)	(%)
	(in thousands, except percentages)			
Benefit from income taxes	\$(22,155)	\$(9,783)	\$(12,372)	126%

Table of Contents

We recognized income tax benefits of \$22.2 million and \$9.8 million for the three months ended October 31, 2017 and 2016, respectively. The increase in tax benefits for the three months ended October 31, 2017 was primarily due to the increase in the loss before taxes and an increase in tax benefits related to stock-based compensation from the adoption of ASU 2016-09 for the period, as compared to the same period a year ago. The effective tax rate was 71% for the three months ended October 31, 2017, compared to 55% for the three months ended October 31, 2016. The increase in our effective income tax rate was primarily a result of an increase in tax benefits related to stock-based compensation due to the adoption of ASU 2016-09 for the period.

Liquidity and Capital Resources

As of October 31, 2017 and July 31, 2017, we had \$653.5 million and \$687.8 million of cash, cash equivalents and investments, respectively, and working capital of \$532.2 million and \$515.6 million, respectively. As of October 31, 2017, approximately \$25.1 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.

In November 2017, we completed the acquisition of Cyence Inc. for approximately \$275 million, subject to customary transaction adjustments. Consideration consisted of net cash of approximately \$130 million and approximately 1.7 million shares of newly issued Guidewire common stock and options. Assets acquired included approximately \$17 million of cash and cash equivalents. A portion of the consideration has been placed into an escrow account as partial security to satisfy any potential claims.

Cash Flows

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 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.

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 additional financing.

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:

	Three Months Ended	
	October 31,	
	2017	2016
	(in thousands)	
Net cash used in operating activities	\$(31,248)	\$(12,910)
Net cash provided by (used in) investing activities	\$23,780	\$(79,797)
Net cash provided by financing activities	\$365	\$1,112
Cash Flows from Operating Activities		

Net cash used by operating activities increased by \$18.3 million for the three months ended October 31, 2017, compared to the three months ended October 31, 2016. The increase in operating cash used was primarily attributable to a \$9.2 million increase in net loss after excluding the impact of non-cash charges such as deferred taxes, stock-based compensation, depreciation and amortization expense, and other non-cash items, partially offset by a \$9.1 million increase in cash used in working capital activity as compared to the same period a year ago. Lower cash flow

from working capital activity in the current period is primarily a result of early payments received in the three months ended July 31, 2017 that were due in the three months ended October 31, 2017, and to a lesser extent the timing of payments to vendors, partially offset by changes in deferred revenues.

Cash Flows from Investing Activities

Net cash provided by investing activities increased by \$103.6 million for the three months ended October 31, 2017 as compared to cash used in investing activities during the three months ended October 31, 2016 primarily due to \$69.9 million in

Table of Contents

net cash inflows resulting from sales and purchases of marketable securities and \$33.6 million cash used for the acquisition of EagleEye in the three months ended October 31, 2016. The completion of the Cyence Inc. acquisition will impact our cash flows from investing activities in the second fiscal quarter of 2018.

Cash Flows from Financing Activities

Net cash provided by financing activities decreased by \$0.7 million for the three months ended October 31, 2017, as compared to the three months ended October 31, 2016 primarily due to fewer options exercised. Excess tax benefits and deficiencies previously classified as financing activities have been classified as operating activities on the condensed consolidated statement of cash flows as a result of our adoption of ASU 2016-09. There were no excess tax benefits or deficiencies in financing activities during the three months ended October 31, 2016.

Contractual Obligations

Our primary contractual obligations are from operating leases for office space and letters of credit related to those leases. See Note 6 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 6 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 October 31, 2017.

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.

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 October 31, 2017 and July 31, 2017. Our cash, cash equivalents and investments as of October 31, 2017 and July 31, 2017 were \$653.5 million and \$687.8 million, respectively, consisted primarily of cash, money market funds, commercial paper, corporate bonds, U. S. agency debt securities, and U.S. government bonds. 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 three months ended October 31, 2017, we recorded a foreign currency loss of \$0.3 million as other expense in our statement of operations due to unfavorable currency exchange rate movement during the three months ended October 31, 2017. We expect to continue to experience fluctuations in foreign currency exchange rates. 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

Table of Contents

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. We are evaluating the potential impact a new ERP system and related accounting systems will have on our internal control over financial reporting. We currently anticipate completing implementation of these applications by the third quarter of fiscal year 2018.

