

Guidewire Software, Inc.
Form 10-Q
March 07, 2019
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark one)

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

For the quarterly period ended January 31, 2019

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 (I.R.S. Employer
Incorporation or organization) 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 every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer 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 Smaller reporting company

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Emerging growth company

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

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

On February 28, 2019, the registrant had 81,414,683 shares of common stock issued and outstanding.

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FORWARD-LOOKING STATEMENTS

The section titled “Management’s Discussion and Analysis of Financial Condition and Results of Operations” as well as 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 may 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, revenue, gross margins, operating expenses, products, projected costs and capital expenditures, research and development programs, sales and marketing initiatives, and competition. In some cases, you can identify these statements by forward-looking words, such as “will,” “may,” “might,” “should,” “could,” “estimate,” “expect,” “suggest,” “believe,” “anticipate,” “intend,” “plan,” and “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 “Part II - Other Information - 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, judgments related to revenue recognition, 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.”

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PART I – Financial Information

ITEM 1. Financial Statements (unaudited)

GUIDEWIRE SOFTWARE, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(unaudited, in thousands)

	January 31, 2019	July 31, 2018
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$360,169	\$437,140
Short-term investments	706,203	630,008
Accounts receivable, net of allowances of \$1,175 and \$1,062, respectively	119,699	124,849
Unbilled accounts receivable, net	47,493	—
Prepaid expenses and other current assets	30,234	30,510
Total current assets	1,263,798	1,222,507
Long-term investments	171,873	190,952
Unbilled accounts receivable, net	11,459	—
Property and equipment, net	30,017	18,595
Intangible assets, net	81,037	95,654
Goodwill	340,877	340,877
Deferred tax assets, net	83,922	87,482
Other assets	35,330	22,525
TOTAL ASSETS	\$2,018,313	\$1,978,592
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable	\$20,967	\$30,635
Accrued employee compensation	44,448	60,135
Deferred revenue, net	90,979	114,138
Other current liabilities	13,276	20,280
Total current liabilities	169,670	225,188
Convertible senior notes, net	311,141	305,128
Deferred revenue, net	21,381	23,758
Other liabilities	1,739	774
Total liabilities	503,931	554,848
STOCKHOLDERS' EQUITY:		
Common stock	8	8
Additional paid-in capital	1,346,620	1,297,979
Accumulated other comprehensive loss	(7,554)	(7,748)
Retained earnings	175,308	133,505
Total stockholders' equity	1,514,382	1,423,744
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$2,018,313	\$1,978,592
See accompanying Notes to Condensed Consolidated Financial Statements.		

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

	Three Months Ended		Six Months Ended	
	January 31,		January 31,	
	2019	2018	2019	2018
Revenue:				
License and subscription	\$87,124	\$84,221	\$181,393	\$114,314
Maintenance	21,264	19,110	42,267	38,040
Services	60,878	60,457	125,289	119,605
Total revenue	169,266	163,788	348,949	271,959
Cost of revenue:				
License and subscription	14,739	9,040	28,069	15,755
Maintenance	3,954	3,593	7,822	7,060
Services	60,937	55,136	126,198	107,848
Total cost of revenue	79,630	67,769	162,089	130,663
Gross profit:				
License and subscription	72,385	75,181	153,324	98,559
Maintenance	17,310	15,517	34,445	30,980
Services	(59)	5,321	(909)	11,757
Total gross profit	89,636	96,019	186,860	141,296
Operating expenses:				
Research and development	46,471	43,657	91,967	79,368
Sales and marketing	31,173	31,961	63,492	55,571
General and administrative	17,541	21,066	35,886	39,737
Total operating expenses	95,185	96,684	191,345	174,676
Loss from operations	(5,549)	(665)	(4,485)	(33,380)
Interest income	7,553	1,573	14,404	3,485
Interest expense	(4,287)	(7)	(8,531)	(11)
Other income (expense), net	1,148	1,658	(341)	1,396
Income (loss) before income taxes	(1,135)	2,559	1,047	(28,510)
Provision for (benefit from) income taxes	(1,891)	48,114	(5,198)	25,959
Net income (loss)	\$756	\$(45,555)	\$6,245	\$(54,469)
Net income (loss) per share:				
Basic	\$0.01	\$(0.59)	\$0.08	\$(0.72)
Diluted	\$0.01	\$(0.59)	\$0.08	\$(0.72)
Shares used in computing net income (loss) per share:				
Basic	81,217,517	76,859,040	81,058,562	76,023,237
Diluted	82,191,668	76,859,040	82,289,773	76,023,237

See accompanying Notes to Condensed Consolidated Financial Statements.

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

	Three Months Ended January 31,		Six Months Ended January 31,	
	2019	2018	2019	2018
Net income (loss)	\$756	\$(45,555)	\$6,245	\$(54,469)
Other comprehensive income (loss):				
Foreign currency translation adjustments	235	2,124	(577)	1,428
Unrealized gains (losses) on available-for-sale securities	1,485	(457)	1,285	(592)
Tax benefit (expense) on unrealized gains (losses) on available-for-sale securities	(288)	122	(241)	167
Reclassification adjustment for realized (gains) losses included in net income (loss)	(273)	—	(273)	15
Other comprehensive income (loss)	1,159	1,789	194	1,018
Comprehensive income (loss)	\$1,915	\$(43,766)	\$6,439	\$(53,451)

See accompanying Notes to Condensed Consolidated Financial Statements

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GUIDEWIRE SOFTWARE, INC. AND SUBSIDIARIES
 CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY
 (unaudited, in thousands except share amounts)

	Common stock		Additional paid-in capital	Accumulated other comprehensive income (loss)	Retained Earnings	Total Stockholders' Equity
	Shares	Amount				
Balance as of October 31, 2017	75,362,109	\$ 8	\$ 850,705	\$ (6,567)	\$ 144,255	\$ 988,401
Net loss	—	—	—	—	(45,555)	(45,555)
Issuance of common stock upon exercise of stock options	36,694	—	362	—	—	362
Issuance of common stock upon vesting of Restricted Stock Units ("RSU")	311,119	—	—	—	—	—
Stock-based compensation	—	—	25,035	—	—	25,035
Foreign currency translation adjustment	—	—	—	2,124	—	2,124
Unrealized loss on available-for-sale securities, net of tax	—	—	—	(335)	—	(335)
Issuance of common stock for Cyence acquisition	1,569,238	—	117,457	—	—	117,457
Balance as of January 31, 2018	77,279,160	\$ 8	\$ 993,559	\$ (4,778)	\$ 98,700	\$ 1,087,489
	Common stock		Additional paid-in capital	Accumulated other comprehensive income (loss)	Retained Earnings	Total Stockholders' Equity
	Shares	Amount				
Balance as of July 31, 2017	75,007,625	\$ 8	\$ 830,014	\$ (5,796)	\$ 69,055	\$ 893,281
Net loss	—	—	—	—	(54,469)	(54,469)
Issuance of common stock upon exercise of stock options	59,078	—	729	—	—	729
Issuance of common stock upon vesting of RSUs	643,219	—	—	—	—	—
Stock-based compensation	—	—	44,170	—	—	44,170
Issuance of common stock for Cyence acquisition	1,569,238	—	117,935	—	—	117,935
Foreign currency translation adjustment	—	—	—	1,428	—	1,428
Unrealized loss on available-for-sale securities, net of tax	—	—	—	(410)	—	(410)
Adoption of ASU 2016-09 and related tax impact	—	—	711	—	84,114	84,825
Balance as of January 31, 2018	77,279,160	\$ 8	\$ 993,559	\$ (4,778)	\$ 98,700	\$ 1,087,489

See accompanying Notes to Condensed Consolidated Financial Statements.

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GUIDEWIRE SOFTWARE, INC. AND SUBSIDIARIES
 CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY
 (unaudited, in thousands except share amounts)

	Common stock		Additional paid-in capital	Accumulated other comprehensive income (loss)	Retained Earnings	Total Stockholders' Equity
	Shares	Amount				
Balance as of October 31, 2018	81,009,507	\$ 8	\$ 1,321,878	\$ (8,713)	\$ 174,552	\$ 1,487,725
Net income	—	—	—	—	756	756
Issuance of common stock upon exercise of stock options	68,120	—	413	—	—	413
Issuance of common stock upon vesting of RSUs	312,878	—	—	—	—	—
Stock-based compensation	—	—	24,329	—	—	24,329
Foreign currency translation adjustment	—	—	—	235	—	235
Unrealized gain on available-for-sale securities, net of tax	—	—	—	924	—	924
Balance as of January 31, 2019	81,390,505	\$ 8	\$ 1,346,620	\$ (7,554)	\$ 175,308	\$ 1,514,382
	Common stock		Additional paid-in capital	Accumulated other comprehensive income (loss)	Retained Earnings	Total Stockholders' Equity
	Shares	Amount				
Balance as of July 31, 2018	80,611,698	\$ 8	\$ 1,297,979	\$ (7,748)	\$ 133,505	\$ 1,423,744
Net income	—	—	—	—	6,245	6,245
Issuance of common stock upon exercise of stock options	142,818	—	1,102	—	—	1,102
Issuance of common stock upon vesting of RSUs	684,957	—	—	—	—	—
Cancellation of Restricted Stock Awards ("RSA")	(48,968)	—	—	—	—	—
Stock-based compensation	—	—	47,539	—	—	47,539
Foreign currency translation adjustment	—	—	—	(577)	—	(577)
Unrealized gain on available-for-sale securities, net of tax	—	—	—	771	—	771
Adoption of ASC 606	—	—	—	—	35,558	35,558
Balance as of January 31, 2019	81,390,505	\$ 8	\$ 1,346,620	\$ (7,554)	\$ 175,308	\$ 1,514,382

See accompanying Notes to Condensed Consolidated Financial Statements.

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

	Six Months Ended January 31,	
	2019	2018
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss)	\$6,245	\$(54,469)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	19,442	16,315
Amortization of debt discount and issuance costs	6,013	—
Stock-based compensation	47,686	44,655
Charges to bad debt and revenue reserves	352	—
Deferred income tax	(7,340)	24,287
Amortization of premium (accretion of discount) on available-for-sale securities	(3,816)	361
Other non-cash items affecting net income (loss)	515	—
Changes in operating assets and liabilities:		
Accounts receivable	4,414	(16,345)
Unbilled accounts receivable	(30,190)	—
Prepaid expenses and other assets	(66)	(3,139)
Accounts payable	(14,475)	4,834
Accrued employee compensation	(15,262)	(17,547)
Deferred revenue	(27,650)	16,690
Other liabilities	1,111	804
Net cash provided by (used in) operating activities	(13,021)	16,446
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of available-for-sale securities	(462,902)	(110,820)
Sales and maturities of available-for-sale securities	410,583	170,316
Purchases of property and equipment	(11,006)	(4,620)
Capitalized software development costs	(1,103)	(769)
Net cash used in investing activities	(64,428)	(76,269)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from issuance of common stock upon exercise of stock options	1,103	727
Net cash provided by financing activities	1,103	727
Effect of foreign exchange rate changes on cash and cash equivalents	(625)	1,207
NET DECREASE IN CASH AND CASH EQUIVALENTS	(76,971)	(57,889)
CASH AND CASH EQUIVALENTS—Beginning of period	437,140	263,176
CASH AND CASH EQUIVALENTS—End of period	\$360,169	\$205,287
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid for income taxes, net of tax refunds	\$2,540	\$1,677
Accruals for purchase of property and equipment	\$3,609	\$1,497
Accruals for capitalized software costs	\$75	\$40

See accompanying Notes to Condensed Consolidated Financial Statements.

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

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

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; insights into data that can improve business decision making; and digital sales, service and claims experiences for policyholders, agents, and other key stakeholders. The Company’s customers are primarily property and casualty insurance carriers.

Basis of Presentation and Consolidation

The accompanying 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 intercompany 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 (“GAAP”) have been condensed or omitted under the rules and regulations of the U.S. Securities and Exchange Commission (“SEC”).

These 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, 2018. There have been no changes in the Company’s significant accounting policies from those that were disclosed in the Company’s consolidated financial statements included in the Company’s Annual Report on Form 10-K for the fiscal year ended July 31, 2018, except for changes to revenue recognition, customer acquisition costs, and costs to fulfill a contract resulting from the adoption of Accounting Standards Update No. 2014-09, “Revenue from Contracts with Customers” (“ASC 606”).

Use of Estimates

The preparation of the accompanying condensed consolidated financial statements in conformity with 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 revenue 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, fair value of convertible senior notes, valuation of goodwill and intangible assets, software development costs to be capitalized, 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.

Foreign Currency

The functional currency of the Company’s foreign subsidiaries is their respective local currency. The Company translates all assets and liabilities of foreign subsidiaries to U.S. dollars at the current exchange rate as of the applicable balance sheet date. Revenue and expenses are translated at the average exchange rate prevailing during the period in which the transactions occur. The effects of foreign currency translations are recorded in accumulated other comprehensive income (loss) as a separate component of stockholders’ equity in the accompanying condensed

consolidated balance sheets. Transaction gains and losses that arise from exchange rate fluctuations on transactions denominated in a currency other than the functional currency are recorded as other income (expense) in the condensed consolidated statements of operations.

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.

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Investments

Management determines the appropriate classification of investments at the time of purchase based upon management's intent with regard to such investments. All current investments have been 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 income (loss).

Property and Equipment

Property and equipment are stated at cost less accumulated depreciation and amortization. Depreciation is calculated on a straight-line basis over the estimated useful lives of the assets. Maintenance and repairs that do not extend the life or improve an asset are expensed in the period incurred.

The estimated useful lives of property and equipment are as follows:

Computer hardware	3 years
Purchased software	3 years
Furniture and fixtures	5 years
Leasehold improvements	Shorter of 10 years or remaining lease term

Software Development Costs

Certain on-premise software development costs incurred subsequent to the establishment of technological feasibility are subject to capitalization and amortized over the estimated lives of the related products. Technological feasibility is established upon completion of a working model. Costs incurred subsequent to the establishment of technological feasibility have not been material and, therefore, all software development costs related to on-premise software have been charged to research and development expense in the accompanying consolidated statements of operations as incurred.

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, it is probable that the project will be completed, and the software will be used as intended. If any of these criteria cease being met before the software reaches its intended use, any capitalized costs related to the project will be impaired. When the software reaches its intended use, capitalized costs are amortized to cost of revenue over the estimated useful life of the related assets, generally estimated to be three to five 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 condensed consolidated statements of operations. Capitalized software development costs are recorded in property and equipment on the Company's condensed consolidated balance sheets.

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 amount 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 amount of the assets over the estimated fair value of the assets.

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 the Company's single 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

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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.

Convertible Senior Notes

In March 2018, the Company issued \$400.0 million aggregate principal amount of 1.25% Convertible Senior Notes due 2025 (the “Convertible Senior Notes”). The Company accounts for the liability and equity components of the issued Convertible Senior Notes separately. The carrying amount of the equity component, representing the conversion option, was determined by deducting the fair value of the liability component from the par value of the Convertible Senior Notes as a whole. This difference represents a debt discount that is amortized to interest expense using the effective interest method over the term of the Convertible Senior Notes. The carrying amount of the liability component was calculated by measuring the fair value of a similar liability that does not have an associated convertible feature. The liability and equity components will not be remeasured as long as the conversion option continues to meet the requirements for equity classification. The equity component is net of issuance costs and recorded in additional paid-in capital.

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, subsequent adjustments, if any, are recorded to the Company’s condensed consolidated statements of operations.

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 condensed consolidated balance sheets are in excess of amounts that are insured by the Federal Deposit Insurance Corporation.

No customer individually accounted for 10% or more of the Company’s revenue in any of the periods presented or for 10% or more of the Company’s accounts receivable as of January 31, 2019 and July 31, 2018.

Accounts Receivable and Allowance for Doubtful Accounts

Accounts receivable are recorded at invoiced amounts and do not bear interest. While the Company does not require collateral, the Company performs ongoing credit evaluations of its customers. The Company maintains an allowance for doubtful accounts based upon the expected collectability of its accounts receivable. The expectation of collectability is based on historical loss patterns, the number of days that billings are past due, and an evaluation of the potential risk of loss associated with delinquent accounts.

Revenue Recognition

The Company’s revenue is derived from contracts with customers. The majority of the Company’s revenue is derived from licensing arrangements that can span multiple years, and implementation and other professional services arrangements. The Company accounts for revenue in accordance with ASC 606, which the Company adopted on August 1, 2018 using the modified retrospective method. Refer to the Company’s Annual Report on Form 10-K for the fiscal year ended July 31, 2018 for a description of the Company’s revenue recognition policy prior to August 1, 2018. The core principle of ASC 606 is to recognize revenue upon the transfer of services or products to customers in an amount that reflects the consideration the Company expects to be entitled to in exchange for those services or products. The Company applies the following framework to recognize revenue:

Identification of the contract, or contracts, with the customer

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The Company considers the terms and conditions of written contracts and its customary business practices in identifying its contracts under ASC 606. The Company determines it has a contract with a customer when the contract is approved, the Company can identify each party's rights regarding the services and products to be transferred, the Company can identify the payment terms for the services and products, the Company has determined that the customer has the ability and intent to pay, and the contract has commercial substance. In general, contract terms will be reflected in a written document that is signed by both parties. At contract inception, the Company evaluates whether two or more contracts should be combined and accounted for as a single contract. The Company also evaluates the customer's ability and intent to pay, which is based on a variety of factors, including the customer's historical payment experience or, in the case of a new customer, credit and financial information pertaining to the customer.

Identification of the performance obligation in the contract

Performance obligations promised in a contract are identified based on the services or products that will be transferred to the customer that are both:

- i. capable of being distinct, whereby the customer can benefit from the service or product either on its own or together with other resources that are readily available from the Company or third parties, and
- ii. distinct in the context of the contract, whereby the transfer of the services or products is separately identifiable from other promises in the contract.

