

QUALYS, INC.
Form 10-Q
August 06, 2015
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the Quarterly Period Ended June 30, 2015

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 001-35662

QUALYS, INC.
(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

77-0534145
(I.R.S. Employer
Identification Number)

1600 Bridge Parkway, Redwood City, California 94065
(Address of principal executive offices, including zip code)

(650) 801-6100
(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

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(Do not check if a
smaller reporting
company)

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

The number of shares of the Registrant's common stock outstanding as of July 31, 2015 was 34,090,124.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

Qualys, Inc.

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

(in thousands, except share and per share data)

	June 30, 2015	December 31, 2014
Assets		
Current assets:		
Cash and cash equivalents	\$84,058	\$76,504
Short-term investments	74,052	50,714
Accounts receivable, net of allowance of \$500 and \$590 at June 30, 2015 and December 31, 2014, respectively	34,552	32,993
Deferred tax assets, current	5,540	8,520
Prepaid expenses and other current assets	7,311	6,528
Total current assets	205,513	175,259
Long-term investments	29,031	39,448
Property and equipment, net	29,238	26,618
Deferred tax assets, net	14,035	14,119
Intangible assets, net	1,805	2,001
Goodwill	317	317
Other noncurrent assets	2,106	2,262
Total assets	\$282,045	\$260,024
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	\$1,042	\$5,661
Accrued liabilities	10,598	10,353
Deferred revenues, current	87,411	81,147
Total current liabilities	99,051	97,161
Deferred revenues, noncurrent	9,711	10,064
Other noncurrent liabilities	1,115	972
Total liabilities	109,877	108,197
Commitments and contingencies (Note 5)		
Stockholders' equity:		
Preferred stock, \$0.001 par value; 20,000,000 shares authorized, no shares issued and outstanding at June 30, 2015 and December 31, 2014	—	—
Common stock, \$0.001 par value; 1,000,000,000 shares authorized, 34,079,161 and 33,594,285 shares issued and outstanding at June 30, 2015 and December 31, 2014, respectively	34	34
Additional paid-in capital	209,139	195,133
Accumulated other comprehensive income	27	10
Accumulated deficit	(37,032)	(43,350)
Total stockholders' equity	172,168	151,827
Total liabilities and stockholders' equity	\$282,045	\$260,024

See accompanying Notes to Condensed Consolidated Financial Statements

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Qualys, Inc.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

(in thousands, except per share data)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2015	2014	2015	2014
Revenues	\$39,877	\$32,302	\$77,370	\$62,658
Cost of revenues	8,157	7,175	16,121	14,021
Gross profit	31,720	25,127	61,249	48,637
Operating expenses:				
Research and development	7,205	6,411	14,355	12,815
Sales and marketing	12,776	11,845	24,219	24,337
General and administrative	6,427	5,081	12,443	9,956
Total operating expenses	26,408	23,337	51,017	47,108
Income from operations	5,312	1,790	10,232	1,529
Other income (expense), net:				
Interest expense	(4	) (3	) (4	) (7
Interest income	132	130	233	238
Other income (expense), net	—	(86	) (178	) (178
Total other income, net	128	41	51	53
Income before income taxes	5,440	1,831	10,283	1,582
Provision for income taxes	2,124	174	3,965	356
Net income	\$3,316	\$1,657	\$6,318	\$1,226
Net income per share:				
Basic	\$0.10	\$0.05	\$0.19	\$0.04
Diluted	\$0.09	\$0.04	\$0.16	\$0.03
Weighted average shares used in computing net income per share:				
Basic	34,003	32,818	33,889	32,668
Diluted	38,475	36,839	38,363	36,966

See accompanying Notes to Condensed Consolidated Financial Statements

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Qualys, Inc.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

(in thousands)

	Three Months Ended		Six Months Ended		
	June 30,		June 30,		
	2015	2014	2015	2014	
Net income	\$3,316	\$1,657	\$6,318	\$1,226	
Available-for-sale investments:					
Change in net unrealized gain (loss) on investments, net of tax	(8	) 27	16	39
Less: reclassification adjustment for net realized gain included in net income	—	(7) 1	(7)
Net change, net of tax	(8	) 20	17	32
Other comprehensive income (loss), net	(8	) 20	17	32
Comprehensive income	\$3,308	\$1,677	\$6,335	\$1,258	

See accompanying Notes to Condensed Consolidated Financial Statements

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Qualys, Inc.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(in thousands)