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. 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 results of operations 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 results of operations 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 investors and research analysts 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;
- the proportion and timing of subscription sales as opposed to software licenses, and the variations in revenue recognition between the two sales methods;
- volatility in the sales of our products and the execution timing of new and renewal agreements within such periods;
- our ability to increase sales to and renew agreements with our existing customers, particularly larger customers;
- our ability to attract new customers in both domestic and international markets;
- the structure of our licensing contracts, including delayed payment or acceptance terms and escalating payments, 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 with customers and prospects that possess substantial negotiating leverage and procurement expertise;
- introduction of new, or the increase of existing, licensing models that feature ratable revenue recognition;
- our ability to develop and achieve market adoption of cloud-based services;
- increases in cloud-related development and services costs;
- the incurrence of penalties for failing to meet certain contractual obligations, including service levels and implementation times;
- 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;
-

variations in the amount of policies sold by our customers, where pricing to such customers is based on the direct written premium that is managed by our solutions;
erosion in services margins or significant fluctuations in services revenues caused by changing customer demand;
our ability to realize expected benefits from our acquisitions;

Table of Contents

• 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; and
• future accounting pronouncements or changes in accounting rules or our accounting policies.

In addition, our license and other revenue may fluctuate if our customers make early payments of their annual license fees in advance of the invoice due date. This may cause an unexpected increase in revenues in one quarter reducing revenue and 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 revenue shortfall is very limited and our inability to do so could magnify the adverse impact of such revenue shortfall on our results of operations. If we fail to achieve our quarterly forecasts, if our forecasts fall below the expectations of investors or research analysts, or if our actual results fail to meet the expectations of investors or research analysts, 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 have signed 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 and our sales are typically greatest the fourth 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 in our second and fourth fiscal 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. However, we currently anticipate that sales of subscription services will increase as a percentage of new and total yearly sales. Subscriptions are recognized ratably over the term of the agreement after provisioning of the software, which may take as many as 90 days for our more complex implementations. Over time, this may reduce the impact of our historic seasonality, but in the near term the introduction of proportionally more subscription services into our revenue stream, together with their delayed and ratable recognition, will likely impact quarter over quarter and year over year revenue growth comparisons. The concentration of sales in the fourth quarter, including sales of subscription services, may exacerbate this effect.

Our quarterly growth in license revenues also may not match up to new orders we receive in a given quarter which could mask the impact of seasonal variations. This mismatch is primarily due to the following reasons:

- for the initial year of a multi-year term license, revenue recognition may not occur in the period when the order is placed due to certain revenue recognition criteria not being met;
- 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 escalate every year and may be modest in the first year; and
- our subscription arrangements are recognized ratably and only a portion of the revenue from an order is recognized in the same fiscal period of the order.

Additionally, seasonal patterns may be affected by timing of particularly large transactions. For example, in fiscal year 2017, we achieved higher revenue growth in the third fiscal quarter than in the fourth fiscal quarter due to the effects of a single large contract that was entered into in the third fiscal quarter.

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. 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 necessarily 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

Table of Contents

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.

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 in turn may cause our stock price to decline.

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 2017, 2016 and 2015, our ten largest customers accounted for 27%, 27% and 31% 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 of these anticipated customers in any particular period or fail to identify additional potential customers or such customers purchase fewer of our products or services, defer or cancel orders, fail to renew their license or subscription agreements or otherwise terminate their relationship with us, our business, results of operations and financial condition would be harmed. Additionally, if our sales to one or more of these anticipated customers in any particular period are ratable in nature, or if we fail to achieve the required performance or acceptance criteria for one or more of these relatively small number of customers, our quarterly and annual results of operations may fluctuate significantly. If we are required to, and fail to successfully manage any changes to our business model, including the transition of our products to cloud offerings, our results of operations could be harmed.