To the extent a contract includes multiple promised services or products, the Company applies judgment to determine whether promised services or products are capable of being distinct and distinct in the context of the contract. If these criteria are not met the promised services or products are accounted for as a combined performance obligation.

The Company generates revenue from the following sources, which represent the performance obligations of the Company:

- i. On-premise software licenses related to term or perpetual agreements;
- ii. Maintenance activities that consist of email and phone support, bug fixes, and unspecified software updates and upgrades released when, and if, available during the maintenance term;
- iii. Subscription services related to the Company's Software-as-a-Service ("SaaS") offerings; and
- iv. Services related to the implementation and configuration of the Company's software, reimbursable travel, and training.

Term licenses generally have a two-year initial term with a customer option to renew on an annual basis after the initial term. Maintenance for term licenses follows the same contract periods. Subscriptions are typically sold with a three- to five-year initial term with a customer option to renew on an annual basis after the initial term. Professional services typically are time and materials contracts that last for an average period of approximately one year.

Determination of the transaction price

The transaction price is determined based on the consideration to which the Company expects to be entitled in exchange for transferring services and products to the customer. Variable consideration is estimated and included in the transaction price if, in the Company's judgment, it is probable that there will not be a significant future reversal of cumulative revenue under the contract.

On-premise software licenses and subscription services may be subject to either fixed or variable installments.

Variable installments are generally subject to changes in a customer's Direct Written Premium ("DWP") or a customer's Gross Written Premium ("GWP"). When consideration is subject to variable installments, the Company estimates variable consideration using the expected value method based on historical DWP or GWP usage to the extent that a significant revenue reversal is not probable to occur. When consideration is subject to a customer termination right, the Company estimates the total transaction price using the most likely method, and defers consideration associated with the customer's termination right until it expires.

The Company evaluates whether a significant financing component exists when the timing of revenue recognition occurs in advance of invoicing. This timing difference occurs when control of the software license is transferred at a point in time, usually at the contract onset, but the customer payments occur over time. A significant financing component generally does not exist under the Company's standard contracting and billing practices. For example, the Company's typical time-based licenses have a two-year initial term with the final payment due at the end of the first

year.

Allocation of the transaction price to the performance obligations in the contract

If the contract contains a single performance obligation, the entire transaction price is allocated to the single performance obligation. Contracts that contain multiple performance obligations require an allocation of the transaction price to each performance

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obligation based on its standalone selling price (“SSP”) in relation to the total fair value of all performance obligations in the arrangement. The majority of the Company’s contracts contain multiple performance obligations, such as when licenses are sold with maintenance, implementation services or training services. Some of the Company’s performance obligations, such as maintenance, implementation services, and training services, have observable inputs that are used to determine the SSP of those distinct performance obligations. Where SSP is not directly observable, the Company determines the SSP using information that may include market conditions and other observable inputs. In the circumstances when available information to determine SSP is highly variable or uncertain, such as for our term licenses, the Company will use the residual method.

Recognition of revenue when, or as, the Company satisfies a performance obligation

The Company recognizes revenue when control of the services or products are transferred to a customer, in an amount that reflects the consideration the Company expects to be entitled to in exchange for those services or products. The Company is principally responsible for the satisfaction of its distinct performance obligations, which are satisfied either at a point in time or over a period of time.

Performance obligations satisfied at a point in time

On-premise software licenses

On-premise term and perpetual software licenses comprise the majority of distinct performance obligations that are satisfied at a point in time. Revenue is recognized at the point in which the on-premise software licenses are made available to a customer. Consideration for on-premise software licenses is typically billed in advance on an annual basis over the license term.

Performance obligations satisfied over a period of time

Subscriptions, maintenance activities, and professional service arrangements comprise the majority of distinct performance obligations that are satisfied over a period of time.

Subscription arrangements

Revenue from subscription arrangements is recognized ratably over the subscription period using a time-based measure of progress as customers receive the benefits from their subscriptions over the contractually agreed-upon term. The Company’s subscription periods are generally three to five years. Consideration from subscription arrangements is typically billed in advance on an annual basis over the contract period.

Maintenance activities

Revenue from maintenance activities associated with on-premise licenses is a stand-ready obligation, which is recognized over the contractually agreed-upon term using a time-based measure of progress as customers receive benefits from the availability of support technicians over the support period. Consideration for maintenance activities is typically billed in advance on an annual basis. The Company’s maintenance activities are consistently priced as a percentage of the associated on-premise software license.

Services

Revenue from professional service arrangements is recognized over the respective service period as the underlying services are performed.

In substantially all of the Company’s professional service contracts, services are separately identifiable performance obligations for which related revenue and costs are recognized according to when each respective service obligation is delivered. Substantially all professional services engagements are billed and recognized on a time and materials basis. In select situations, the Company will contract professional services on a fixed fee basis, where the Company generally recognizes services revenue over time, using an input method. The measure of progress of the professional services being provided under these fixed fee arrangements is based on hours incurred compared to estimates of the total hours to complete the performance obligation.

When professional services are sold with an on-premise license or subscription arrangement, the Company evaluates whether the performance obligations are distinct or separately identifiable, or whether they constitute a single performance obligation. In the limited cases where professional services are not considered to be distinct from the on-premise license or subscription services, the Company will recognize revenue based on the nature and term of the combined performance obligation when control of the combined performance obligation is transferred to the customer.

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Contract Costs

Contract costs consists of two components, customer acquisition costs and costs to fulfill a contract.

Customer acquisition costs are capitalized only if the costs are incrementally incurred to obtain a customer contract, and mainly consist of sales commissions paid to sales personnel and their related taxes. Capitalized customer acquisition costs related to software licenses, subscriptions, and support services are amortized over the anticipated period of time that such goods and services are expected to be provided to a customer, which the Company estimates to be approximately five years. The amortization of customer acquisition costs is classified as a sales and marketing expense in the condensed consolidated statement of operations.

Costs to fulfill a contract, or fulfillment costs, mainly consist of royalties payable to third-party software providers that support both the Company's software offerings and support services. Fulfillment costs are only capitalized if they relate directly to a contract with a customer, the costs generate or enhance resources that will be used to satisfy performance obligations in the future, and the costs are expected to be recoverable. Fulfillment costs would be generally amortized over the same period of time as the customer acquisition costs. The amortization of fulfillment costs is classified as a cost of revenue.

Advertising Costs

Advertising costs are expensed as incurred and amounts incurred were not material during the three and six months ended January 31, 2019 and 2018.

Stock-Based Compensation

The Company accounts for stock-based compensation using the fair value method, which requires the Company to measure 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 or assumed stock options, restricted stock awards ("RSAs"), 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"). RSAs, RSUs, PSUs, and TSR PSUs are collectively referred to as "Stock Awards."

The fair value of the Company's RSAs, RSUs, and PSUs is equal to 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 that 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 performance conditions, market conditions, or both using the graded vesting method.

The fair value of the Company's stock options and TSR PSUs are estimated at the grant date using the Black-Scholes model and Monte Carlo simulation method, respectively. The assumptions utilized under these methods require judgments and estimates. Changes in these inputs and assumptions could affect the measurement of the estimated fair value of the related compensation expense of these stock options and stock awards. Compensation expense associated with 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 estimates of the achievement of the performance conditions. All TSR PSUs will vest at the end of a three-year period.

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 and tax basis 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 the Company's 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 both 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.

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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 tax regulations and resulting changes in the deferred tax valuation allowance; changes in the mix and level of income or losses; changes in the expected outcome of tax audits; permanent differences for stock-based compensation, including excess tax benefits; research and development credits; the tax rate differences between the United States and foreign countries; foreign withholding taxes; certain non-deductible expenses, including executive compensation; acquisition-related expenses; and provisions under the Tax Cuts and Jobs Act (“Tax Act”), including a provision to tax global intangible low-taxed income of foreign subsidiaries, a special deduction for foreign-derived intangible income, and a base erosion anti-abuse tax that may tax certain payments between a U.S. corporation and its foreign subsidiaries.

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

Recently Adopted Accounting Pronouncements

Interim Disclosure Requirement: Changes in Stockholders’ Equity

In August 2018, the SEC issued SEC Final Rule 33-10532, Disclosure Update and Simplification, which requires public companies to disclose the changes in each caption of stockholders’ equity and non-controlling interests for the current and comparative year-to-date periods, with subtotals for each interim period and the amount of dividends per share for each class of shares. This rule is effective for interim periods, beginning after November 5, 2018, with early adoption permitted. The Company has presented this disclosure beginning with its fiscal quarter ended January 31, 2019.

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

In May 2014, the Financial Accounting Standards Board (“FASB”) issued ASC 606, which supersedes the revenue recognition requirements in Accounting Standards Codification Topic 605, “Revenue Recognition” (“ASC 605”) as well as other industry-specific guidance. The core principle of ASC 606 is that an entity should recognize revenue when control of the promised goods or services is transferred to customers at an amount that reflects the consideration to which the Company expects to be entitled to in exchange for those goods or services.

The Company adopted ASC 606 as of August 1, 2018 using the modified retrospective transition method and applied ASC 606 to those contracts that were not completed, as defined under ASC 606, as of August 1, 2018. The results for reporting periods beginning after August 1, 2018 are presented under ASC 606, while prior period amounts are not adjusted and continue to be presented under ASC 605. The main difference in reporting between ASC 605 and ASC 606 is that under ASC 606, the Company recognizes the revenue associated with term licenses not when payments 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, whereas under ASC 605, revenue associated with term software licenses was recognized over time in the earlier of the period in which the payments are due or are actually made because of extended payment terms. As a result, under ASC 606, all contractually obligated payments under a term license that the Company reasonably expects to collect would be recognized upon the transfer of control of the on-premise software licenses, which is generally when made available to a customer. Under ASC 606, costs to obtain a contract and costs to fulfill a contract are capitalized as an asset and amortized on a basis that is consistent with the pattern of transfer of performance obligations with which the asset relates. In contrast, under ASC 605, costs to obtain and costs to fulfill a contract were historically expensed as incurred.

The Company recorded a net increase to opening retained earnings of \$35.6 million as of August 1, 2018 due to the cumulative impact of adopting ASC 606 using the modified retrospective method. The cumulative impact results from the differences between applying ASC 606 as opposed to applying ASC 605 to existing contracts that were not yet completed as of the date of initial adoption. For contracts completed before August 1, 2018, the Company has not retrospectively applied ASC 606 to the contracts.

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Under ASC 606, contracts with customers are reflected in the condensed consolidated balance sheets as follows:

- Accounts receivable, net represents amounts billed to customers in accordance with contract terms for which payment has not yet been received. It is presented net of the allowance for doubtful accounts as part of current assets on the condensed consolidated balance sheets.
- Unbilled accounts receivable, net represents revenue recognized prior to the end of the reporting period for performance on a portion of the contract in advance of both billing the customer and receiving consideration. Under ASC 606, this balance represents our contract assets.
- Contract costs include deferred commissions and their related taxes, royalties, and referral fees. The short-term portion is presented as prepaid and other current assets, and the long-term portion is presented as other assets.
- Deferred costs represent costs related to our professional services that have been deferred to align with revenue recognition. The short-term portion is presented as prepaid and other current assets, and the long-term portion is presented as other assets.
- Deferred revenue represents amounts received as consideration from the Company's customers in advance of performance on a portion of the contract as of the end of the reporting period. Under ASC 606, this balance represents our contract liabilities.

The Company may receive consideration from its customers in advance of performance on a portion of the contract and, on another portion of the contract, perform in advance of receiving consideration. Contract assets and liabilities related to rights and obligations in a contract are interdependent. Therefore, contract assets and liabilities are presented net at the contract level, as either a single contract asset or a single contract liability, on the condensed consolidated balance sheets.

The following table summarizes the impact to the financial statement line items within the condensed consolidated balance sheets as a result of the initial adoption of ASC 606 (in thousands):

	Balances reported as of July 31, 2018	Cumulative effect adjustment due to adoption of ASC 606	Adjusted beginning balance as of August 1, 2018
Unbilled accounts receivable, net	\$ —	\$ 28,762	\$ 28,762
Contract costs, net	—	12,932	12,932
Deferred tax asset, net	87,482	(10,612)	76,870
Prepaid expenses and other assets	53,035	(239)	52,796
Other liabilities	(21,054)	7,055	(13,999)
Deferred revenue, net	(137,896)	(2,341)	(140,237)
Retained earnings	(133,505)	(35,558)	(169,063)

The cumulative effect adjustment on unbilled accounts receivable is driven by revenue that is recognized in advance of billings under ASC 606. The Company's on-premise software license arrangements result in revenue being recognized at the point in which the software license is transferred to customers, while agreed-upon contractual terms generally provide for billings to occur over a stated licensing period.

The cumulative effect adjustment on contract costs is driven by the requirement in ASC 606 to capitalize incremental, direct costs of either obtaining or fulfilling a contract. In prior periods, these costs were expensed as incurred under ASC 605.

The cumulative effect adjustment on deferred revenue is primarily driven by the requirement under ASC 606 to recognize revenue upfront rather than over the contract period as described in the paragraph above related to unbilled accounts receivable.

The following table summarizes the financial statement line items within the condensed consolidated balance sheets as of January 31, 2019 that were impacted as a result of the adoption of ASC 606 (in thousands):

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	As Reported	Change	As if presented under ASC 605
Unbilled accounts receivable, net	\$58,952	\$(58,952)	\$ —
Contract costs, net ⁽¹⁾	16,614	(16,614)	—
Deferred tax asset, net	83,922	36,240	120,162
Prepaid expenses and other assets	48,950	1,431	50,381
Other liabilities	(15,015)	(7,673)	(22,688)
Deferred revenue, net	(112,360)	(75,648)	(188,008)
Retained earnings	(175,308)	117,915	(57,393)

⁽¹⁾The short- and long-term portions of this balance are reported in 'Prepaid expenses and other current assets' and 'Other assets,' respectively, on the condensed consolidated balance sheets.

The difference between the 'As Reported' amounts and the 'As if presented under ASC 605' amounts within the condensed consolidated balance sheets is due to the same considerations described above with respect to the transition adjustments as a result of the adoption of ASC 606.

The following table summarizes the financial statement line items within the condensed consolidated statement of operations that were impacted as a result of the adoption of ASC 606 for the three months ended January 31, 2019 (in thousands):

	As Reported	Change	As if presented under ASC 605
Revenue:			
License and subscription	\$87,124	\$(39,330)	\$47,794
Maintenance	21,264	357	21,621
Services	60,878	4,996	65,874
Total revenue	169,266	(33,977)	135,289
Cost of revenue	79,630	(285)	79,345
Gross profit	89,636	(33,692)	55,944
Total operating expenses	95,185	2,409	97,594
Loss from operations	(5,549)	(36,785)	(42,334)
Other income (expense), net	4,414	(421)	3,993
Benefit from income taxes	(1,891)	(8,724)	(10,615)
Net income (loss)	\$756	\$(28,481)	\$(27,725)
Net income (loss) per share	\$0.01	\$(0.35)	\$(0.34)

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The following table summarizes the financial statement line items within the condensed consolidated statement of operations that were impacted as a result of the adoption of ASC 606 for the six months ended January 31, 2019 (in thousands):

	As Reported	Change	As if presented under ASC 605
Revenue:			
License and subscription	\$ 181,393	\$(110,487)	\$70,906
Maintenance	42,267	994	43,261
Services	125,289	4,906	130,195
Total revenue	348,949	(104,587)	244,362
Total cost of revenue	162,089	(327)	161,762
Gross profit	186,860	(104,260)	82,600
Total operating expenses	191,345	2,714	194,059
Loss from operations	(4,485)	(107,674)	(112,159)
Other income (expense), net	5,532	(312)	5,220
Benefit from income taxes	(5,198)	(25,632)	(30,830)
Net income (loss)	\$6,245	\$(82,354)	\$(76,109)
Net income (loss) per share	\$0.08	\$(1.02)	\$(0.94)

The difference between the 'As Reported' amounts and the 'As if presented under ASC 605' amounts within revenue is primarily due to term license fees for the entire committed term being recognized upfront as reported under ASC 606 rather than annually or ratably under ASC 605 and subscription arrangements with escalating annual fees that are recognized ratably over the committed term under ASC 606, rather than as escalating fees in each year under ASC 605, partially offset by the difference in revenue recognized associated with a fixed fee contract. Also, hosting fees associated with our subscriptions are classified as subscription revenue under ASC 606 instead of services revenue under ASC 605.

The impact to the condensed consolidated statements of cash flows for the six months ended January 31, 2019 as a result of adopting ASC 606 was not significant.

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, and presentation and disclosure of financial instruments. Under ASU 2016-01, unconsolidated non-equity method investments shall be measured at fair value. If such investments do not have a readily determinable fair value, an election may be made to measure them at cost after considering observable price changes for similar instruments. The Company adopted this standard beginning August 1, 2018, using the measurement alternative election, and the adoption did not result in a significant impact.

Recent Accounting Pronouncements Not Yet Adopted

Leases (Topic 842): Accounting for Leases

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842) and subsequent amendments to the initial guidance: ASU No. 2017-13, ASU No. 2018-10, and ASU No. 2018-11 (collectively, “ASC 842”), 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. ASC 842 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, and earlier adoption is permitted. The Company is evaluating the impact this guidance will have on its 2020 fiscal year and subsequent periods, and currently expects that most of its operating lease commitments will be subject to the new standard and recognized as operating lease liabilities and

right-of-use assets upon our adoption of ASC 842, which will increase total assets and total liabilities that the Company reports relative to such amounts prior to adoption.