	Six Months Ended June 30,	
	2015	2014
Cash flows from operating activities:		
Net income	\$6,318	\$1,226
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization expense	6,586	5,782
Bad debt expense	333	153
Loss on disposal of property and equipment	4	1
Stock-based compensation	8,257	4,606
Amortization of premiums and accretion of discounts on investments	324	325
Excess tax benefits from stock-based compensation	(191)	(54)
Deferred income taxes	3,064	(19)
Changes in operating assets and liabilities:		
Accounts receivable	(1,892)	367
Prepaid expenses and other assets	(534)	(772)
Accounts payable	(4,619)	(195)
Accrued liabilities	1,846	(558)
Deferred revenues	5,911	4,240
Other noncurrent liabilities	143	92
Net cash provided by operating activities	25,550	15,194
Cash flows from investing activities:		
Purchases of investments	(61,442)	(76,907)
Sales and maturities of investments	48,214	64,960
Purchases of property and equipment	(10,407)	(6,524)
Capitalized software development costs	(99)	—
Net cash used in investing activities	(23,734)	(18,471)
Cash flows from financing activities:		
Proceeds from exercise of stock options	5,547	3,053
Excess tax benefits from stock-based compensation	191	54
Principal payments under capital lease obligations	—	(536)
Net cash provided by financing activities	5,738	2,571
Effect of exchange rate changes on cash and cash equivalents	—	9
Net increase (decrease) in cash and cash equivalents	7,554	(697)
Cash and cash equivalents at beginning of period	76,504	42,369
Cash and cash equivalents at end of period	\$84,058	\$41,672
Non-cash investing and financing activities:		
Vesting of early exercised common stock options	\$11	\$35

See accompanying Notes to Condensed Consolidated Financial Statements

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Qualys, Inc.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

NOTE 1. The Company and Summary of Significant Accounting Policies

Description of Business

Qualys, Inc. (the "Company") was incorporated in the state of Delaware on December 30, 1999. The Company is headquartered in Redwood City, California and has majority-owned subsidiaries throughout the world. The Company is a pioneer and leading provider of cloud security and compliance solutions that enable organizations to identify security risks to their IT infrastructures, help protect their IT systems and applications from ever-evolving cyber-attacks and achieve compliance with internal policies and external regulations. The Company's cloud solutions address the growing security and compliance complexities and risks that are amplified by the dissolving boundaries between internal and external IT infrastructures and web environments, the rapid adoption of cloud computing and the proliferation of geographically dispersed IT assets. Organizations can use the Company's integrated suite of solutions delivered on its QualysGuard Cloud Platform to cost-effectively obtain a unified view of their security and compliance posture across globally-distributed IT infrastructures.

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements and condensed footnotes have been prepared by the Company in accordance with accounting principles generally accepted in the United States ("U.S. GAAP") for interim financial information as well as the instructions to Form 10-Q and the rules and regulations of the U.S. Securities and Exchange Commission ("SEC"). Certain information and note disclosures normally included in the financial statements prepared in accordance with U.S. GAAP have been condensed or omitted pursuant to such rules and regulations. The condensed consolidated balance sheet as of December 31, 2014, included herein, was derived from the audited financial statements as of that date but does not include all disclosures, including notes required by U.S. GAAP. In the opinion of management, the accompanying unaudited condensed consolidated financial statements reflect all adjustments, which include only normal recurring adjustments, necessary for the fair presentation of the financial position, results of operations and cash flows for the interim periods. The results of operations for the three and six month periods ended June 30, 2015 are not necessarily indicative of the results of operations expected for the entire year ending December 31, 2015 or for any other future annual or interim period. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2014 filed with the SEC on March 6, 2015.

Certain prior year amounts related to income taxes have been reclassified to conform to the current year presentation. These reclassifications did not change previously reported total assets, liabilities, stockholders' equity, income from operations or net income.

Principles of Consolidation

The accompanying condensed consolidated financial statements include the accounts of the Company and its majority-owned subsidiaries. All significant intercompany transactions and balances have been eliminated upon consolidation.

Correction of Immaterial Error

During the fourth quarter of 2014, the Company identified an immaterial error in the financial statements of its foreign subsidiaries reporting in the applicable local foreign currencies as their functional currencies, resulting in translation adjustments included as a component of accumulated other comprehensive income (loss) in stockholders' equity. It was determined that the functional currency for the Company's local subsidiaries should be the U.S. dollar.

Accordingly, remeasurement gains and losses on monetary assets and liabilities denominated in foreign currencies should be recorded to foreign exchange gains and losses in other income (expense) in the condensed consolidated statements of operations in accordance with GAAP.