To address demand trends in the P&C insurance industry, we now offer customers the use of our software products through a cloud-based offering in addition to our on-premises offering. This adjustment to our business model requires a considerable investment of technical, financial, legal and sales resources. Our transition to cloud offerings will continue to divert resources and increase costs, especially in cost of license and other revenues, in any given period. Such investments may not improve our long-term growth and results of operations. Further, the increase in some costs associated with our cloud services, such as the cost of public infrastructure, may be difficult to predict over time, especially in light of our lack of historical experience with the costs of delivering cloud-based versions of our applications. Our subscription contracts also contain penalty clauses, for matters such as failing to meet stipulated service levels, which represent new risks we are not accustomed to managing. Should these penalties be triggered, our results of operations may be adversely affected. Furthermore, we may assume greater responsibilities for implementation related services during this transition. As a result, we may face risks associated with new and complex implementations, the cost of which may differ from original estimates. As with our stated history, the consequences in such circumstances could include: monetary credits for current or future service engagements, reduced fees for additional product sales, and a customer's refusal to pay their contractually-obligated subscription or service fees. We expect the revenue we would recognize under our cloud-based subscription model to be recognized ratably over the term of the contract. The transition to ratable revenue recognition may reduce license revenue we otherwise would have recognized in those periods in which the portion of our revenues attributable to ratable subscription contracts grows. This effect on recognized revenue may be magnified in any fiscal year due to the concentration of our orders in the fourth quarter. A combination of increased costs and delayed recognition of revenue would adversely impact our gross and operating margins during those periods.

In addition, market acceptance of our cloud-based offerings may be affected by a variety of factors, including but not limited to: price, security, reliability, performance, customer preference, public concerns regarding privacy and the enactment of restrictive laws or regulations. We are in the early stages of re-architecting our existing products and developing new products in an effort to offer customers greater choices on how they consume our software. As our business practices in this area develop and evolve over time, we may be required to revise the subscription agreements we initially develop in connection with this transition, which may result in revised terms and conditions that impact how we recognize revenue and the costs and risks associated with these offerings. Whether our product development efforts or business model transition will prove successful and accomplish our business objectives is subject to numerous uncertainties and risks, including but not limited to: customer demand, our ability to further develop and scale infrastructure, our ability to include functionality and usability in such offerings that address customer requirements, tax and accounting implications, and our costs. In addition, the metrics we and our investors use to gauge the status

Table of Contents

of our business model transition may evolve over the course of the transition as significant trends emerge. It may be difficult, therefore, to accurately determine the impact of this transition on our business on a contemporaneous basis, or to clearly communicate the appropriate metrics to our investors. If we are unable to successfully establish these new cloud offerings and navigate our business model transition in light of the foregoing risks and uncertainties, our reputation could suffer and our results of operations could be harmed, which may cause our stock price to decline. Increases in services revenues as a percentage of total revenues or lower services or license margins could adversely affect our overall gross margins and profitability.

Our services revenues were 34%, 34% and 40% of total revenues for each of fiscal years 2017, 2016 and 2015, respectively. Our services revenues produce lower gross margins than our license revenues. The gross margin of our services revenues was 7%, 8% and 12% for fiscal years 2017, 2016 and 2015, respectively, while the gross margin for license revenues was 94%, 97% and 97% for fiscal years 2017, 2016 and 2015, respectively. Our gross margins will decline in the event that lower-margin service revenues constitute a greater percentage of total revenues and if associated service or license margins decline.

We anticipate that in fiscal year 2018, services revenues will grow at a faster rate than license revenues and increase significantly as a percentage of total revenues. This trend is the result of several factors, some of which may be beyond our control, including increased customer demand for our service team involvement in new products and services, the rates we charge for our services and the extent to which SIs are willing and able to provide services directly to customers.