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Income Statement, Reporting Comprehensive Income (Topic 220): Reclassification of Certain Effects from Accumulated Other Comprehensive Income

In February 2018, the FASB issued ASU No. 2018-02, Income Statement, Reporting Comprehensive Income (Topic 220): Reclassification of Certain Effects from Accumulated Other Comprehensive Income (“ASU 2018-02”), which allows a reclassification of stranded tax effects from accumulated other comprehensive income to retained earnings, as a result of the Tax Act. The standard will be effective for the Company beginning August 1, 2019, and earlier adoption is permitted. The Company is currently evaluating the impact of adopting the new standard for its 2020 fiscal year and subsequent periods.

Intangibles, Goodwill and Other (Subtopic 350-40): Customer’s Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement that is a Service Contract

In August 2018, the FASB issued ASU No. 2018-15, Intangibles, Goodwill and Other (Subtopic 350-40): Customer’s Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement that is a Service Contract (“ASU 2018-15”), which requires implementation costs incurred by customers in cloud computing arrangements to be deferred and recognized over the term of the arrangement, if those costs would be capitalized by the customer in a software licensing arrangement under the internal-use software guidance in ASC 350-40. ASU 2018-15 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2019, with early adoption permitted. The Company will evaluate the impact of adopting the new standard for its 2021 fiscal year and subsequent periods.

Other recent accounting pronouncements that are or will be applicable to the Company did not, or are not expected to, have a material impact on the Company's present or future financial statements.

2. Revenue

Disaggregation of Revenue

Revenue for the three months ended January 31, 2019 by revenue type and by geography is as follows (in thousands):

	License and subscription	Maintenance	Services	Total
Geography:				
United States	\$ 59,361	\$ 13,291	\$41,449	\$114,101
Canada	8,748	2,272	2,514	13,534
Other Americas	385	1,100	1,581	3,066
Total Americas	68,494	16,663	45,544	130,701
United Kingdom	7,146	1,178	3,053	11,377
Other EMEA	7,170	1,749	7,801	16,720
Total EMEA	14,316	2,927	10,854	28,097
Total APAC	4,314	1,674	4,480	10,468
Total revenue	\$ 87,124	\$ 21,264	\$60,878	\$169,266

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Revenue for the six months ended January 31, 2019 by revenue type and by geography is as follows (in thousands):

	License and subscription	Maintenance	Services	Total
Geography:				
United States	\$ 97,896	\$ 26,412	\$ 85,160	\$ 209,468
Canada	18,170	4,421	5,231	27,822
Other Americas	973	2,181	3,502	6,656
Total Americas	117,039	33,014	93,893	243,946
United Kingdom	15,633	2,309	5,753	23,695
Other EMEA	24,546	3,612	17,301	45,459
Total EMEA	40,179	5,921	23,054	69,154
Total APAC	24,175	3,332	8,342	35,849
Total revenue	181,393	42,267	125,289	348,949

Revenue for the three and six months ended January 31, 2019 by major product or service type is as follows (in thousands):

	Three Months Ended January 31, 2019	Six Months Ended January 31, 2019
License and subscription		
Term license	\$ 72,002	\$ 150,928
Subscription	14,770	30,113
Perpetual license	352	352
Maintenance	21,264	42,267
Services	60,878	125,289
Total revenue	\$ 169,266	\$ 348,949

Customer Contract - Related Balance Sheet Amounts

The Company generally invoices customers in annual installments payable in advance. The difference between the timing of revenue recognition and the timing of billings results in the recognition of unbilled accounts receivable or deferred revenue in the condensed consolidated balance sheets. Amounts related to customer contract-related arrangements are included on the condensed consolidated balance sheets as of August 1, 2018 and January 31, 2019 as follows (in thousands):

	Beginning balance as of August 1, 2018 adjusted	Ending balance as of January 31, 2019 as reported
Unbilled accounts receivable, net	\$ 28,762	\$ 58,952
Contract costs, net ⁽¹⁾	12,932	16,614
Deferred revenue, net	(140,237)	(112,360)

⁽¹⁾The short- and long-term portions of this balance are reported in 'Prepaid expenses and other current assets' and 'Other assets,' respectively, on the condensed consolidated balance sheets.

Unbilled accounts receivable

Unbilled accounts receivable includes those amounts that are unbilled due to agreed-upon contractual terms in which billing occurs subsequent to revenue recognition. This situation typically occurs when the Company transfers control of time-based software licenses to customers up-front, but invoices customers annually over the term of the license, which is typically two years. Unbilled accounts receivable is classified as either current or non-current based on the duration of remaining time between the date of the condensed consolidated balance sheets and the anticipated due date of the underlying receivables. During the three and six months ended January 31, 2019, \$5.2 million and \$7.6 million, respectively, of the Company's unbilled contract revenue balance as of August 1, 2018 became an unconditional right to payment and was billed to its customers.

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Contract costs

Contract costs consist of customer acquisition costs and costs to fulfill a contract, which includes commissions and their related taxes, royalties, and referral fees. Contract costs are classified as either current or non-current based on the duration of time remaining between the date of the condensed consolidated balance sheets and the anticipated amortization date of the associated costs. The current portion of contract costs in the amount of \$3.1 million is included in prepaid and other current assets on the Company's condensed consolidated balance sheets. The non-current portion of contract costs in the amount of \$13.5 million is included in other assets on the Company's condensed consolidated balance sheets. The Company amortized \$1.3 million and \$2.4 million of contract costs during the three and six months ended January 31, 2019, respectively.

Deferred revenue

Deferred revenue consists of amounts that have been invoiced and for which the Company has the right to bill, but that have not been recognized as revenue because the related goods or services have not been transferred. Deferred revenue that will be realized during the 12-month period following the date of the condensed consolidated balance sheets is recorded as current, and the remaining deferred revenue is recorded as non-current. During the three and six months ended January 31, 2019, the Company recognized revenue of \$34.8 million and \$85.0 million, respectively, related to the Company's deferred revenue balance reported as of August 1, 2018.

Performance Obligations

Remaining performance obligations represent contracted revenue that has not yet been recognized, which includes deferred revenue and amounts that will be invoiced and recognized as revenue in future periods. The Company applied the practical expedient in accordance with ASC 606 to exclude amounts related to professional services contracts that are on a time and materials basis. The aggregate amount of consideration allocated to performance obligations either not satisfied or partially satisfied was \$169.1 million as of January 31, 2019. Subscription services are typically satisfied over three to five years, maintenance services are generally satisfied within one year, and professional services are typically satisfied within one year.

3. Fair Value of Financial Instruments

Available-for-sale investments within cash equivalents and investments consist of the following (in thousands):

	January 31, 2019			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
U.S. Government agency securities	\$7,084	\$ —	\$ (12)	\$7,072
Commercial paper	438,248	4	(21)	438,231
Corporate bonds	516,999	416	(292)	517,123
U.S. Government bonds	65,187	6	(5)	65,188
Foreign government bonds	9,340	30	—	9,370
Certificates of deposit	88,501	30	(6)	88,525
Money market funds	57,403	—	—	57,403
Total	\$1,182,762	\$ 486	\$ (336)	\$1,182,912

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	July 31, 2018			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
U.S. Government agency securities	\$9,000	\$ —	\$ (27)	\$8,973
Commercial paper	471,966	4	(141)	471,829
Corporate bonds	432,234	69	(763)	431,540
U.S. Government bonds	89,986	—	(55)	89,931
Foreign government bonds	9,306	7	(1)	9,312
Certificate of deposit	81,985	53	(8)	82,030
Money market funds	90,766	—	—	90,766
Total	\$1,185,243	\$ 133	\$ (995)	\$1,184,381

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

	January 31, 2019					
	Less Than 12 Months		12 Months or Greater		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
U.S. Government agency securities	\$7,072	\$ (12)	\$—	\$ —	\$7,072	\$ (12)
Commercial paper	438,231	(21)	—	—	438,231	(21)
Corporate bonds	359,383	(240)	157,741	(52)	517,124	(292)
U.S. Government bonds	65,188	(5)	—	—	65,188	(5)
Foreign government bonds	5,247	—	4,123	—	9,370	—
Certificate of deposit	78,516	(6)	10,009	—	88,525	(6)
Total	\$953,637	\$ (284)	\$171,873	\$ (52)	\$1,125,510	\$ (336)

As of January 31, 2019, the Company had 149 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 January 31, 2019 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 condensed consolidated balance sheets, with unrealized gains and losses reported as a component of accumulated other comprehensive income (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.

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The following table summarizes the contractual maturities of the Company's available-for-sale investments measured at fair value (in thousands):

	January 31, 2019		Total
	Less Than 12 Months	12 to 24 Months	
U.S. Government agency securities	\$7,072	\$—	\$7,072
Commercial paper	438,231	—	438,231
Corporate bonds	359,382	157,741	517,123
U.S. Government bonds	65,188	—	65,188
Foreign government bonds	5,247	4,123	9,370
Money market funds	57,403	—	57,403
Certificates of deposit	78,516	10,009	88,525
Total	\$1,011,039	\$171,873	\$1,182,912

Fair Value Measurement

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.

Available-for-sale investments

The following tables summarize the Company's available-for-sale investments measured at fair value on a recurring basis, by level within the fair value hierarchy (in thousands):

	January 31, 2019			Total
	Level 1	Level 2	Level 3	
Cash equivalents:				
Corporate bonds	\$—	\$6,101	\$—	—\$6,101
Commercial paper	—	241,332	—	241,332
Money market funds	57,403	—	—	57,403
Total cash equivalents	57,403	247,433	—	304,836
Short-term investments:				
U.S. Government agency securities	—	7,072	—	7,072
Commercial paper	—	196,899	—	196,899
U.S. Government bonds	—	65,188	—	65,188
Foreign government bonds	—	5,247	—	5,247
Corporate bonds	—	353,281	—	353,281
Certificates of deposit	—	78,516	—	78,516
Total short-term investments	—	706,203	—	706,203
Long-term investments:				
Certificates of deposit	—	10,009	—	10,009
Corporate bonds	—	157,741	—	157,741
Foreign government bonds	—	4,123	—	4,123
Total long-term investments	—	171,873	—	171,873
Total	\$57,403	\$1,125,509	\$—	—\$1,182,912

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	July 31, 2018			Total
	Level 1	Level 2	Level 3	
Cash equivalents:				
Commercial paper	\$—	\$269,654	\$	-\$269,654
Corporate bonds	—	3,001	—	3,001
Money market funds	90,766	—	—	90,766
Total cash equivalents	90,766	272,655	—	363,421
Short-term investments:				
U.S. Government agency securities	—	1,999	—	1,999
Commercial paper	—	195,376	—	195,376
U.S. Government bonds	—	89,931	—	89,931
Foreign government bonds	—	4,448	—	4,448
Corporate bonds	—	277,248	—	277,248
Certificate of deposit	—	61,006	—	61,006
Total short-term investments	—	630,008	—	630,008
Long-term investments:				
U.S. Government agency securities	—	6,974	—	6,974
Certificate of deposit	—	21,024	—	21,024
Corporate bonds	—	151,291	—	151,291
Commercial paper	—	6,799	—	6,799
Foreign government bonds	—	4,864	—	4,864
Total long-term investment	—	190,952	—	190,952
Total	\$90,766	\$1,093,615	\$	-\$1,184,381

Convertible Senior Notes

The fair value of the Convertible Senior Notes was \$408.0 million at January 31, 2019. The Company estimates the fair value of the Convertible Senior Notes using commonly accepted valuation methodologies and market-based risk measurements that are directly observable, such as unadjusted quoted prices (Level 2). The Company carries the Convertible Senior Notes at initial fair value less unamortized debt discount and issuance costs on its condensed consolidated balance sheets. For further information on the Convertible Senior Notes, see Note 6.

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4. Balance Sheet Components

Prepaid Expenses and Other Current Assets

Prepaid expenses and other current assets consist of the following (in thousands):

	January 31, July 31,	
	2019	2018
Prepaid expenses	\$ 12,950	\$14,704
Contract costs	3,123	—
Deferred costs	6,272	9,120
Deposits and other receivables	7,889	6,686
Prepaid expenses and other current assets	\$ 30,234	\$30,510

Property and Equipment, net

Property and equipment consist of the following (in thousands):

	January	July 31,
	31, 2019	2018
Computer hardware	\$25,574	\$24,879
Purchased software	4,756	4,664
Capitalized software development costs	4,560	3,978
Furniture and fixtures	5,260	4,217
Leasehold improvements	23,526	10,751
Total property and equipment	63,676	48,489
Less accumulated depreciation	(33,659)	(29,894)
Property and equipment, net	\$30,017	\$18,595

As of January 31, 2019 and July 31, 2018, no property and equipment was pledged as collateral. Depreciation expense, excluding the amortization of software development costs, was \$2.3 million and \$1.9 million for each of the three months ended January 31, 2019 and 2018, respectively, and was \$4.4 million and \$3.8 million for each of the six months ended January 31, 2019 and 2018, respectively.

The Company capitalizes software development costs for technology applications that the Company will offer solely as cloud-based subscriptions, which is primarily comprised of compensation for employees who are directly associated with the software development projects. The Company begins amortizing the capitalized software development costs once the technology applications are available for general release over the estimated lives of the applications, ranging from three to five years. The Company recognized approximately \$0.3 million and \$0.1 million in amortization expense in cost of revenue - license and subscription on the accompanying condensed consolidated statements of operations during the three months ended January 31, 2019 and 2018, respectively, and recognized approximately \$0.6 million and \$0.1 million during the six months ended January 31, 2019 and 2018, respectively.

Other assets

Other assets consists of the following (in thousands):

	January 31, July 31,	
	2019	2018
Prepaid expenses	\$ 2,179	\$2,476
Contract costs	13,491	—
Deferred costs	8,988	9,377
Strategic investments	10,672	10,672
Other assets	\$ 35,330	\$22,525

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The Company's other assets includes a strategic equity investment in a privately-held company. The strategic investment is a non-marketable equity security, in which the Company does not have a controlling interest or the ability to exert significant influence. This investment does not have a readily determinable market value. The Company records this strategic investment at cost less impairment and adjusts cost for subsequent observable price changes. As of January 31, 2019 and July 31, 2018, there were no changes in the investment's carrying value of \$10.7 million.

Goodwill and Intangible Assets

Changes in the carrying amount of goodwill during the six months ended January 31, 2019 was as follows (in thousands):

Goodwill, July 31, 2018	\$340,877
Changes in carrying value	—
Goodwill, January 31, 2019	\$340,877

The Company's intangible assets are amortized over their estimated useful lives. Intangible assets consist of the following (in thousands):

	Weighted-Average Useful Life (in years)	January 31, 2019			July 31, 2018		
		Cost	Accumulated Amortization	Net Book Value	Cost	Accumulated Amortization	Net Book Value
Intangible assets:							
Acquired technology	4.5	\$93,600	\$ 44,079	\$49,521	\$93,600	\$ 34,189	\$59,411
Customer contracts and related relationships	5.9	35,700	9,600	26,100	35,700	6,633	29,067
Partner relationships	9.0	200	63	137	200	52	148
Trademarks	7.0	2,500	446	2,054	2,500	268	2,232
Order backlog	4.4	8,700	5,475	3,225	8,700	3,904	4,796
Total intangible assets	5.0	\$140,700	\$ 59,663	\$81,037	\$140,700	\$ 45,046	\$95,654

Amortization expense was \$7.3 million and \$7.6 million for the three months ended January 31, 2019 and 2018, respectively, and was \$14.6 million and \$12.4 million for the six months ended January 31, 2019 and 2018, respectively. The future amortization expense for existing intangible assets as of January 31, 2019, based on their current useful lives, is as follows (in thousands):

	Future Amortization
Fiscal year ending July 31,	
2019 (remainder of fiscal year)	\$ 14,495
2020	26,834
2021	19,965
2022	11,143
2023	3,799
Thereafter	4,801
Total future amortization expense	\$ 81,037

Accounts Receivables

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Accounts receivable, net consists of the following (in thousands):

	January 31, 2019	July 31, 2018
Accounts receivable	\$120,874	\$125,911
Allowance for doubtful accounts	(1,175)	(1,062)
Accounts receivable, net	\$119,699	\$124,849

Allowance for Doubtful Accounts

Changes to the allowance for doubtful accounts during the six months ended January 31, 2019 were as follows (in thousands):

Allowance for doubtful accounts as of July 31, 2018	\$1,062
Charges to bad debt and revenue reserves	352
Write-offs, net	(239)
Allowance for doubtful accounts as of January 31, 2019	\$1,175

Accrued Employee Compensation

Accrued employee compensation consists of the following (in thousands):

	January 31, 2019	July 31, 2018
Bonus	\$16,353	\$31,273
Commission	4,163	7,287
Vacation	13,002	13,132
Salaries, payroll taxes and benefits	10,930	8,443
Total accrued employee compensation	\$44,448	\$60,135

5. Net Income (Loss) Per Share

The following table sets forth the computation of the Company's basic and diluted net income (loss) per share (in thousands, except share and per share amounts):

	Three Months Ended January 31, 2019		Six Months Ended January 31, 2018	
Numerator:				
Net income (loss)	\$756	\$(45,555)	\$6,245	\$(54,469)
Net income (loss) per share:				
Basic	\$0.01	\$(0.59)	\$0.08	\$(0.72)
Diluted	\$0.01	\$(0.59)	\$0.08	\$(0.72)
Denominator:				
Weighted average shares used in computing net income (loss) per share:				
Basic	81,217,761	859,040	81,058,576	2023,237
Weighted average effect of dilutive stock options	238,436	—	280,481	—
Weighted average effect of dilutive stock awards	735,724	—	950,730	—
Diluted	82,191,766	859,040	82,289,776	2023,237

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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 anti-dilutive:

	Three Months		Six Months Ended	
	Ended January 31, 2019	2018	January 31, 2019	2018
Stock options to purchase common stock	—	657,271	—	601,370
Stock awards	923,640	3,474,549	660,386	3,222,956

Since the Company has the intent and ability to settle the principal amount of the Convertible Senior Notes in cash and any excess in shares of the Company's common stock, the Company uses the treasury stock method for calculating any potential dilutive effect of the conversion spread on diluted net income per share, if applicable. The conversion spread will have a dilutive impact on net income (loss) per share of common stock when the average market price of the Company's common stock for a given period exceeds the conversion price of \$113.75 per share for the Convertible Senior Notes. During the three and six months ended January 31, 2019, the Company's weighted average common stock price was below the conversion price of the Convertible Senior Notes.

6. Convertible Senior Notes

In March 2018, the Company offered and sold \$400.0 million aggregate principal amount of its 1.25% Convertible Senior Notes due 2025, including the underwriters' exercise in full of their option to purchase an additional \$40.0 million of the Convertible Senior Notes. The Convertible Senior Notes were issued in accordance with the Indenture, dated as of March 13, 2018, between the Company and U.S. Bank National Association, as trustee (the "Trustee") (the "Base Indenture"), as amended and supplemented by the First Supplemental Indenture, dated as of March 13, 2018, between the Company and the Trustee (together with the Base Indenture, the "Indenture"). The net proceeds from the issuance of the Convertible Senior Notes were \$387.2 million, after deducting issuance costs.

The Convertible Senior Notes are unsecured obligations of the Company, and interest is payable semi-annually in arrears at a rate of 1.25% per year, on March 15th and September 15th of each year, from September 15, 2018. The Convertible Senior Notes will mature on March 15, 2025 unless repurchased, redeemed, or converted prior to such date. Prior to the close of business on the business day immediately preceding October 15, 2024, the Convertible Senior Notes are convertible at the option of holders during certain periods, upon satisfaction of certain conditions. On or after October 15, 2024, the Convertible Senior Notes are convertible at any time until the close of business on the second scheduled trading day immediately preceding the maturity date. The Convertible Senior Notes will have an initial conversion rate of 8.7912 shares of common stock per \$1,000 principal (equivalent to an initial conversion price of approximately \$113.75 per share of its common stock). The conversion rate is subject to customary adjustments upon the occurrence of certain events but will not be adjusted for any accrued and unpaid interest. Upon conversion, the Company will pay or deliver, as the case may be, cash, shares of its common stock or a combination of cash and shares of its common stock, at its election.

The Company may redeem the Convertible Senior Notes, at its option, on or after March 20, 2022, at a redemption price equal to 100% of the principal amount thereof, plus accrued and unpaid interest if the last reported sale price of the Company's common stock has been at least 130% of the conversion price then in effect for at least 20 trading days (whether or not consecutive), including at least one of the three trading days immediately preceding the date on which the Company provides notice of redemption, during any 30 consecutive trading day period ending on, and including, the trading day immediately preceding the date on which the Company provides notice of redemption. No sinking fund is provided for the Convertible Senior Notes. Upon the occurrence of a fundamental change (as defined in the Indenture) prior to the maturity date, holders may require the Company to repurchase all or a portion of the Convertible Senior Notes for cash at a price equal to 100% of the principal amount of the notes to be repurchased, plus any accrued and unpaid interest to, but excluding, the fundamental change repurchase date.

The Convertible Senior Notes rank senior in right of payment to any of the Company's indebtedness that is expressly subordinated in right of payment to the Convertible Senior Notes, and equal in right of payment to any of its indebtedness that is not so subordinated. The Convertible Senior Notes are effectively junior in right of payment to any of the Company's secured indebtedness to the extent of the value of the assets securing such indebtedness; and structurally junior to all indebtedness and other liabilities (including trade payables) and any preferred equity of its current or future subsidiaries.

In accounting for the issuance of the Convertible Senior Notes, the Company separated the Convertible Senior Notes into liability and equity components. The carrying amount of the liability component was calculated by measuring the fair value of a similar liability that does not have an associated convertible feature. The carrying amount of the equity component representing

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the conversion option was determined by deducting the fair value of the liability component from the par value of the Convertible Senior Notes as a whole. The excess of the principal amount of the Convertible Senior Notes over its carrying amount is amortized to interest expense using the effective interest method over the term of the Convertible Senior Notes. The equity component of the Convertible Senior Notes is recorded as the difference between the initial proceeds less the fair value of the liability component and will not be remeasured as long as it continues to meet the requirements for equity classification. The equity component is net of issuance costs and recorded as additional paid-in capital in stockholders' equity.

The net carrying value of the liability component, unamortized debt discount and issuance costs of the Convertible Senior Notes was as follows (in thousands):

	January
	31, 2019
Principal	\$400,000
Less unamortized:	
Debt discount	79,848
Debt issuance cost	9,011
Net carrying amount	\$311,141

The following table sets forth the interest expense recognized related to the Convertible Senior Notes (in thousands, except for percentages):

	Three Months Ended January 31, 2019	Six Months Ended January 31, 2019
Contractual interest expense	\$1,250	\$2,500
Amortization of debt discount	2,765	5,495
Amortization of debt issuance costs	262	517
Total	\$4,277	\$8,512
Effective interest rate of the liability component	5.53 %	5.53 %

Capped Call

The Company paid \$37.2 million to purchase capped calls with certain financial institutions pursuant to capped call confirmations (the "Capped Calls"). The Capped Calls have an initial strike price of \$113.75 per share, subject to certain adjustments, which corresponds to the initial conversion price of the Convertible Senior Notes. The Capped Calls have initial cap prices of \$153.13 per share, subject to certain adjustments. The Capped Calls cover, subject to anti-dilution adjustments, 3.5 million shares of common stock. By entering into the Capped Calls, the Company expects to reduce the potential dilution to its common stock (or, in the event the conversion is settled in cash, to reduce its cash payment obligation) in the event that at the time of conversion its stock price exceeds the conversion price under the Convertible Senior Notes. The Capped Calls are subject to either adjustment or termination upon the occurrence of specified extraordinary events affecting the Company, including a merger event, tender offer, and a nationalization, insolvency, or delisting involving the Company. Additionally, the Capped Calls are subject to certain specified additional disruption events that may give rise to a termination of the Capped Calls, including change in law, insolvency filing, and hedging disruptions. The Capped Calls were recorded as a reduction of the Company's additional paid-in capital in the accompanying condensed consolidated balance sheets.

7. 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, 2018. See the Annual Report on Form 10-K for the fiscal year ended July 31, 2018 for additional information regarding the Company's contractual obligations.

Leases

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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 the terms of the various leases, was \$3.6 million and \$2.1 million for the three months ended January 31, 2019 and 2018, respectively, and was \$6.0 million and \$4.0 million for the six months ended January 31, 2019 and 2018, respectively.

In December 2017, the Company entered into a new lease agreement for its future headquarter facility and began recognizing rent expense in December 2018 when access and control of the premises was provided. The contractual lease term is expected to commence in June 2019 for a period of 10.5 years. Total payments committed under the lease are \$126.4 million. In connection with this lease agreement, the Company also entered into an irrevocable stand-by letter of credit to guarantee the \$1.8 million security deposit.

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 January 31, 2019 or July 31, 2018. 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 Licenses”). Each Software License contains the terms of the contractual arrangement with the customer and generally includes certain provisions for defending the customer against any claims that the Company’s software infringes upon a patent, copyright, trademark, or other proprietary right of a third party. Software Licenses also indemnify the customer against losses, expenses, and liabilities from damages that may be assessed against the customer in the event the Company’s software is found to infringe upon such third-party rights.

The Company has not had to reimburse any of its customers for losses related to indemnification provisions and no material claims against the Company were outstanding as of January 31, 2019 or July 31, 2018. 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.

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8. Stock-Based Compensation Expense and Shareholders' Equity

Stock-Based Compensation Expense

Stock-based compensation expense related to options and Stock Awards is included in the Company's condensed consolidated statements of operations as follows (in thousands):

	Three Months Ended January 31,		Six Months Ended January 31,	
	2019	2018	2019	2018
Total stock-based compensation	\$24,329	\$25,035	\$47,539	\$44,649
Net impact of deferred stock-based compensation	24	(3)	147	6
Total stock-based compensation expense	\$24,353	\$25,032	\$47,686	\$44,655
Stock-based compensation expense was charged to the following categories:				
Cost of license and subscription revenue	\$535	\$258	\$869	\$432
Cost of maintenance revenue	558	481	1,092	936
Cost of services revenue	6,191	5,446	12,159	10,672
Research and development	6,440	7,697	12,844	12,609
Sales and marketing	5,074	5,024	9,695	9,241
General and administrative	5,555	6,126	11,027	10,765
Total stock-based compensation expense	\$24,353	\$25,032	\$47,686	\$44,655

Total unrecognized stock-based compensation cost for our options and Stock Awards were as follows:

As of January 31, 2019		
Unrecognized Expense (in thousands)	Weighted Average	Expected Recognition Period (in years)
Stock Options \$4,189		1.9
Stock Awards 196,446		2.4
\$200,635		

Stock Awards

A summary of the Company's 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, 2018	2,932,155	\$ 69.43	\$ 252,752
Granted	1,024,913	\$ 101.28	
Released	(803,618)	\$ 88.97	\$ 76,138
Canceled	(192,747)	\$ 78.37	
Balance as of January 31, 2019	2,960,703	\$ 81.26	\$ 256,634
Expected to vest as of January 31, 2019	2,960,703	\$ 81.26	\$ 256,634

Aggregate intrinsic value at each period end represents the total market value of Stock Awards at the Company's (1) closing stock price of \$86.68 and \$86.20 on January 31, 2019 and July 31, 2018, respectively. Aggregate intrinsic value for released Stock Awards represents the total market value of released Stock Awards at date of release.

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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.

RSAs are issued and outstanding upon grant; however, vesting is based on continued employment. The weighted average grant date fair value is based on the market value of our common stock on the date of grant.

The Company recognized stock-based compensation of \$3.3 million and \$7.0 million that were related to these performance-based and market-based stock awards for the three months ended January 31, 2019 and 2018, respectively, and \$7.0 million and \$10.0 million for the six months ended January 31, 2019 and 2018, respectively.

Stock Options

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

	Stock Options Outstanding			Aggregate Intrinsic Value
	Number of Stock Options Outstanding	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (in years)	
Balance as of July 31, 2018	537,064	\$ 21.45	4.3	\$ 34,774
Granted	—			
Exercised	(142,818)	\$ 7.73		\$ 12,026
Canceled	(3,563)	\$ 10.96		
Balance as of January 31, 2019	390,683	\$ 26.57	4.5	\$ 23,486
Vested and expected to vest as of January 31, 2019	390,683	\$ 26.57	4.5	\$ 23,486
Exercisable as of January 31, 2019	327,330	\$ 29.59	3.9	\$ 18,688

(1) Aggregate intrinsic value at each period end represents the difference between the Company's closing stock prices of \$86.68 and \$86.20 on January 31, 2019 and July 31, 2018, 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**

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 January 31,		Six Months Ended January 31,	
	2019	2018	2019	2018
Expected term (in years)	*	*	2.88	2.88
Risk-free interest rate	*	*	2.8%	1.4%
Expected volatility of the Company	*	*	27.2%	28.0%
Average expected volatility of the peer companies in the S&P Index	*	*	33.0%	34.7%

Expected dividend yield * * —% —%

*There were no TSR PSUs granted during the three months ended January 31, 2019 and 2018.

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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 and Public Equity Offering

As of January 31, 2019 and July 31, 2018, 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, 81,390,505 and 80,611,698 shares of common stock were issued and outstanding, respectively. Per the terms of the Company's 2011 Stock Plan, on January first of each year, an additional number of shares equal to 5% of the number of shares of common stock issued and outstanding on the preceding December 31st is added to the Company's 2011 Stock Plan reserve. As of January 31, 2019 and July 31, 2018, the Company had reserved shares of common stock for future issuance as follows:

	January 31, 2019	July 31, 2018
Exercise of stock options to purchase common stock	390,683	537,064
Vesting of stock awards	2,960,703	2,932,155
Shares available under stock plans	24,783,516	21,592,494
Total common stock reserved for issuance	28,134,902	25,061,713

In March 2018, the Company completed a public offering of 2,628,571 shares of its common stock, including the sale of shares in connection with the underwriters' exercise in full of their option to purchase additional shares of common stock from the Company. The public offering price of the shares sold in the offering was \$87.50 per share. No shares were sold by the Company's stockholders in this public offering.

9. Income Taxes

The Company recognized an income tax benefit of \$1.9 million and an income tax expense of \$48.1 million for the three months ended January 31, 2019 and 2018, respectively; and an income tax benefit of \$5.2 million and an income tax expense of \$26.0 million for the six months ended January 31, 2019 and 2018, respectively. The change in the amount of the provision for income taxes for each of the three and six months ended January 31, 2019 compared to the same period a year ago was primarily due to a one-time provisional net charge during the quarter ended January 31, 2018 from re-measuring deferred tax assets and liabilities as a result of the Tax Act. The effective tax rate of 167% and (497)% for the three and six months ended January 31, 2019, respectively, differs from the statutory U.S. federal income tax rate of 21% mainly due to permanent differences for stock-based compensation, including excess tax benefits, 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.

During the three and six months ended January 31, 2019, unrecognized tax benefits increased by \$0.3 million and \$0.6 million, respectively. As of January 31, 2019, the Company had unrecognized tax benefits of \$5.8 million that, if recognized, would affect the Company's effective tax rate.

On December 22, 2017, the Tax Act was enacted into law which substantially changed U.S. tax law, including a reduction in the U.S. corporate income tax rate to 21% effective January 1, 2018 and several provisions that may impact the Company in current and future periods. The Tax Act includes a provision to tax global intangible low-taxed income ("GILTI") of foreign subsidiaries, a special deduction for foreign-derived intangible income, and a

base erosion anti-abuse tax (“BEAT”) measure that taxes certain payments between a U.S. corporation and its foreign subsidiaries. These provisions of the Tax Act became effective for the Company beginning on August 1, 2018 and had no impact on the tax benefit for the six months ended January 31, 2019.

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Under GAAP, the Company can make an accounting policy election to either treat taxes due on the GILTI inclusion as a current period expense or factor such amounts into its measurement of deferred taxes. The Company has elected the current period expense method.

In December 2018, the IRS issued proposed regulations related to the BEAT tax, which the Company is in the process of evaluating. If the proposed BEAT regulations are finalized in their current form, the impact may be material to the tax provision in the quarter of enactment.

The U.S. Treasury Department, the Internal Revenue Service (“IRS”), and other standard-setting bodies will continue to interpret or issue guidance on how provisions of the Tax Act will be applied or otherwise administered. The Company continues to obtain, analyze, and interpret guidance as it is issued and will revise its estimates as additional information becomes available. Any legislative changes, including any other new or proposed U.S. Department of the Treasury regulations that have yet to be issued, may result in income tax adjustments, which could be material to our provision for income taxes and effective tax rate in the period any such changes are enacted. The Company has finalized its assessment of the transitional impacts of the Tax Act.

10. 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 revenue information for the Company’s term license, perpetual license, subscription, maintenance, and 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.

Revenue by country and region based on the billing address of the customer is as follows (in thousands):

	Three Months		Six Months Ended	
	Ended January 31,		January 31,	
	2019	2018	2019	2018
United States	\$ 114,101	\$ 104,422	\$ 209,468	\$ 174,256
Canada	13,534	16,458	27,822	26,653
Other Americas	3,066	3,418	6,656	8,160
Total Americas	130,701	124,298	243,946	209,069
United Kingdom	11,377	9,315	23,695	18,652
Other EMEA	16,720	10,554	45,459	17,178
Total EMEA	28,097	19,869	69,154	35,830
Total APAC	10,468	19,621	35,849	27,060
Total revenue	\$ 169,266	\$ 163,788	\$ 348,949	\$ 271,959

No country or region, other than those presented above, accounted for more than 10% of revenue during the three and six months ended January 31, 2019 and 2018.

The Company’s long-lived assets, including intangibles and goodwill, net by geographic region is as follows (in thousands):

	January	July 31,
	31, 2019	2018
Americas	\$446,469	\$449,588
EMEA	5,407	5,491
APAC	55	47
Total	\$451,931	\$455,126

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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 Quarterly Report on Form 10-Q 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 provide a technology platform, composed of software, services, and a partner ecosystem for the global Property and Casualty (“P&C”) insurance industry.

Guidewire InsurancePlatform™ consists of cloud and on-premise 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 primarily comprised of three applications (PolicyCenter, BillingCenter, and ClaimCenter) 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, gain insights into their business, and underwrite new and evolving risks. Our digital engagement applications enable digital sales, omni-channel service and enhanced claims experiences for policyholders, agents, vendor partners, and field personnel. 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 team 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 or assesses the benefits of a cloud-based subscription in addition to our more traditional on-premises 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 license and maintenance fees are typically invoiced annually in advance. Substantially all term licenses are sold with an initial two-year committed term with optional annual renewals commencing after the initial term. A small portion of our revenue is derived from perpetual licenses. Term and perpetual license revenue are typically recognized when software is made available to the customer, provided that all other revenue recognition criteria have been met.

We also offer cloud-based subscriptions. Generally, these subscriptions have an initial term of three to five years, and are typically billed annually in advance, although in some instances additional fees may be assessed in arrears as

customers increase their DWP. Revenue derived from these subscriptions are recognized ratably over the contractual term beginning after the subscription is effectively provisioned, which is the date our software service is made available to customers. We anticipate that sales of subscriptions will increase as a percentage of annual new sales as we sell more cloud-based services. As a result of the ratable recognition of revenue associated with subscriptions, a significant shift from term licenses to subscriptions will adversely affect our reported revenue growth. As this relatively new sales model matures, we may decide to change certain terms to remain competitive or otherwise meet market demands.