Services margins may decline in periods which require a significant expansion of our services capabilities as we hire and train additional services personnel to support customer demand, enter new markets, or if we require additional personnel on challenging projects to ensure customer success. In some cases, customer success will require us to provide additional services personnel at significantly reduced rates. Services margins may also decline if we are required to defer services revenues in connection with an engagement. This may happen for a number of reasons, including if there is a specific product deliverable associated with a broader services engagement. In these situations, we would defer only the direct costs associated with the engagement. Deferring all revenue but only direct costs will reduce services margins in those periods, however the eventual recognition of those deferred revenues and direct costs will have a positive impact on margins. In fiscal year 2017, for example, we deferred a significant amount of revenue and direct costs associated with one project, which reduced margins and reported services revenues during fiscal year 2017, but is currently being recognized in fiscal year 2018.

Gross margins will also decline should license margins decline. We expect that significant investments in our cloud operations and Guidewire Production services divisions will decrease license margins.

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 holding such intellectual property rights, including leading companies, competitors, patent holding companies and/or non-practicing entities, 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.

Table of Contents

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.

Our business strategy includes the potential acquisition of shares or assets of companies with software, technologies or businesses complementary to ours. Our strategy also includes alliances with such companies. For example, in March 2016, we acquired EagleEye Analytics Inc., a provider of cloud-based predictive analytics products designed for P&C insurers, in August 2016, we acquired FirstBest Systems, Inc., a provider of an underwriting management system for P&C insurers, in February 2017, we acquired ISCS, Inc., a provider of a cloud-based, all-in-one platform that offers policy, billing, and claims management functionality for P&C insurers; and in November 2017, we acquired Cyence, a software company that applies data science and risk analytics to enable P&C insurers to grow by underwriting "21st century risks" that have gone underinsured or uninsured. Each of these acquisitions was initially dilutive to earnings. 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; or 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. In addition, we may be required to make additional capital investments or undertake remediation efforts to ensure the success of our acquisitions, which may reduce the benefits of such acquisitions. 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 continue to be, intense. As such, even if we are able to identify an acquisition that we would like to pursue, 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 software and services is intensely competitive. The competitors we face in any sale may change depending on, among other things, the line of business purchasing the software, the application being sold, the geography in which we are 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 may compete on the basis of price, the time and cost required for software implementation, custom development, 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.

Additionally, many of our prospective customers operate firmly entrenched legacy systems, some of which have been in operation for decades. Our implementation cycles may be lengthy, variable and require the investment of

significant time and expense by our customers. These expenses and associated operating risks attendant on any significant process of re-engineering and technology implementation exercise, may cause customers to prefer maintaining legacy systems. Also, 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. We also compete against technology consulting firms that either helped create such legacy systems or may own, in full or in part, subsidiaries that develop software and systems for the P&C insurance industry.

As we expand our product portfolio, we may begin to compete with software and service providers we have not competed against previously. Such potential competitors offer data and analytics tools that may, in time, become more competitive with our offerings.

We expect the intensity of competition to remain high in the future as the amount of capital invested in current and potential competitors has increased significantly in recent years , and this may lead to improved product or sales capabilities, which in turn could lead to new or expanded partnerships with systems integrators. Continuing intense competition could result in increased pricing pressure, increased sales and marketing expenses, and greater investments in research and development, each of which

Table of Contents

could negatively impact our profitability. In addition, the failure to increase, or the loss of, market share, would harm our business, results of operations, financial condition and / or future prospects. Our larger current and potential 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, thus leading to their 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.