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To extend our technology leadership in the global market, we continue to invest in product development and cloud operations to enhance and improve our current products, introduce new products, and advance our ability to deploy cost-effectively each of our products in the cloud. Continued investment in product innovation is critical as we seek to assist our customers obtain their IT goals, maintain our competitive advantage, grow our revenue, 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 SI partners to meet our customers' implementation needs. Our services organization comprises 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 allow 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, increasing the overall adoption of our products, and managing the infrastructure of our cloud-based customers. 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 \$260.3 million, including approximately \$146.6 million in cash and equity consideration valued at approximately \$113.7 million of newly issued Guidewire common stock and options, net of certain adjustments.

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. The results of Cyence's operations have been included in our results of operations since November 1, 2017, the date of acquisition.

Seasonality

We have historically experienced seasonal variations in our license and subscription revenue 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 ending July 31, due to efforts by our sales team to achieve annual incentives. This seasonal pattern, however, may be absent in any given year. Additionally, the adoption of new revenue guidance, also referred to as ASC 606, could heighten or change the seasonal impact on our new term licenses that are multi-year in nature with more revenue recognized upfront upon delivery of our software. For example, in the first quarter of fiscal year 2019, we experienced license revenue growth due to the remediation of customer contracts, which were done in anticipation of the transition to ASC 606, and a 10-year term license deal under which revenue was recognized upfront under ASC 606, which overshadowed the usual positive seasonal impact in our second quarter of fiscal year 2019. On an annual basis, our maintenance revenue which is recognized ratably, may also be impacted in the event that seasonal patterns change significantly. Additionally, as subscriptions increase as a percentage of total sales, the revenue we can recognize in the initial fiscal year of an order will be reduced,

deferred revenue will increase, and our reported revenue growth will be adversely affected due to the ratable nature of these arrangements. The seasonal nature of our sales and the concentration of such sales in our fiscal fourth quarter increases this impact.

Our services revenue is also subject to seasonal fluctuations, though to a lesser degree than our license revenue. Our services revenue is impacted by the number of billable days in a given fiscal quarter. The quarter ending January 31 usually has fewer billable days due to the impact of the Thanksgiving, Christmas, and New Year's holidays. The fiscal quarter ending July 31 usually has fewer billable days due to the impact of vacation times taken by our professional staff. Because we pay our services professionals the same amount throughout the year, our gross margins on our services revenue is usually lower in these quarters. This seasonal pattern, however, may be absent in any given year.

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Public Offerings

On March 13, 2018, we completed a public offering of 2,628,571 shares of our common stock, including the underwriters' exercise in full of their option to purchase additional shares of our common stock. The public offering price of the shares sold in the offering was \$87.50 per share. Our stockholders did not sell any shares in this public offering. Concurrently, we offered and sold \$400.0 million aggregate principal amount of our 1.25% Convertible Senior Notes due 2025 (the "Convertible Senior Notes"), including the underwriters' exercise in full of their option to purchase additional Convertible Senior Notes. Net of issuance costs, we received proceeds of approximately \$220.9 million related to the common stock offering and \$387.2 million related to the convertible note offering.

Key Business Metrics

We use certain key metrics and financial measures not prepared in accordance with select United States Generally Accepted Accounting Principles ("GAAP") to evaluate and manage our business, including Free Cash Flow. For a further discussion of how we use certain non-GAAP financial measures, see "Non-GAAP Financial Measures."

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Free Cash Flow

We monitor our free cash flow, 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, amortization and stock-based compensation expenses. Additionally, free cash flow takes into account the impact of changes in deferred revenue, which reflects the receipt of cash payment for products before they are recognized as revenue, and unbilled accounts receivable, which reflects revenue that has been recognized that has yet to be invoiced to our customers. Our net cash provided by (used in) operating activities is significantly impacted by the timing of invoicing and collections of accounts receivable, the timing and amount of annual bonus payments, as well as payroll and tax payments. Our capital expenditures consisted of purchases of property and equipment, most of which were computer hardware, software, capitalized software development costs, and leasehold improvements. For a further discussion of our operating cash flows, see “Liquidity and Capital Resources - Cash Flows.”

	Six Months Ended	
	January 31,	
	2019	2018
Net cash provided by (used in) operating activities	\$(13,021)	\$16,446
Net cash used for capital expenditures	(12,109)	(5,389)
Free cash flow	\$(25,130)	\$11,057

Critical Accounting Policies and Estimates

Our condensed consolidated financial statements are prepared in accordance with GAAP Accounting policies, methods, and estimates are an integral part of the preparation of condensed consolidated financial statements in accordance with 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, which are described in Note 1 “The Company and Summary of Significant Accounting Policies and Estimates” to our condensed consolidated financial statements included in this Quarterly Report on Form 10-Q, areas that are particularly significant include:

- Revenue recognition; and
- Business combinations.

While we continue to evaluate our significant accounting policies to determine which ones involve the most judgment and complexity, aside from revenue recognition, as described herein, there have been no changes to our business combinations or other significant accounting policies as described in our Annual Report on Form 10-K for the fiscal year ended July 31, 2018 that have had a material impact on our condensed consolidated financial statements and related notes.

Revenue Recognition

During our first fiscal quarter of 2019, we adopted ASC 606 using the modified retrospective method. The net cumulative effect adjustment of \$35.6 million was recorded to our retained earnings balance as of August 1, 2018. Revenue recognition requires judgment and the use of estimates, especially in identifying and evaluating the various non-standard terms and conditions in our contracts with customers as to their effect on reported revenue under ASC 606.

Our revenue is derived from contracts with customers. The majority of our revenue is derived from licensing arrangements that can span multiple years, and implementation and other professional services arrangements. On August 1, 2018, we adopted ASC 606 using the modified retrospective method. Refer to our Annual Report on Form 10-K for the fiscal year ended July 31, 2018 for a description of our revenue recognition policy prior to August 1, 2018. The core principle of ASC 606 is to recognize revenue upon the transfer of services or products to customers in an amount that reflects the consideration we expect to be entitled to in exchange for those services or products. We apply a five-step framework to recognize revenue as described in our Revenue Recognition policy included in Note 1

of our condensed consolidated financial statements included in this Quarterly Report on Form 10-Q. Our customers have significant negotiating power during the sales process which can and does result in terms and conditions that are different from our standard terms and conditions. When terms and conditions of our customer contracts are not standard, certain negotiated terms may require significant judgment in order to determine the transaction price, the allocation thereof to the performance obligations identified in the contract and the timing of revenue recognition.

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The estimates and assumptions requiring significant judgment under our revenue policy in accordance with ASC 606 are as follows:

Determination of the transaction price

The transaction price is determined based on the consideration to which we expect to be entitled in exchange for transferring services and products to our customer. Variable consideration is estimated and included in the transaction price if, in our judgment, it is probable that there will not be a significant future reversal of cumulative revenue under the contract.

On-premise software licenses and subscription services may be subject to either fixed or variable installments.

Variable installments are generally subject to changes in a customer's DWP or a customer's Gross Written Premium ("GWP"). When consideration is subject to variable installments, we estimate variable consideration using the expected value method based on historical DWP or GWP usage to the extent that a significant revenue reversal is not probable to occur. When consideration is subject to a customer termination right, we estimate the total transaction price using the most likely method, and defer consideration associated with the customer's termination right until it expires.

We evaluate whether a significant financing component exists when the timing of revenue recognition occurs in advance of invoicing. This timing difference occurs when control of the software license is transferred at a point in time, usually at the contract onset, but the customer payments occur over time. A significant financing component generally does not exist under our standard contracting and billing practices. For example, our typical time-based licenses have a two-year initial term with the final payment due at the end of the first year.

Allocation of the transaction price to the performance obligations in the contract

If the contract contains a single performance obligation, the entire transaction price is allocated to the single performance obligation. Contracts that contain multiple performance obligations require an allocation of the transaction price to each performance obligation based on its standalone selling price ("SSP") in relation to the total fair value of all performance obligations in the arrangement. The majority of our contracts contain multiple performance obligations, such as when licenses are sold with maintenance, implementation services or training services. Some of our performance obligations, such as maintenance, implementation services, and training services, have observable inputs that are used to determine the SSP of those distinct performance obligations. Where SSP is not directly observable, we determine the SSP using information that may include market conditions and other observable inputs. In the circumstances when available information to determine SSP is highly variable or uncertain, such as for our term licenses, we use the residual method.

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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 fairly present 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 for the fiscal year ended July 31, 2018, filed with the Securities and Exchange Commission (the "SEC") on September 19, 2018.

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	Three Months Ended January 31,			
	% of		As a %	
	2019	total	2018	of total
		revenue		revenue
	(in thousands, except percentages)			
Revenue:				
License and subscription	\$87,124	51 %	\$84,221	52 %
Maintenance	21,264	13	19,110	12
Services	60,878	36	60,457	36
Total revenue	169,266	100	163,788	100
Cost of revenue:				
License and subscription	14,739	9	9,040	6
Maintenance	3,954	2	3,593	2
Services	60,937	37	55,136	34
Total cost of revenue	79,630	48	67,769	41
Gross profit:				
License and subscription	72,385	42	75,181	46
Maintenance	17,310	11	15,517	10
Services	(59)	(1)	5,321	2
Total gross profit	89,636	52	96,019	59
Operating expenses:				
Research and development	46,471	28	43,657	26
Sales and marketing	31,173	18	31,961	20
General and administrative	17,541	10	21,066	13
Total operating expenses	95,185	56	96,684	59
Loss from operations	(5,549)	(4)	(665)	—
Interest income	7,553	4	1,573	1
Interest expense	(4,287)	(3)	(7)	—
Other income (expense), net	1,148	1	1,658	1
Income (loss) before income taxes	(1,135)	(2)	2,559	2
Provision for (benefit from) income taxes	(1,891)	(2)	48,114	29
Net income (loss)	\$756	— %	\$(45,555)	(27)%

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	Six Months Ended January 31,					
	2019		2018		As a %	
					of total	
					revenue	
					revenue	
	(in thousands, except percentages)					
Revenue:						
License and subscription	\$181,393	52 %	\$114,314	42 %		
Maintenance	42,267	12	38,040	14		
Services	125,289	36	119,605	44		
Total revenue	348,949	100	271,959	100		
Cost of revenue:						
License and subscription	28,069	8	15,755	6		
Maintenance	7,822	2	7,060	3		
Services	126,198	36	107,848	40		
Total cost of revenue	162,089	46	130,663	48		
Gross profit:						
License and subscription	153,324	44	98,559	36		
Maintenance	34,445	10	30,980	11		
Services	(909)	—	11,757	4		
Total gross profit	186,860	54	141,296	52		
Operating expenses:						
Research and development	91,967	26	79,368	30		
Sales and marketing	63,492	18	55,571	20		
General and administrative	35,886	10	39,737	15		
Total operating expenses	191,345	54	174,676	65		
Loss from operations	(4,485)	—	(33,380)	(13)		
Interest income	14,404	4	3,485	1		
Interest expense	(8,531)	(2)	(11)	—		
Other income (expense), net	(341)	—	1,396	—		
Income (loss) before income taxes	1,047	2	(28,510)	(12)		
Provision for (benefit from) income taxes	(5,198)	(1)	25,959	10		
Net income (loss)	\$6,245	3 %	\$(54,469)	(22)%		

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Revenue

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

We adopted ASC 606 effective August 1, 2018 using the modified retrospective method. Refer to Note 1 to our condensed consolidated financial statements included in this Quarterly Report on Form 10-Q for further details on the impact of ASC 606 as well as a description of our accounting policies related to revenue recognition.

License and Subscription

A substantial majority of our license and subscription revenue consists of term license fees. We also recognize revenue from sales of subscriptions and perpetual licenses. Our term license revenue is primarily generated through annual license fees that recur during the term of the contract. Since the beginning of fiscal year 2017, a substantial majority of our term licenses have been sold under a two-year initial term with optional annual renewals after the initial term. Term license revenue for the initial term of the customer agreement is generally fully recognized upon delivery of the software, which accelerates the timing of revenue recognition compared to previous accounting guidance.

In a limited number of cases, we license our software on a perpetual basis. Perpetual license revenue is generally recognized upon delivery.

Subscription revenue is recognized ratably over the term of the arrangement, beginning at the point in time our provisioning process has been completed and access has been made available to the customer. The initial term of such arrangements is generally from three to five years, unlike our term license arrangements that generally have a two-year initial term. Subscription agreements also contain optional annual renewals commencing upon the expiration of the initial contract term.

We generally price our software based on the amount of DWP that will be managed by our software. A majority of our term license customers are billed annually in advance, and we currently bill our subscription customers similarly. We invoice our perpetual license customers either in full at contract signing or on an installment basis.

Maintenance

Our maintenance revenue is generally recognized over the committed maintenance term. Our maintenance fees are typically priced as a fixed percentage of the associated license fees. We invoice a majority of our customers annually in advance.

Services

Our services revenue is primarily derived from implementation services performed for our customers, reimbursable travel expenses, and training fees in addition to customization work associated with subscription contracts acquired through the acquisition of ISCS, Inc., a provider of a cloud-based, all-in-one platform that offers policy, billing, and claims management functionality for P&C insurers ("ISCS"). A substantial majority of our services engagements generate revenue on a time and materials basis and revenue is recognized upon providing our services.

Three Months Ended January 31,					
2019		2018			
Amount	% of total revenue	Amount	% of total revenue	Change (\$)	Change (%)
(in thousands, except percentages)					

Revenue:

License and subscription

Term license	\$72,002	42 %	\$73,738	45 %	\$(1,736)	(2)%
Subscription	14,770	9	7,666	5	7,104	93
Perpetual license	352	—	2,817	2	(2,465)	(88)
Maintenance	21,264	13	19,110	12	2,154	11

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Services	60,878	36	60,457	36	421	1
Total revenue	\$169,266	100 %	\$163,788	100 %	\$5,478	3

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	Six Months Ended January 31,		2018		Change	
	2019		2018		(\$)	(%)
	Amount	% of total revenue	Amount	% of total revenue		
	(in thousands, except percentages)					
Revenue:						
License and subscription						
Term license	\$150,928	43 %	\$99,087	36 %	\$51,841	52 %
Subscription	30,113	9	12,287	5	17,826	145
Perpetual license	352	—	2,940	1	(2,588)	(88)
Maintenance	42,267	12	38,040	14	4,227	11
Services	125,289	36	119,605	44	5,684	5
Total revenue	\$348,949	100 %	\$271,959	100 %	\$76,990	28

License and Subscription

Our license and subscription revenue primarily consists of term license revenue, subscriptions and, to a lesser extent, perpetual licenses. In certain periods prior to August 1, 2018, our reported license revenue was positively impacted by early receipt of payments due in future periods and negatively impacted by early payments received in preceding periods. Effective with our adoption of ASC 606 on August 1, 2018, license revenue under term licenses is recognized upon delivery for the entire initial term rather than annually upon the earlier of receipt or when the payment is due. While term licenses are currently our predominant licensing model, we anticipate subscriptions will continue to grow as a percentage of annual sales in future periods. Due to the ratable recognition of subscription revenue, growth in subscription revenue will lag behind the growth of subscription sales and will impact the comparative growth of our reported revenue.

Term license revenue decreased by \$1.7 million during the three months ended January 31, 2019, compared to the same period a year ago, primarily due to the timing of the recognition of term license renewals in the first quarter of fiscal year 2019 that would have been recognized in the second quarter of fiscal year 2019 or later due to the adoption of ASC 606, partially offset by term license revenue growth from increased adoption of our product offerings. Going forward, we anticipate the impact on the timing and amount of term license revenue under ASC 606 may cause us to experience greater volatility in our quarterly and annual results.

Term license revenue increased by \$51.8 million during the six months ended January 31, 2019, compared to the same period a year ago, primarily due to the remediation of contracts related to the transition to ASC 606, a ten-year term license deal, and term license revenue growth from increased adoption of our product offerings. Revenue from new customer agreements, the licensing of additional software by existing customers, and renewals increased by \$39.9 million. Revenue from existing contract renewals increased due to the timing of renewals and the recognition of the term license portion of renewals at the renewal date as opposed to over time under previous revenue recognition guidance. Additionally, one existing customer entered into a new ten-year term license agreement that resulted in \$13.0 million of revenue being recognized during the six months ended January 31, 2019 that would have been recognized in years two through ten under previous revenue recognition guidance. Going forward, we anticipate the impact on the timing and amount of term license revenue under ASC 606 may cause us to experience greater volatility in our quarterly and annual results.

Subscription revenue increased by \$7.1 million during the three months ended January 31, 2019, compared to the same period a year ago. The increase is primarily attributable to net increases of \$2.9 million of hosting revenue related to our subscription offerings that is included as subscription revenue under ASC 606 that was previously

included as services revenue under ASC 605, \$2.5 million in additional subscription orders from new and existing customers, and \$1.8 million in subscription billings from acquired products and services related to the Cyence acquisition.

Subscription revenue increased by \$17.8 million during the six months ended January 31, 2019, compared to the same period a year ago. The increase is primarily attributable to net increases of \$6.9 million in additional subscription orders from new and existing customers, \$6.5 million in subscription billings from acquired products and services related to the Cyence acquisition, and \$5.7 million of hosting revenue related to our subscription offerings that is included as subscription revenue under ASC 606 that was previously included as services revenue under ASC 605.

Perpetual license revenue decreased by \$2.5 million and \$2.6 million during the three and six months ended January 31, 2019, respectively, compared to the same periods a year ago. We expect perpetual license revenue to continue to represent a small

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percentage of our total license and subscription revenue. Nevertheless, we expect perpetual license revenue to remain volatile across quarters due to the large amount of perpetual revenue that may be generated from a single customer order.

Maintenance Revenue

Maintenance revenue increased by \$2.2 million and \$4.2 million during the three and six months ended January 31, 2019, respectively, compared to the same periods a year ago. The increase in our maintenance revenue reflects our growing term license customer base. Maintenance related to subscription arrangements is included in subscription revenue, as maintenance is not quoted or priced separately from the subscription services. As a result, we expect an increase in the mix of subscription orders in the future will reduce the growth in maintenance revenue.

Services Revenue

Services revenue increased \$0.4 million and \$5.7 million during the three and six months ended January 31, 2019, respectively, compared to the same periods a year ago. The increase is primarily driven by an increase in professional services relating to projects for new and existing customers, partially offset by the change in presentation of hosting revenue.

Historically, we have worked closely with our network of third-party SI partners to facilitate new sales and implementations of our on-premise products. 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 certified consultants with whom we work. However, implementations of InsuranceSuite Cloud are currently requiring greater levels of participation by our services professionals than is necessary for on-premise versions of our products. With respect to InsuranceSuite Cloud, our obligation to manage the platform in production requires us to have a greater familiarity with its configuration and integrations. At the time of acquisition, ISCS had few third-party resources to assist with implementations of InsuranceNow. While we are actively training consultants from existing and new partners to assist with such implementations, we currently take primary responsibility for most InsuranceNow implementations. As we gain experience with the deployment and maintenance of cloud solutions, we intend to leverage our SI partners more effectively and, over time, rely more on their efforts, similar to on-premise implementations. Reflecting this shift to SI partners and timing of our cloud implementations, we anticipate service revenue to modestly decrease as a percentage of total revenue in fiscal year 2019 as compared to fiscal year 2018.

We also expect modestly higher levels of variability in our service revenue. 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 revenue and associated costs until we are able to meet certain contractual obligations, including customer acceptance criteria or the delivery of new products, and contracts that are fixed in value and that may take more effort to complete than originally anticipated.

Cost of Revenue and Gross Profit

Our total cost of revenue and gross profit are variable and depend on the type of revenue earned in each period. Our cost of license and subscription revenue primarily consists of personnel costs for our production services employees, cloud infrastructure costs, amortization of our acquired intangible assets, and royalty fees paid to third parties. Our cost of maintenance revenue primarily consists of personnel costs for our technical support team. Our cost of services revenue primarily consists of personnel costs for our professional service employees, third-party contractors, and travel-related costs. In instances where we have primary responsibility for the delivery of services, subcontractor fees are expensed as cost of services revenue. In each case, personnel costs include salaries, bonuses, benefits, and stock-based compensation.

We allocate overhead such as information technology support, information security, facilities, and other administrative costs to all functional departments based on headcount. As such, these general overhead expenses are reflected in cost of revenue and each functional operating expense.

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Cost of Revenue:

	Three Months Ended January 31,			
	2019	2018	Change	
	Amount	Amount	(\$)	(%)
	(in thousands, except percentages)			
Cost of revenue:				
License and subscription	\$14,739	\$9,040	\$5,699	63%
Maintenance	3,954	3,593	361	10
Services	60,937	55,136	5,801	11
Total cost of revenue	\$79,630	\$67,769	\$11,861	18

Includes stock-based compensation of:

Cost of license and subscription revenue	\$535	\$258	\$277
Cost of maintenance revenue	558	481	77
Cost of services revenue	6,191	5,446	745
Total	\$7,284	\$6,185	\$1,099

The increase in cost of license and subscription revenue during the three months ended January 31, 2019, compared to the same period a year ago, includes \$2.1 million of hosting related costs under ASC 606 that were previously recorded in cost of services revenue under ASC 605. The overall \$5.7 million increase was primarily attributable to increases of \$2.5 million in cloud operations personnel expenses, \$1.9 million in cloud infrastructure costs incurred in order to support the growth of our subscription and cloud offerings, and \$1.2 million in royalties. We anticipate higher cost of license and subscription revenue as we continue to invest in our cloud operations.

Cost of maintenance revenue increased by \$0.4 million during the three months ended January 31, 2019 due to the increase in personnel required to support our term and perpetual license customers.

The increase in cost of services revenue during the three months ended January 31, 2019, compared to the same period a year ago, was attributable to an increase of \$3.3 million in personnel expenses and a \$2.5 million increase in third-party consultants billable to customers, primarily for InsuranceNow implementation engagements. This \$5.8 million increase would have been \$2.1 million higher if hosting related costs were still recorded as cost of services revenue. Hosting related costs are now recorded under cost of license and subscription revenue, consistent with the way hosting revenue is now recorded under ASC 606.

	Six Months Ended January 31,			
	2019	2018	Change	
	Amount	Amount	(\$)	(%)
	(in thousands, except percentages)			
Cost of revenue:				
License and subscription	\$28,069	\$15,755	\$12,314	78%
Maintenance	7,822	7,060	762	11
Services	126,198	107,848	18,350	17
Total cost of revenue	\$162,089	\$130,663	\$31,426	24

Includes stock-based compensation of:

Cost of license and subscription revenue	\$869	\$432	\$437
Cost of maintenance revenue	1,092	936	156
Cost of services revenue	12,159	10,672	1,487

Total	\$14,120	\$12,040	\$2,080
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The increase in cost of license and subscription revenue during the six months ended January 31, 2019, compared to the same period a year ago, includes \$4.7 million of hosting related costs under ASC 606 that were previously recorded in cost of services revenue under ASC 605. The overall \$12.3 million increase was primarily attributable to increases of \$5.2 million in

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personnel expenses, \$3.7 million in cloud infrastructure costs incurred in order to support the growth of our subscription and cloud offerings, \$1.7 million in royalties, and \$0.7 million related to the amortization of intangible assets. We anticipate higher cost of license and subscription revenue as we continue to invest in our cloud operations. Cost of maintenance revenue increased by \$0.8 million during the six months ended January 31, 2019 due to the increase in personnel required to support our term and perpetual license customers.

The increase in cost of services revenue during the six months ended January 31, 2019, compared to the same period a year ago, was \$18.4 million and was primarily attributable to increases of \$11.7 million in third-party consultants billable to customers primarily for InsuranceNow implementation engagements and \$7.8 million in personnel expenses, partially offset by a decrease of \$1.1 million in costs associated with the discontinuance of fulfillment services acquired as part of the ISCS acquisition that are not considered core to our offerings.

We had 822 professional service employees and 153 technical support and licensing operations employees at January 31, 2019 compared to 790 professional services employees and 100 technical support and licensing operations employees at January 31, 2018. The growth in technical support and licensing operations is largely driven by investments in cloud operations personnel to support current and future cloud customers.

Gross Profit:

		Three Months Ended January 31,		Change	
		2019	2018		
Amount	Margin %	Amount	Margin %	(\$)	(%)
(in thousands, except percentages)					

Gross profit:

License and subscription	\$72,385	83 %	\$75,181	89 %	\$(2,796)	(4)%
Maintenance	17,310	81	15,517	81	1,793	12
Services	(59)	—	5,321	9	(5,380)	(101)
Total gross profit	\$89,636	52	\$96,019	59	\$(6,383)	(7)

Our gross margin decreased to 52% during the three months ended January 31, 2019, compared to 59% in the same period a year ago. The decrease in our gross margin was primarily due to lower license and subscription and services margins. The decline in our license and subscription margin is primarily attributable to the increase in our costs associated with amortization of acquired intangible assets, headcount, and cloud infrastructure costs incurred in order to support the growth of our subscription and cloud operations. The decrease in services gross margin was a result of increased personnel costs and third-party subcontractor costs to increase capacity for future implementations and incremental costs associated with a fixed-fee contract as part of our continued investment in our transition to the cloud.

		Six Months Ended January 31,		Change	
		2019	2018		
Amount	Margin %	Amount	Margin %	(\$)	(%)
(in thousands, except percentages)					

Gross profit:

License and subscription	\$153,324	85 %	\$98,559	86 %	\$54,765	56 %
Maintenance	34,445	81	30,980	81	3,465	11
Services	(909)	(1)	11,757	10	(12,666)	(108)
Total gross profit	\$186,860	54	\$141,296	52	\$45,564	32

Our gross margin increased to 54% during the six months ended January 31, 2019, compared to 52% in the same period a year ago. The increase in our gross margin was primarily driven by an overall increase in license and subscription revenue, partially offset by lower gross margin on services revenue. The decrease in services gross

margin was a result of increased personnel costs and third-party subcontractor costs to increase capacity for future implementations and incremental costs associated with a fixed-fee contract as part of our continued investment in our transition to the cloud.

We intend to continue to invest in our cloud operations as our subscription revenue increases, which will impact license and subscription margins.

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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. We allocate overhead such as information technology support, information security, facilities, and other administrative costs to all functional departments based on headcount. As a result, these general overhead expenses are reflected in cost of revenue and each functional operating expense.

	Three Months Ended January 31,		2018		Change	
	2019					
		% of	% of		(\$)	(%)
	Amount	total	total	Amount		
	revenue	Amount	revenue	revenue		
	(in thousands,	except	percentages)			
Operating expenses:						
Research and development	\$46,471	28 %	\$43,657	26 %	\$2,814	6 %
Sales and marketing	31,173	18	31,961	20	(788)	(2)
General and administrative	17,541	10	21,066	13	(3,525)	(17)
Total operating expenses	\$95,185	56	\$96,684	59	\$(1,499)	(2)

Includes stock-based compensation of:

Research and development	\$6,440		\$7,697		\$(1,257)	
Sales and marketing	5,074		5,024		50	
General and administrative	5,555		6,126		(571)	
Total	\$17,069		\$18,847		\$(1,778)	

	Six Months Ended January 31,		2018		Change	
	2019					
		% of	% of		(\$)	(%)
	Amount	total	total	Amount		
	revenue	Amount	revenue	revenue		
	(in thousands,	except	percentages)			
Operating expenses:						
Research and development	\$91,967	26 %	\$79,368	30 %	\$12,599	16 %
Sales and marketing	63,492	18	55,571	20	7,921	14
General and administrative	35,886	10	39,737	15	(3,851)	(10)
Total operating expenses	\$191,345	54	\$174,676	65	\$16,669	10

Includes stock-based compensation of:

Research and development	\$12,844		\$12,609		\$235	
Sales and marketing	9,695		9,241		454	
General and administrative	11,027		10,765		262	
Total	\$33,566		\$32,615		\$951	

Research and Development

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

The \$2.8 million increase in research and development expenses during the three months ended January 31, 2019, as compared to the same period in the prior year, was due to increases in our headcount as we continue to invest in

enhancing our existing products, developing new products and migrating our products to the cloud.

The \$12.6 million increase in research and development expenses during the six months ended January 31, 2019, as compared to the same period in the prior year, was primarily due to an \$11.6 million increase in our headcount-related costs related to our Cyence acquisition and as we continue to invest in enhancing our existing products, developing new products, and migrating our products to the cloud, as well a \$1.1 million increase in web hosting costs incurred in order to support the development of our subscription and cloud offerings.

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Our research and development headcount was 727 at January 31, 2019 compared with 678 at January 31, 2018. The increase in headcount reflects our continued investment in our products.

We expect our research and development expenses to continue to increase in absolute dollars as we continue to hire in research and development and continue to dedicate internal resources to develop, improve and expand the functionality of our solutions and migrate our solutions to the cloud. Research and development expenses may also increase if we pursue additional acquisitions.

Sales and Marketing

Our sales and marketing expenses primarily consist of costs incurred for compensation and benefit expenses for our sales and marketing employees, including stock-based awards and commissions. It also includes travel expenses, professional services for marketing activities, and amortization of certain acquired intangibles.

The \$0.8 million decrease in sales and marketing expenses during the three months ended January 31, 2019, compared to the same period a year ago, was primarily attributable to decreases of \$2.3 million in marketing and advertising expenses resulting from the timing of expenses for our annual Connections User Conference, which occurred in the first quarter of our current fiscal year compared to the second quarter in our prior fiscal year, and \$1.7 million due to the change in accounting for commission costs under ASC 606. Under ASC 606, certain commissions are capitalized when earned and expensed over the anticipated period of time that goods and services are expected to be provided to a customer, which we estimate to be approximately five years. These decreases were partially offset by an increase of \$3.1 million in personnel expenses due to higher headcount to sell our products.

The \$7.9 million increase in sales and marketing expenses during the six months ended January 31, 2019, compared to the same period a year ago, was primarily attributable to increases of \$7.5 million in personnel expenses due to higher headcount to sell our products and \$1.5 million due to the amortization of intangible assets, partially offset by a decrease of \$1.8 million due to the change in accounting for commission costs under ASC 606. Under ASC 606, certain commissions are capitalized when earned and expensed over the anticipated period of time that goods and services are expected to be provided to a customer, which we estimate to be approximately five years.

Our sales and marketing headcount was 358 at January 31, 2019 compared with 318 at January 31, 2018.

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

General and Administrative

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

The \$3.5 million decrease during the three months ended January 31, 2019, compared to the same period a year ago, was primarily attributable to a decrease in professional services of \$5.3 million, partially offset by increases of \$0.5 million in personnel expenses due to higher headcount to support our growth and \$0.8 million in software system and subscription costs incurred in order to support our growth. Professional services were higher in the prior year period, as a result of professional services incurred in connection with our acquisition of Cyence, our investments in corporate infrastructure and support services, a new enterprise resource planning platform, and a new product configuration and quoting system.

The \$3.9 million decrease in our general and administrative expenses during the six months ended January 31, 2019, compared to the same period a year ago, was primarily attributable to a decrease in professional services of \$9.3 million, partially offset by increases of \$3.5 million in personnel expenses due to higher headcount to support our growth and \$1.4 million in cloud infrastructure costs incurred in order to support our growth. Professional services were higher in the prior year period, as a result of professional services incurred in connection with our acquisition of Cyence, our investments in corporate infrastructure and support services, a new enterprise resource planning platform, and a new product configuration and quoting system.

Our general and administrative headcount was 254 at January 31, 2019 compared with 219 at January 31, 2018.

We expect that our general and administrative expenses will increase in absolute dollars as we continue to invest in personnel, corporate infrastructure, and systems required to support our strategic initiatives, the growth of our business, and our compliance and reporting obligations.

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Other Income (Expense)

	Three Months Ended January 31,				
	2019	2018	Change		
	Amount	Amount	(\$)	(%)	
	(in thousands, except percentages)				
Interest income	\$7,553	\$1,573	\$5,980	380	%
Interest expense	(4,287)	(7)	(4,280)	61,143	%
Other income (expense), net	1,148	1,658	(510)	(31)	%
	Six Months Ended January 31,				
	2019	2018	Change		
	Amount	Amount	(\$)	(%)	
	(in thousands, except percentages)				
Interest income	\$14,404	\$3,485	\$10,919	313	%
Interest expense	(8,531)	(11)	(8,520)	77,455	%
Other income (expense), net	(341)	1,396	(1,737)	(124)	%

Interest Income

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

Interest income increased \$6.0 million and \$10.9 million during the three and six months ended January 31, 2019, respectively, compared to the same periods a year ago. The increase in our interest income is associated with the increase in our investment portfolio primarily as a result of proceeds of approximately \$220.9 million related to the common stock offering and \$387.2 million related to the convertible note offering in March 2018 and, to a lesser extent, higher yields on invested funds.

Interest Expense

Interest expense represents interest expense associated with the \$400.0 million aggregate principal amount of our Convertible Senior Notes that were issued in March 2018.

Interest expense increased \$4.3 million and \$8.5 million during the three and six months ended January 31, 2019, respectively, compared to the same periods a year ago. The increase in our interest expense is due to the non-cash interest expense of \$3.0 million and \$6.0 million related to the amortization of debt discount and issuance costs, and stated interest of \$1.2 million and \$2.5 million during the three and six months ended January 31, 2019, respectively, associated with the Convertible Senior Notes issued in March 2018.

Other Income (Expense), Net

Other income (expense), net consists primarily of foreign exchange gains and losses resulting from fluctuations in foreign exchange rates on monetary asset and monetary liability balances that are denominated in currencies other than the functional currency of the entity.

Other income (expense), net decreased by \$0.5 million and \$1.7 million during the three and six months ended January 31, 2019, respectively, as compared to the same periods a year ago. We realized a net currency exchange gain of \$1.1 million and an exchange loss of \$0.3 million in the current quarter-to-date and year-to-date periods,

respectively, resulting from exchange rate movements for transactions denominated in the Argentine Peso, Australian Dollar, Brazilian Real, British Pound, Canadian Dollar, Euro, Japanese Yen, Malaysian Ringgit, and Polish Zloty.

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Provision for (benefit from) Income Taxes

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

	Three Months Ended			
	January 31,			
	2019	2018	Change	
	Amount	Amount	(\$)	(%)
	(in thousands, except percentages)			
Provision for (benefit from) income taxes	\$(1,891)	\$48,114	\$(50,005)	(104)%
Effective tax rate	167	% 1,880	%	
	Six Months Ended			
	January 31,			
	2019	2018	Change	
	Amount	Amount	(\$)	(%)
	(in thousands, except percentages)			
Provision for (benefit from) income taxes	\$(5,198)	\$25,959	\$(31,157)	(120)%
Effective tax rate	(497))%	(91)%

We recognized an income tax benefit of \$1.9 million and \$5.2 million for the three and six months ended January 31, 2019, respectively, compared to an income tax expense of \$48.1 million and \$26.0 million for the three and six months ended January 31, 2018, respectively.

The decrease in tax expense for the three and six months ended January 31, 2019 compared to the same period a year ago was primarily due to a one-time provisional net charge from re-measuring deferred tax assets and liabilities in the quarter ended January 31, 2018 as a result of the Tax Cuts and Jobs Act (the "Tax Act"). The effective tax rate of 167% and (497)% for the three and six months ended January 31, 2019, respectively, differs from the statutory U.S. federal income tax rate of 21% mainly due to permanent differences for stock-based compensation, including excess tax benefits, 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.