In addition, our industry is evolving rapidly and we anticipate the market for cloud-based solutions will become increasingly competitive. If our current and potential customers move a greater proportion of their data and computational needs to the cloud, new competitors may emerge that offer services either comparable or better suited than ours to address the demand for such cloud-based solutions, which could reduce demand for our offerings. To compete effectively we will likely be required to increase our investment in research and development, as well as the personnel and third party services required to improve reliability and lower the cost of delivery of our cloud-based solutions. This may increase our costs more than we anticipate and may adversely impact our results of operations. Our current and potential competitors may also establish cooperative relationships among themselves or with third parties to further enhance their resources and offerings. 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 are to adapt quickly to new technologies and customer needs, to devote greater resources to the promotion or sale of their products and services, to initiate or withstand substantial price competition, or to take advantage of emerging opportunities by developing and expanding their product and service offerings more quickly than we can. Additionally, they may hold larger portfolios of patents and other intellectual property rights as a result of such relationships or acquisitions. If we are unable to compete effectively with these evolving competitors for market share, 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, including in some cases, personal data, and security breaches could result in the loss of this information, which in turn could result in litigation, breach of contract claims, indemnity obligations and other liability for our company. While we have taken steps to protect the confidential information to which we have access, 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. We rely on third-party technology and systems for a variety of services, including, without limitation, encryption and authentication technology, employee email, content delivery to customers, back-office support and other functions, and our ability to control or prevent breaches of any of these systems may be beyond our control. 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. 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. Any or all of these issues could negatively impact our ability to attract new customers or to increase engagement by existing customers, could cause existing customers to elect not to renew their term licenses, or could subject us to third-party lawsuits, regulatory fines or other action or liability, thereby adversely affecting our results of operations.

We have implemented a new enterprise resource planning system and are in the process of implementing other accounting and sales IT systems. If these new systems prove ineffective, or if we experience issues with the transition from our current systems, we may be unable to timely or accurately prepare financial reports, or invoice and collect from our customers.

In fiscal year 2017, we began the process of implementing a new enterprise resource planning (“ERP”) system and other accounting systems, including a new revenue reporting system in advance of the adoption of ASC 606 in fiscal year 2019. These systems are critical for accurately maintaining books and records and preparing our financial statements. We intend to transition to our new ERP and revenue systems during fiscal year 2018. In November 2017, we completed the implementation of the new system and are continuing efforts towards implementation of other accounting systems, including a revenue reporting system. We currently anticipate completing implementation of these applications by the third quarter of fiscal year 2018. While we will invest significant amounts, including for additional personnel and third-party consultants, to implement these systems, we cannot assure you that the implementation will be successful or that we will not experience difficulties following the transition. Any delay or error in the implementation or transition could adversely affect our operations, including our ability to accurately report our financial results in a timely manner, file our quarterly or annual reports with the SEC, and invoice and collect from our customers,

Table of Contents

each of which may harm our operations and reduce investor confidence. Even if we are able to complete the implementation, data integrity problems or other issues may subsequently be discovered which, if not corrected, could impact our business, reputation or results of operations. If we encounter unforeseen difficulties with our new ERP and revenue system implementations, there will be additional demands on our management team and our business, operations and results of operations could be adversely affected.

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

General worldwide economic conditions remain unstable. Prolonged economic uncertainties or downturns could harm our business operations or financial results. For example, the decision by referendum to withdraw the United Kingdom (U.K.) from the European Union (“Brexit”) in June 2016 caused significant volatility in global stock markets and fluctuations in currency exchange rates and the impending Brexit has arguably caused and may continue to cause delays in purchasing decisions by our potential and current customers affected by this transition. The results of this referendum, or other global events, may continue to create global economic uncertainty not only in the U.K., but in other regions in which we have significant operations. 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.

Our customers are P&C insurers 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, without limitation, 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 to our business 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 forecast the timing of such events or estimate the amount of losses they will generate. In 2017, for example, parts of the United States suffered extensive damage due to multiple hurricanes and fires. We anticipate the combined effect of those losses on P&C insurers to be very large. Such losses and losses due to 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 offerings and professional service engagements or to discontinue existing 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 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. Customers may also insist that we commit to certain time frames in which systems built around our products will be

Table of Contents

operational, or that once implemented our products will be able to meet certain operational requirements. Our ability to meet such timeframes and requirements may involve factors that are outside of our control, and failure to meet such timeframes and requirements could result in us incurring penalties, costs and/or additional resource commitments, which would adversely affect our business and results of operations.

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' and third-party's systems, as well as adding customer and third-party 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 about us and our products and services. Such failure could result from deficiencies in our product capabilities or inadequate 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 of such failure could include, and have included: monetary credits for current or future service engagements, reduced fees for additional product sales or upon renewal of existing licenses, 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.