On December 22, 2017, the Tax Act was enacted into law which substantially changed U.S. tax law, including a reduction in the U.S. corporate income tax rate to 21% effective January 1, 2018 and several provisions that may impact us in current and future periods. The Tax Act includes a provision to tax global intangible low-taxed income ("GILTI") of foreign subsidiaries, a special deduction for foreign-derived intangible income, and a base erosion anti-abuse tax ("BEAT") measure that taxes certain payments between a U.S. corporation and its foreign subsidiaries. These provisions of the Tax Act became effective for us beginning on August 1, 2018 and had no impact on the tax benefit for the six months ended January 31, 2019.

Under GAAP, we can make an accounting policy election to either treat taxes due on the GILTI inclusion as a current period expense or factor such amounts into its measurement of deferred taxes. We have elected the current period expense method.

In December 2018, the IRS issued proposed regulations related to the BEAT tax, which we are in the process of evaluating. If the proposed BEAT regulations are finalized in their current form, the impact may be material to the tax provision in the quarter of enactment.

The U.S. Treasury Department, the Internal Revenue Service ("IRS"), and other standard-setting bodies will continue to interpret or issue guidance on how provisions of the Tax Act will be applied or otherwise administered. We continue to obtain, analyze, and interpret guidance as it is issued and will revise our estimates as additional information becomes available. Any legislative changes, including any other new or proposed U.S. Department of the Treasury regulations that have yet to be issued, may result in income tax adjustments which could be material to our provision for income taxes and effective tax rate in the period any such changes are enacted. We have finalized our assessment

of the transitional impacts of the Tax Act.

Non-GAAP Financial Measures

We believe that the following non-GAAP financial measures, along with Free Cash Flow presented above, provide useful information to management and investors regarding certain financial and business trends relating to our financial condition and results of operations. Management uses these non-GAAP measures to compare our performance to that of prior periods for trend analysis, for purposes of determining executive and senior management incentive compensation and for budgeting and planning purposes. We believe that the use of these non-GAAP financial measures provides an additional tool for investors to use in evaluating ongoing operating results and trends and in comparing our financial results with other software companies because it provides consistency and comparability with past financial performance and assists in comparisons with other companies, many of which

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present similar non-GAAP financial measures to investors. However, our management does not consider these non-GAAP measures in isolation or as an alternative to financial measures determined in accordance with GAAP. The non-GAAP financial information is presented for supplemental informational purposes only and should not be considered a substitute for financial information presented in accordance with GAAP, and may be different from similarly-titled non-GAAP measures used by other companies. The principal limitation of these non-GAAP financial measures is that they exclude significant expenses and income that are required by GAAP to be recorded in our financial statements. In addition, they are subject to inherent limitations as they reflect the exercise of judgment by management about which expenses and income are excluded or included in determining these non-GAAP financial measures. We urge investors to review the reconciliation of non-GAAP financial measures to the comparable GAAP financial measures included herein and not to rely on any single financial measure to evaluate the Company's business. The following tables reconcile the specific items excluded from GAAP in the calculation of non-GAAP financial measures for the periods indicated below:

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	Three Months Ended January 31, 2019		Six Months Ended January 31, 2019	
Income (loss) from operations reconciliation:				
GAAP income (loss) from operations	\$(5,549)	\$(665)	\$(4,485)	\$(33,380)
Non-GAAP adjustments:				
Stock-based compensation ⁽¹⁾	24,353	25,032	47,686	44,655
Amortization of intangibles ⁽¹⁾	7,309	7,669	14,618	12,445
Non-GAAP income (loss) from operations	\$26,113	\$32,036	\$57,819	\$23,720
Net income (loss) reconciliation:				
GAAP net income (loss)	\$756	\$(45,555)	\$6,245	\$(54,469)
Non-GAAP adjustments:				
Stock-based compensation ⁽¹⁾	24,353	25,032	47,686	44,655
Amortization of intangibles ⁽¹⁾	7,309	7,669	14,618	12,445
Amortization of debt discount and issuance costs ⁽²⁾	3,027	—	6,013	—
Tax impact of non-GAAP adjustments ⁽³⁾	(7,501)	38,364	(16,724)	18,081
Non-GAAP net income (loss)	\$27,944	\$25,510	\$57,838	\$20,712
Tax provision (benefit) reconciliation:				
GAAP tax provision (benefit)	\$(1,891)	\$48,114	\$(5,198)	\$25,959
Non-GAAP adjustments:				
Stock-based compensation ⁽¹⁾	4,030	6,721	7,890	13,191
Amortization of intangibles ⁽¹⁾	1,210	2,060	2,419	3,635
Amortization of debt discount and issuance costs ⁽²⁾	501	—	995	—
Other income tax effects and adjustments ⁽³⁾	1,760	(47,145)	5,420	(34,907)
Non-GAAP tax provision (benefit)	\$5,610	\$9,750	\$11,526	\$7,878
Net income (loss) per share reconciliation:				
GAAP net income (loss) per share - diluted	\$0.01	\$(0.59)	\$0.08	\$(0.72)
Non-GAAP adjustments:				
Stock-based compensation ⁽¹⁾	0.30	0.33	0.58	0.59
Amortization of intangibles ⁽¹⁾	0.09	0.10	0.18	0.16
Amortization of debt discount and issuance costs ⁽²⁾	0.04	—	0.07	—
Tax impact of non-GAAP adjustments ⁽³⁾	(0.10)	0.49	(0.20)	0.23
Non-GAAP net income (loss) per share - diluted	\$0.34	\$0.33	\$0.71	\$0.26
Shares used in computing Non-GAAP income (loss) per share amounts:				
GAAP weighted average shares - diluted	82,191,668	86,859,040	82,289,773	86,023,237
Non-GAAP dilutive shares excluded from GAAP loss per share calculation ⁽⁴⁾	—	1,460,188	—	1,429,707
Pro forma weighted average shares - diluted	82,191,668	88,319,228	82,289,773	87,452,944

(1) Adjustments relate to amortization of acquired intangibles and stock-based compensation recognized during the period for GAAP purposes.

(2) Adjustments reflect the amortization of debt discount and issuance costs related to the issuance of our Senior Convertible Notes recognized during the period for GAAP purposes.

(3) Adjustments reflect the tax benefit (provision) resulting from all non-GAAP adjustments.

(4) Due to the occurrence of a net loss on a GAAP basis, potentially dilutive securities were excluded from the calculation of GAAP earnings per share, as they would have an anti-dilutive effect. However, as net income was earned on a non-GAAP basis, these shares have a dilutive effect on a non-GAAP earnings per share and are included here.

Liquidity and Capital Resources

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Our principal sources of liquidity are as follows (in thousands):

	As of	
	January 31, 2019	July 31, 2018
	Amount	Amount
Cash, cash equivalents, and investments	\$ 1,238,245	\$ 1,258,100
Working capital	\$ 1,094,128	\$ 997,319

Cash, Cash Equivalents, and Investments

Our cash and cash equivalents are primarily comprised of cash and liquid investments with remaining maturities of 90 days or less from the date of purchase, commercial paper and money market funds. Substantially all of our investments are comprised of corporate debt securities, U.S. government and agency debt securities, commercial paper and non-U.S. government securities, which include state, municipal and foreign government securities.

As of January 31, 2019, approximately \$25.7 million of our cash and cash equivalents were domiciled in foreign tax jurisdictions. While we have no current plans to repatriate these funds to the United States, we may repatriate foreign earnings in the future to the extent that the repatriation is not restricted by local laws or there are no substantial incremental costs associated with such repatriation.

Cash Flows

Our cash flows from operations are significantly impacted by timing of invoicing and collections of accounts receivable, annual bonus payments, as well as payments of payroll, payroll taxes 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 customer orders booked 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, the timing and extent of our spending to support our research and development efforts, and expansion into other markets. We also anticipate the possibility of investing in, or acquiring complementary businesses, applications or technologies, which may require the use of significant cash resources and/or 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:

	Six Months Ended	
	January 31, 2019	2018
	(in thousands)	
Net cash provided by (used in) operating activities	\$(13,021)	\$ 16,446
Net cash used in investing activities	(64,428)	(76,269)
Net cash provided by financing activities	1,103	727

Cash Flows from Operating Activities

Net cash used in operating activities was \$13.0 million for the six months ended January 31, 2019, compared to cash provided by operating activities of \$16.4 million during the six months ended January 21, 2018. This \$29.5 million decrease in operating cash used was primarily attributable to a \$67.4 million decrease in cash used in working capital activities as compared to the same period a year ago, partially offset by a \$37.9 million increase in net income after excluding the impact of non-cash charges such as deferred taxes, stock-based compensation expense, depreciation and amortization expense, and other non-cash items.

Cash Flows from Investing Activities

Net cash used in investing activities decreased by \$11.8 million for the six months ended January 31, 2019 as compared to the six months ended January 31, 2018 primarily due to \$130.4 million in net cash outflows due to the acquisition of Cyence in November 2017, partially offset by a \$111.8 million change in net cash flows from marketable securities and a \$6.7 million increase in capital expenditures.

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Cash Flows from Financing Activities

Net cash provided by financing activities for the six months ended January 31, 2019 was comparable to net cash provided by financing activities for the six months ended January 31, 2018. Cash provided by financing activities in both periods was primarily due to the exercise of employee stock options.

Commitments and Contractual Obligations

Our primary contractual obligations consist of our Convertible Senior Notes due in 2025, obligations under operating leases for office facilities, and letters of credit.

See Notes 6 and 7 to our condensed consolidated financial statements included in this Quarterly Report on Form 10-Q for discussions of our Convertible Senior Notes, lease commitments, and letters of credit. There has been no material change in our contractual obligations and commitments other than in the ordinary course of business since our fiscal year ended July 31, 2018. See the Annual Report on Form 10-K for the fiscal year ended July 31, 2018 for additional information regarding the Company's contractual obligations.

Off-Balance Sheet Arrangements

Through January 31, 2019, we did not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes.

ITEM 3. Quantitative and Qualitative Disclosures about Market Risk

We are exposed to market risks in the ordinary course of our business. Market risk represents the risk of loss that may impact our financial position due to adverse changes in financial market prices and rates. Our market risk exposure is primarily a result of fluctuations in interest rates and foreign currency exchange rates. We do not hold or issue financial instruments for trading purposes.

Interest Rate Sensitivity

Our exposure to market risk for changes in interest rates relates primarily to our cash, cash equivalents, and investments as of January 31, 2019 and July 31, 2018. Our cash, cash equivalents, and investments as of January 31, 2019 and July 31, 2018 were \$1,238.2 million and \$1,258.1 million, respectively, primarily consisting of cash, corporate bonds, U.S. agency debt securities, commercial paper, money market funds, and municipal debt securities. Changes in U.S. interest rates affect the interest earned on our cash and cash equivalents and marketable securities, and the market value of those securities. A hypothetical 100 basis point increase in interest rates would have resulted in a decrease of \$3.9 million and \$4.5 million in the market value of our available-for-sale securities as of January 31, 2019 and July 31, 2018, respectively. Any realized gains or losses resulting from such interest rate changes would only occur if we sold the investments prior to maturity.

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 Argentine Peso, Australian Dollar, Brazilian Real, British Pound, Canadian Dollar, Euro, Japanese Yen, Malaysian Ringgit, and Polish Zloty. The volatility of exchange rates depends on many factors that we cannot forecast with reliable accuracy. We believe our operating activities act as a natural hedge for a substantial portion of our foreign currency exposure because we typically collect revenue and incur costs in the currency in the location in which we provide our services. However, 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 monetary asset and monetary liability balances that are denominated in currencies other than the functional currency of the entities in which they are recorded. For the six months ended January 31, 2019 and 2018, we recorded foreign currency losses of \$0.3 million and gains of \$1.4 million, respectively, as other expense in our condensed consolidated statement of operations due to currency exchange rate movement against the U.S. Dollar. We will continue to experience fluctuations in foreign currency exchange rates. If a hypothetical ten percent change in foreign exchange rates were to occur in the future, the resulting transaction gain or loss would be approximately \$5.9 million.

As our international operations grow, we will continue to assess our approach to managing our risk relating to fluctuations in currency rates.

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Fair Value of Financial Instruments

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

ITEM 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

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

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.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting during the quarter ended January 31, 2019 identified in management’s evaluation pursuant to Rules 13a-15(d) or 15d-15(d) of the Exchange Act compared to the internal controls in our previously filed Annual Report on Form 10-K for the fiscal year ended July 31, 2018, that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. In the quarter ended October 31, 2019, we disclosed that our internal controls over financial reporting related to revenue changed due to the adoption of ASC 606.

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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 and/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.

Risks Related to our Business

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 ability to attract new domestic and international customers and the timing of new orders and revenue recognition for new and existing orders;
- seasonal buying patterns of our customers;
- the proportion and timing of subscription sales as opposed to term software licenses, and the variations in revenue recognition between the two contract types;
- changes in contract durations of term software licenses;
- introduction of new cloud-based, 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;
- erosion in services margins or significant fluctuations in services revenue caused by changing customer demand;
- our ability to realize expected benefits from our acquisitions;
- the lengthy and variable nature of our product implementation cycles;
- future accounting pronouncements or changes in accounting rules and our related accounting policies and interpretations;
- volatility in the sales of our products and the 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;
- 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;
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the incurrence of penalties for failing to meet certain contractual obligations, including service levels and implementation times;

- 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;

• the timing of hiring personnel and employee related expenses;

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the impact of a recession or any other adverse global economic conditions on our business, including trade tariffs and other uncertainties that may cause a delay in entering into or a failure to enter into significant customer agreements; fluctuations in foreign currency exchange rates; and

- unanticipated trade sanctions and other restrictions that may impede our ability to sell internationally.

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. Further, in light of the transition to ASC 606 for revenue recognition, our recent changes to the length of license agreements, and our increased cloud-based subscription services, among other ongoing changes to our business, it is challenging to forecast our quarterly and annual results. Moreover, the transition to ASC 606 has caused additional complexity to our financial statements, especially during this transition period, which could cause investors to misinterpret our reported results and trends in our underlying business.

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 a 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 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 in the fourth fiscal quarter due to efforts by our sales team to achieve annual incentives. As a result, a significantly higher percentage of our annual license revenue has historically been recognized in our second and fourth fiscal quarters. Since a substantial majority of our license revenue has annual renewals after the initial term of the contract, we expect to continue to experience this seasonality effect in subsequent years. Further, the adoption of ASC 606 for revenue recognition will heighten the seasonal impact on our new term licenses that are multi-year in nature with more revenue recognized upfront upon delivery of our software. 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 fiscal quarter, including sales of subscription services, may exacerbate this effect.

Our quarterly growth in license revenue 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:

- 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; 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 the timing of particularly large transactions. For example, in fiscal year 2019, we achieved higher revenue growth in the first fiscal quarter due to the effects of a single license agreement with a term of ten years.

Our revenue may fluctuate versus comparable prior periods or prior quarters within the same fiscal year based on the terms of the agreements and the timing of new orders executed in the quarter. 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 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. Our perpetual license revenue is 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 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 may lead to variability in our revenue and may affect our ability to show consistent growth in license revenue in subsequent periods.

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

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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 revenue, and the loss of any of these customers would significantly harm our business, results of operations and financial condition.

Our revenue is 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 revenue. While the composition of our individual top customers will vary from year to year, in fiscal years 2018, 2017 and 2016, our ten largest customers accounted for 31%, 27% and 27% of our revenue, respectively. Customers for this metric are measured at the parent corporation level, while our total customer count is measured at the purchasing entity level. 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 revenue 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 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 liabilities for us. Our transition to cloud offerings will continue to divert resources and increase costs, especially in cost of license and subscription revenue, 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 revenue 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 fiscal 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 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.

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Increases in services revenue as a percentage of total revenue or lower services margins could adversely affect our overall gross margins and profitability.

Our services revenue was 41%, 34% and 34% of total revenue for each of fiscal years 2018, 2017 and 2016, respectively. Our services revenue produces lower gross margins than our license revenue. The gross margin of our services revenue was 8%, 7% and 8% for fiscal years 2018, 2017 and 2016, respectively, while the gross margin for license revenue was 89%, 94% and 97% for fiscal years 2018, 2017 and 2016, respectively. An increase in the percentage of total revenue represented by services revenue, like we experienced in fiscal year 2018 due to acquisitions and the recognition of revenue on certain cloud-based implementations that were completed in prior years, or lower services margins could reduce our overall gross margins and operating margins. Such a trend can be 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, our ability to bill our customers for all time incurred to complete a project, and the extent to which system integrators are willing and able to provide services directly to customers. Erosion in our services margins would also adversely affect our gross and operating margins. Services margins may erode for a period of time as we work to grow our business and overall revenue; for instance, services margins may erode if we hire and train additional services personnel to support new products including cloud-based services, if we require additional service personnel to support entry into new markets, or if we require additional personnel on unexpectedly difficult projects to ensure customer success, perhaps without commensurate compensation.

Services margins may also decline if we are required to defer services revenue in connection with an engagement. This may happen if our term license and services are considered a combined performance obligation. 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 revenue during fiscal year 2017, and increased margins and services revenue during fiscal year 2018 when certain amounts of this deferred revenue and direct costs were recognized.

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 revenue, and therefore our own issued and pending patents may provide little or no deterrence to these patent owners in bringing intellectual property rights claims against us.

If we are forced to defend against any infringement or misappropriation claims, whether they are with or without merit, are settled out of court, or are determined in our favor, we may be required to expend significant time and financial resources on the defense of such claims. Furthermore, an adverse outcome of a dispute may require us to pay damages, potentially including treble damages and attorneys' fees, if we are found to have willfully infringed a party's intellectual property; cease making, licensing or using our products or services that are alleged to infringe or misappropriate the intellectual property of others; expend additional development resources to redesign our products or services; enter into potentially unfavorable royalty or license agreements in order to obtain the right to use necessary technologies or works; and to indemnify our partners, customers, and other third parties. Any of these events could seriously harm our business, results of operations and financial condition.

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

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-as-a-Service company that applies data science and risk analytics to enable P&C insurers to underwrite "21st century risks" such as terrorism, cybersecurity, and reputational

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risk. 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 adjust the timing of revenue recognition 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. 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 revenue 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 revenue 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, 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 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 revenue 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-

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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 subscription agreements, or could subject us to third-party lawsuits, regulatory fines or other action or liability, thereby adversely affecting our results of operations.

The nature of our business requires the application of revenue and expense recognition rules that require management to make estimates and assumptions. Additionally, changes in accounting guidance on revenue recognition, such as contained in ASC 606, have and may cause us to experience greater volatility in our quarterly and annual results. If we are unsuccessful in adapting our business to the requirements of the new standards, or in clearly explaining to stockholders how those standards affect reporting of our results of operations, our stock price may decline.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the condensed 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, revenue 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 revenue and

results of operations could be significantly impacted, as they were by the adoption of ASC 606.

The accounting rules and regulations that we must comply with are complex. Additionally, the Financial Accounting Standards Board (the “FASB”) and the SEC have focused on the integrity of financial reporting, and 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 ASC 606, accounting guidance on revenue recognition, that became effective for us on August 1, 2018. The standard permits the use of either the full retrospective or modified retrospective method. We selected the modified retrospective

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method. Any change in how we recognize revenue can have a significant impact on our quarterly or annual financial results from operations, and we recorded a net increase to opening retained earnings of \$35.6 million as of August 1, 2018 due to the cumulative impact of adopting ASC 606 using the modified retrospective method. This amount primarily represents revenue that would have been recognized in fiscal year 2019 under old guidance, but would have been recognized prior to fiscal year 2019 under new guidance and now will not be recognized as revenue. The implementation of ASC 606 could cause the following risks:

• Investors' misunderstanding of our business and underlying trends and what they could mean for the underlying success of our business;

• Misinterpretation of historic and future trends;

• We could make mistakes in explaining our historical results or new known trends under ASC 606; and

• The SEC may question or disagree with our accounting under ASC 606, a new revenue recognition standard.

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 a material adverse effect on our recognized revenue and net income, despite no change in associated cash flows. Further, under ASC 606, more judgment and estimates will be required within the revenue recognition process than was required under previous GAAP. We currently anticipate that this standard could create additional volatility in our reported revenue and results of operations, which could negatively impact our stock price.

We have implemented a new enterprise resource planning system as well as other accounting and sales 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 our adoption of ASC 606. These systems are critical for accurately maintaining books and records and preparing our financial statements. We have completed the transition to our new ERP system and have begun using the new revenue reporting system at the beginning of fiscal year 2019. While we have invested significant amounts, including for additional personnel and third-party consultants, to implement these systems, we cannot assure you that we will not experience difficulties following the transition. Any errors in our new ERP system 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, each of which may harm our operations and reduce investor confidence. Data integrity problems or other issues may be discovered even though the transition is complete which, if not corrected, could impact our business, reputation, reporting, disclosures or results of operations. If we encounter unforeseen difficulties with our new ERP and revenue systems, 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 such as the recent imposition of various trade tariffs, 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 not receive amounts owed to us and 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, reducing their spending on information technology, delaying or canceling 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.

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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 revenue.

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 both 2017 and 2018, 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 revenue 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 revenue.

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 revenue 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 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' 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 renewals 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 revenue 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.

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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 products we may acquire in the future. Our system integrators as channel partners help us reach additional customers. Our growth in revenue, 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 revenue 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 of our products in response to these pressures. If we are unable to avoid reducing our average selling prices, 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 revenue and cash flows from our established product offerings, including InsuranceSuite, InsuranceNow and our digital and data products. We expect to continue to derive a substantial portion of our revenue 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 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 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 revenue 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

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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 revenue, 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. Revenue 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 performed by us, our system integrator partners or our customers' employees, the latter two of which are beyond our direct control. The consequences could include, and have included: monetary credits for current or future service engagements, reduced fees for additional product sales, and a customer's refusal to pay their contractually-obligated license, maintenance or service fees. In addition, time-consuming implementations may also increase the amount of services personnel we must allocate to each customer, thereby increasing our costs and adversely affecting our business, results of operations and financial condition.

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

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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 United States 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.

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.

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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-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 sell additional products and services to these customers, a key group for the growth of our revenue 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 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

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attract and retain qualified personnel, or delays in hiring required personnel, may seriously harm our business, results of operations and financial condition. If U.S. immigration policy related to skilled foreign workers were materially adjusted, such a change could hamper our efforts to hire highly skilled foreign employees, including highly specialized engineers, which would adversely impact our business.

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 and consulting services and enhancements of existing products.

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

We have experienced consistent growth and expect to continue to expand our operations, including the number of employees and 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, we have recently implemented a new ERP system.

Our growth could require significant capital expenditures and may divert financial resources from other projects, such as the development of new products. If we increase the size of our organization without experiencing an increase in sales of our products and services, we will experience reductions in our gross and operating margins and net income. If we are unable to effectively manage our expanding operations, our expenses may increase more than expected, our revenue 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 we are continuing to expand our international operations as part of our growth strategy. In fiscal years 2018, 2017 and 2016, \$244.1 million, \$213.1 million and \$193.5 million of our revenue, respectively, was derived from outside of the United States. 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;
- highly inflationary international economies, such as Argentina;
- the burdens and costs of complying with a wide variety of foreign laws and legal standards;

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- compliance with the U.S. Foreign Corrupt Practices Act of 1977, as amended, 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, tax, compliance, 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 revenue, results of operations and cash flows are subject to fluctuations due to changes in foreign currency exchange rates, particularly changes in the Argentine Peso, Australian Dollar, Brazilian Real, British Pound, Canadian Dollar, Euro, Japanese Yen, Malaysian Ringgit, and Polish Zloty.

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 revenue and incur costs in the currency of the location in which we provide our applications and services, 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 revenue 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. For example, in fiscal year 2018, the Argentine economy became highly inflationary; however, our new Argentina entity has had minimal activity through January 31, 2019. We will continue to experience fluctuations in foreign currency exchange rates, which, if material, may harm our revenue or results of operations.

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.

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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, the European Union (the “EU”) Commission has formally adopted a new mechanism for the transfer of personal data from 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 to comply with the Privacy Shield 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 European Economic Area (“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.

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 condensed 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 processes may result in errors that may not be detected and could result in a material misstatement of our condensed 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. We are also reliant on the internal control environments of organizations

providing software and services supporting our financial reporting processes, and if they fail, those failures will impact the effectiveness of our control environment, some of which is out of our control. Furthermore, transition in enterprise resource planning or other major operational systems could impact the timely generation of our financial statements. In fiscal year 2017, we began implementing a new financial management system, as well as applications to help us manage the recognition of our revenue under a new standard, which changes several of our procedures and controls. We completed the transition to our new ERP system and began using the new revenue reporting system at the beginning of fiscal year 2019. If as a result of implementing this new system or otherwise, we cannot provide timely reliable financial reports, our

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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, including impacts of the Tax Act. The U.S. Treasury Department, the IRS, and other standard-setting bodies are expected to continue to interpret or issue guidance on how provisions of the Tax Act will be applied or otherwise administered. As future guidance is issued, we may make adjustments to amounts that we have previously recorded that may materially impact our financial statements in the period in which the adjustments are made.

In addition, we are subject to the examination of our income tax returns by the IRS 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 or availability 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.

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

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

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

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

- providing for a classified board of directors with staggered three-year terms, which could delay the ability of stockholders to change the membership of a majority of our board of directors;
 - not providing for cumulative voting in the election of directors, which limits the ability of minority stockholders to elect director candidates;
 - authorizing our board of directors to issue, without stockholder approval, preferred stock rights senior to those of common stock, which could be used to significantly dilute the ownership of a hostile acquirer;
 - prohibiting stockholder action by written consent, which forces stockholder action to be taken at an annual or special meeting of our stockholders;
- limiting the persons who may call special meetings of stockholders, which could delay the ability of our stockholders to force consideration of a proposal or to take action, including the removal of directors; and
- requiring advance notification of stockholder nominations and proposals, which may discourage or deter a potential acquirer from conducting a solicitation of proxies to elect the acquirer's own slate of directors or otherwise attempting to obtain control of us.

The affirmative vote of the holders of at least 66 2/3% of our shares of capital stock entitled to vote is generally necessary to amend or repeal the above provisions that are contained in our amended and restated certificate of incorporation. Also, absent approval of our board of directors, our amended and restated bylaws may only be amended or repealed by the affirmative vote of the holders of at least 50% of our shares of capital stock entitled to vote.

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.

Risks Related to Our Indebtedness

Servicing our indebtedness requires a significant amount of cash. We may not have sufficient cash flow from our business to pay our substantial indebtedness, and we may not have the ability to raise the funds necessary to settle for cash conversions of the Convertible Senior Notes or to repurchase the Convertible Senior Notes upon a fundamental change, which could adversely affect our business and results of operations.

As of January 31, 2019, we had outstanding an aggregate principal amount of \$400.0 million of the Convertible Senior Notes. Our indebtedness may increase our vulnerability to any generally adverse economic and industry conditions, and we and our subsidiaries may, subject to the limitations in the terms of our existing and future indebtedness, incur additional debt, secure existing or future debt or recapitalize our debt. If we incur additional indebtedness, the risks related to our business and our ability to service or repay our indebtedness would increase.

Pursuant to their terms, holders may convert their Convertible Senior Notes at their option prior to the scheduled maturities of their Convertible Senior Notes under certain circumstances. Upon conversion of the Convertible Senior Notes, unless we elect to deliver solely shares of our common stock to settle such conversion (other than paying cash in lieu of delivering any fractional share), we will be obligated to make cash payments. In addition, holders of our Convertible Senior Notes will have the right to require us to repurchase their Convertible Senior Notes upon the occurrence of a fundamental change (as defined in the Indenture, dated as of March 13, 2018, between the Company and U.S. Bank National Association, as trustee (the “Trustee”) (the “Base

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Indenture”), as amended and supplemented by the First Supplemental Indenture, dated as of March 13, 2018, between the Company and the Trustee (together with the Base Indenture, the “Indenture”) at a repurchase price equal to 100% of the principal amount of the Convertible Senior Notes to be repurchased, plus accrued and unpaid interest, if any, to, but not including, the fundamental change purchase date. Although it is our intention and we currently expect to have the ability to settle the Convertible Senior Notes in cash, there is a risk that we may not have enough available cash or be able to obtain financing at the time we are required to make repurchases of Convertible Senior Notes surrendered therefor or Convertible Senior Notes being converted. In addition, our ability to make payments may be limited by law, by regulatory authority or by agreements governing our future indebtedness. Our failure to repurchase Convertible Senior Notes at a time when the repurchase is required by the Indenture or to pay any cash payable on future conversions of the Convertible Senior Notes as required by such Indenture would constitute a default under such Indenture. A default under the Indenture or the fundamental change itself could also lead to a default under agreements governing our future indebtedness. If the repayment of the related indebtedness were to be accelerated after any applicable notice or grace periods, we may not have sufficient funds to repay the indebtedness and repurchase the Convertible Senior Notes or make cash payments upon conversions thereof.

Our ability to make scheduled payments of the principal and interest on our indebtedness when due or to make payments upon conversion or repurchase demands with respect to our Convertible Senior Notes, or to refinance our indebtedness as we may need or desire, depends on our future performance, which is subject to economic, financial, competitive and other factors beyond our control. Our business may not continue to generate cash flow from operations in the future sufficient to satisfy our obligations under our existing indebtedness, and any future indebtedness we may incur, and to make necessary capital expenditures. If we are unable to generate such cash flow, we may be required to adopt one or more alternatives, such as reducing or delaying investments or capital expenditures, selling assets, refinancing or obtaining additional equity capital on terms that may be onerous or highly dilutive. Our ability to refinance existing or future indebtedness will depend on the capital markets and our financial condition at such time. We may not be able to engage in any of these activities or engage in these activities on desirable terms or at all, which could result in a default on our existing or future indebtedness and have a material adverse effect on our business, results of operations and financial condition.

The conditional conversion feature of the Convertible Senior Notes, if triggered, may adversely affect our financial condition and operating results.

In the event the conditional conversion feature of the notes is triggered, holders of our Convertible Senior Notes will be entitled to convert the Convertible Senior Notes at any time during specified periods at their option. If one or more holders elect to convert their Convertible Senior Notes, unless we elect to satisfy our conversion obligation by delivering solely shares of our common stock (other than paying cash in lieu of delivering any fractional share), we would be required to settle a portion or all of our conversion obligation through the payment of cash, which could adversely affect our liquidity. In addition, even if holders do not elect to convert their Convertible Senior Notes, we could be required under applicable accounting rules to reclassify all or a portion of the outstanding principal of the notes as a current rather than long-term liability, which would result in a material reduction of our net working capital. Transactions relating to our Convertible Senior Notes may affect the value of our common stock.

The conversion of some or all of the Convertible Senior Notes would dilute the ownership interests of existing stockholders to the extent we satisfy our conversion obligation by delivering shares of our common stock upon any conversion of such Convertible Senior Notes. Our Convertible Senior Notes may become in the future convertible at the option of their holders under certain circumstances. If holders of our Convertible Senior Notes elect to convert their notes, we may settle our conversion obligation by delivering to them a significant number of shares of our common stock, which would cause dilution to our existing stockholders.

In connection with the issuance of the Convertible Senior Notes, we entered into capped call transactions with certain financial institutions (the “option counterparties”). The capped call transactions are expected generally to reduce the potential dilution to our common stock upon any conversion of the notes and/or offset any cash payments we are required to make in excess of the principal amount of converted notes, as the case may be, with such reduction and/or offset subject to a cap.

From time to time, the option counterparties or their respective affiliates may modify their hedge positions by entering into or unwinding various derivative transactions with respect to our common stock and/or purchasing or selling our common stock or other securities of ours in secondary market transactions prior to the maturity of the Convertible Senior Notes. This activity could cause a decrease in the market price of our common stock.

The accounting method for convertible debt securities that may be settled in cash, such as the Convertible Senior Notes, could have a material effect on our reported financial results.

Under FASB Accounting Standards Codification 470-20 (“ASC 470-20”), Debt with Conversion and Other Options, an entity must separately account for the liability and equity components of convertible debt instruments (such as the Convertible

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Senior Notes) that may be settled entirely or partially in cash upon conversion in a manner that reflects the issuer's economic interest cost. ASC 470-20 requires the value of the conversion option of the Convertible Senior Notes, representing the equity component, to be recorded as additional paid-in capital within stockholders' equity in our condensed consolidated balance sheets as an original issue discount to the Convertible Senior Notes, which reduces their initial carrying value. The carrying value of the Convertible Senior Notes, net of the discount recorded, will be accreted up to the principal amount of the notes from the issuance date until maturity, which will result in non-cash charges to interest expense in our condensed consolidated statement of operations. Accordingly, we will report lower net income or higher net loss in our financial results because ASC 470-20 requires interest to include both the current period's accretion of the debt discount and the instrument's coupon interest, which could adversely affect our reported or future financial results, the trading price of our common stock and the trading price of the Convertible Senior Notes.

In addition, under certain circumstances, convertible debt instruments (such as the Convertible Senior Notes) that may be settled entirely or partly in cash are currently accounted for utilizing the treasury stock method, the effect of which is that the shares issuable upon conversion of the Convertible Senior Notes are not included in the calculation of diluted earnings per share except to the extent that the conversion value of the Convertible Senior Notes exceeds their principal amount. Under the treasury stock method, for diluted earnings per share purposes, the transaction is accounted for as if the number of shares of common stock that would be necessary to settle such excess, if we elected to settle such excess in shares, are issued. If we are unable to use the treasury stock method in accounting for the shares issuable upon conversion of the Convertible Senior Notes, then our diluted earnings per share would be adversely affected.

We are subject to counterparty risk with respect to the capped call transactions.

The option counterparties are financial institutions, and we will be subject to the risk that any or all of them might default under the capped call transactions. Our exposure to the credit risk of the option counterparties will not be secured by any collateral. Past global economic conditions have resulted in the actual or perceived failure or financial difficulties of many financial institutions. If an option counterparty becomes subject to insolvency proceedings, we will become an unsecured creditor in those proceedings with a claim equal to our exposure at that time under the capped call transactions with such option counterparty. Our exposure will depend on many factors but, generally, an increase in our exposure will be correlated to an increase in the market price and in the volatility of our common stock. In addition, upon a default by an option counterparty, we may suffer adverse tax consequences and more dilution than we currently anticipate with respect to our common stock. We can provide no assurances as to the financial stability or viability of the option counterparties.

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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>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>4.2</u>	Indenture, dated as of March 13, 2018, by and between Guidewire Software, Inc. and U.S. Bank National Association	8-K	4.1	March 13, 2018
<u>4.3</u>	First Supplemental Indenture, dated as of March 13, 2018, by and between Guidewire Software, Inc. and U.S. Bank National Association	8-K	4.2	March 13, 2018
<u>4.4</u>	Form of 1.250% Convertible Senior Note Due March 15, 2025	8-K	4.3	March 13, 2018
<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.

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SIGNATURES

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

Date: March 7, 2019 GUIDEWIRE SOFTWARE, INC.

By: /s/ Curtis Smith
Curtis Smith
Chief Financial Officer
(Principal Financial and Accounting Officer)

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