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 recruiting, retention and training of our global direct sales force and their ability to obtain new customers, both large and small P&C insurers, 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 retention and expansion of successful relationships with system integrators, including with system integrators that will focus on InsuranceNow and other products we may acquire in the future. 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. 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 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 results of operations.

Some of our customers include the world's largest P&C insurers. These customers have significant bargaining power when negotiating new licenses or subscriptions, or renewals of existing agreements, 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 been required to, 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 increasing our average costs, our results of operations could be harmed.

Failure of any of our established products or services to satisfy customer demands or to maintain 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 our established product offerings, including InsuranceSuite, Insurance Now, and our Digital and Data Products. We expect to continue to derive a substantial portion of our revenues from these sources. As such, continued market acceptance of these products is critical to our 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

Table of Contents

insurance industry. If we are unable to continue to meet customer demands, to achieve and maintain a technological advantage over competitors, or to maintain market acceptance of our products, our business, results of operations, financial condition and growth prospects may be adversely affected.

Our business depends on customers renewing and expanding their license, maintenance and subscription 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 or subscriptions after their contract period expires, and these licenses and subscriptions, if renewed, may be done so on less favorable terms. Moreover, under certain circumstances, our customers have the right to cancel their licenses or subscriptions before they expire. 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, or the sale of their operations to a buyer that is not a current customer.

Also 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, which if exercised would eliminate future term license payments. If our customers do not renew their term licenses or subscriptions 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 some of 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 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.

Table of Contents

The license and support of our software creates the risk of significant liability claims against us. Our license and subscription 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 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 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 applicable 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.

Table of Contents

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. 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, some open source licenses 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 many of the restrictions in 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 some uncertainty. Additionally, we rely on hundreds of software programmers to design our proprietary technologies, and although we take steps to prevent our programmers from including objectionable 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 such 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-

Table of Contents

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 agreements with our 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. In addition, as we further expand our products to include a cloud-based offering, our professional services and support organization will face new challenges, including hiring, training and integrating a large number of new professional services personnel with experience in delivering high-quality support for cloud-based offerings. Alleviating any of these problems could require significant capital expenditures which could adversely affect our growth prospects. Further, as we continue to rely 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 those on our management team, including Marcus Ryu, one of our co-founders and our current president and chief executive officer, and our 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. U.S. immigration policy is currently being reviewed by the federal government, which may or may not result in significant changes and could hamper our efforts to hire highly skilled foreign employees. If future changes to U.S. immigration policy restrict our access to highly specialized engineers, our business would be adversely impacted.

Any one 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 could significantly delay or prevent us from achieving our business and/or development objectives, and could materially harm our business.

We face competition for qualified individuals 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, though we also face significant competition in all of our domestic and foreign development centers. Further, significant amounts of time and resources are required to train technical, sales, services and other personnel. We may incur significant costs to attract, train and retain such personnel, and we may lose new employees to our competitors or other technology companies before we realize the benefit of our investment after recruiting and training them. Also, to the extent that we hire personnel from competitors, we may be subject to allegations that such personnel have been improperly solicited or have divulged proprietary or other confidential information. In addition, 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 managers to lead the local business and employees 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.

Table of Contents

We have experienced consistent 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. For example, in fiscal 2018, we are implementing a new enterprise resource planning system, as well as related revenue recognition modules. 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 and related system implementations, 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 2017, 2016 and 2015, \$162.1 million, \$148.8 million and \$134.6 million 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 and subscription 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;
- 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, Polish Zloty 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. In addition, because our contracts are characterized by large annual payments, significant fluctuations in foreign currency exchange rates that coincide with annual payments may affect our revenues or financial results in such quarter. Our results of operations may also be impacted by 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.

Table of Contents

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.

Our current and predominant business model does not significantly collect and transfer personal information from our customers to us, however, as adoption of our cloud-based services occurs, the amount of customer data we manage, hold and/or collect will increase significantly. In addition, a limited number of our product solutions may collect, process, store, and use transaction-level data aggregated across insurers using our common data model. We anticipate that over time we will expand the use and collection of personal information as greater amounts of such personal information may be transferred from our customers to us and we recognize that personal privacy has become a significant issue in the United States, Europe, and many other jurisdictions 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.

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 managed, 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, resulting in a negative impact on our sales and results from operations.

Privacy concerns in the European Union are evolving and we may face fines and other penalties if we fail to comply with these evolving standards, and compliance with these standards may increase our expenses and adversely affect our business and results of operations.

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, which has resulted in changes in previously accepted practices.

Among other changes, EU Commission has formally adopted a new mechanism for the transfer of personal data from the European Union (the "EU") to the United States, branded the "EU-US Privacy Shield" ("Privacy Shield"). We are currently certified with the U.S. Department of Commerce ("DOC") to comply with the Privacy Shield a Framework, however, companies will continue to face uncertainty to the extent they operate in both jurisdictions and transfer any Personal Data between the two. If we are investigated by a European data protection authority and found to be out of compliance, 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. While we will continue to undertake efforts to conform to current regulatory obligations and evolving best practices, we may be unsuccessful in conforming to means of transferring Personal Data from the EEA. 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 of Personal Data transfers 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, or otherwise objectionable, and therefore may decide not to do business with us if the transfer of Personal Data is a necessary requirement.

Though our current and predominant business model does not significantly collect and transfer personal information from our customers to us, the potential transition to more cloud-based services, and the current data protection landscape in the EU may subject us to greater risk of potential inquiries and/or enforcement actions. We may find it necessary to establish alternative 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 results from operations. Further, any inability to adequately address privacy concerns

in connection with our cloud-based services, or comply with applicable privacy or data protection laws, regulations and policies, could result in additional cost and liability to us, and adversely affect our ability to offer cloud-based services.

Anticipated further evolution of EU regulations on this topic 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 new regulations and we may be required to make significant changes to our software applications and expanding business operations, all of which may adversely affect our results of operations.

Table of Contents

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. Additionally, 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 full retrospective or cumulative effect transition method. We currently intend to select the cumulative effect 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 revised our contracting practices primarily by shortening the initial non-refundable term of our licenses. If we are unsuccessful in adapting our business to the requirements of the new revenue standard, or if changes to our go-to-market strategy create new risks, 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 a portion of the 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.

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 of 2002 (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, transition in enterprise resource planning or other major operational systems could impact the timely generation of our financial statements. In fiscal 2017, we began implementing a new financial management system, as well as applications to help us manage the recognition of our revenues under a new standard. In November 2017, we completed the implementation of the new system and are

continuing efforts towards implementation of other accounting systems, including a revenue reporting system. We currently anticipate completing implementation of these applications by the third quarter of fiscal year 2018. As a result of implementing this new system or otherwise, we cannot provide timely reliable financial reports, 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

Table of Contents

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, and we may not be able to obtain capital or complete acquisitions through the use of equity 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 newly-issued securities may have rights, preferences or privileges senior to those of existing stockholders. If we accumulate 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.

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 information technology systems are vulnerable to computer viruses, break-ins and similar disruptions from unauthorized tampering. To the extent that such disruptions result in delays or cancellations of customer orders or collections, 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:

53

Table of Contents

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.

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.

Table of Contents

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
<u>2.1</u>	Agreement and Plan of Reorganization, by and among Guidewire Software, Inc., Cyence Inc., Caesar Acquisition Sub I, Inc., Caesar Acquisition Sub II, LLC and Shareholder Representative Services LLC dated October 5, 2017.	S-3	2.1	November 2, 2017
<u>3.1</u>	Amended and Restated Certificate of Incorporation	10-Q	3.1	March 14, 2012
<u>3.2</u>	Amended and Restated Bylaws	8-K	3.1	December 5, 2016
<u>4.1</u>	Form of Common Stock certificate of the Registrant	S-1/A	4.1	January 9, 2012
<u>31.1</u>	Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act	Filed herewith		
<u>31.2</u>	Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act	Filed herewith		
<u>32.1*</u>	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: November 30, 2017 GUIDEWIRE SOFTWARE, INC.

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