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Qualys, Inc.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

The Company reviewed the accounting error utilizing SEC Staff Accounting Bulletin No. 99, "Materiality" and SEC Staff Accounting Bulletin No. 108, "Effects of Prior Year Misstatements on Current Year Financial Statements." Management evaluated the materiality of this error from a qualitative and quantitative perspective and determined the impact of the errors did not have a material impact on any individual prior period presentation or affect the trend of financial results. However, because the adjustment to correct the cumulative error on the consolidated balance sheets and statements of stockholders' equity would have had a material effect to the Company's consolidated statements of operations for the year ended December 31, 2014, the Company revised its previously reported financial statements for the 2012 and 2013 annual periods in the Company's Annual Report on Form 10-K for the year ended December 31, 2014 filed with the SEC on March 6, 2015, to reflect the impact of the immaterial errors that had been corrected.

The following table summarizes the correction of previously reported amounts for the three and six month periods ended June 30, 2014 presented in the accompanying condensed consolidated financial statements (in thousands, except per share data):

	Three Months Ended June 30, 2014		Six Months Ended June 30, 2014	
	as reported	as adjusted	as reported	as adjusted
Condensed Consolidated Statements of Operations:				
Other income (expense), net	\$(37)	\$(86)	\$(138)	\$(178)
Total other income, net	90	41	93	53
Net income	1,706	1,657	1,266	1,226
Net income per share:				
Basic	0.05	0.05	0.04	0.04
Diluted	0.05	0.04	0.03	0.03
Condensed Consolidated Statements of Comprehensive Income:				
Change in foreign currency translation loss, net of tax	(49)	—	(40)	—
Comprehensive income	1,677	1,677	1,258	1,258

	Six Months Ended June 30, 2014	
	as reported	as adjusted
Condensed Consolidated Statements of Cash Flows:		
Net cash provided by operating activities	\$15,175	\$15,194
Net cash used in investing activities	(18,442)	(18,471)
Effect of exchange rate changes on cash and cash equivalents	(30)	9
Net decrease in cash and cash equivalents	(697)	(697)

Use of Estimates

The preparation of the condensed consolidated financial statements in conformity with U.S. GAAP requires management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements and the reported results of operations during the reporting period. The Company's management regularly assesses these estimates, which primarily affect revenue recognition, the valuation of accounts receivable, goodwill and intangible

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Qualys, Inc.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

assets, stock-based compensation and the provision for income taxes. Actual results could differ from those estimates and such differences may be material to the accompanying condensed consolidated financial statements.

Concentration of Credit Risk

The Company invests its cash and cash equivalents with major financial institutions. Cash balances with any one institution at times may be in excess of federally insured limits. Cash equivalents are invested in high-quality investment grade financial instruments and are diversified. The Company has not experienced any losses in such accounts and believes it is not exposed to any significant credit risk.

Credit risk with respect to accounts receivable is dispersed due to the large number of customers. Collateral is not required for accounts receivable. The Company maintains an allowance for potential credit losses based upon the expected collectability of accounts receivable. The Company writes off its receivables once collection efforts are unsuccessful. As of June 30, 2015 and December 31, 2014, no customer or channel partner accounted for more than 10% of the Company's accounts receivable balance.

Cash, Cash Equivalents, Short-Term and Long-Term Investments

Cash and cash equivalents include cash held in banks, highly liquid money market funds, commercial paper and fixed-income U.S. government agency securities, all with original maturities of three months or less when acquired. The Company's investments consist of fixed-income U.S. government agency securities, corporate bonds, asset-backed securities, and commercial paper. Management determines the appropriate classification of the Company's investments at the time of purchase and reevaluates such designation at each balance sheet date. The Company classifies its investments as either short-term or long-term based on each instrument's underlying contractual maturity date.

Cash equivalents are stated at cost, which approximates fair market value. Short-term and long-term investments are classified as available-for-sale and are carried at fair value. Unrealized gains and losses in fair value are reported in other comprehensive income (loss). When the available-for-sale securities are sold, cost is based on the specific identification method, and the realized gains and losses are included in other income (expense) in the condensed consolidated statements of operations. Short-term and long-term investments are reviewed quarterly for impairment that is deemed to be other-than-temporary. An investment is considered other-than-temporarily impaired when its fair value is below its amortized cost and (1) there is an intent to sell the security, (2) it is "more likely than not" that the security will be sold before recovery of its amortized cost basis or (3) the present value of expected cash flows from the investment is not expected to recover the entire amortized cost basis. Declines in value that are considered to be other-than-temporary and adjustments to amortized cost for the amortization of premiums and the accretion of discounts are recorded in other income (expense). Interest and dividends are recorded in interest income as earned.

Software Development Costs

The Company capitalizes qualifying software costs developed or obtained for internal use. These costs generally include internal costs, such as payroll and benefits of those employees directly associated with the development of the software, and other consulting expenses. Total capitalized development costs are \$0.4 million and \$0.3 million at June 30, 2015 and December 31, 2014, respectively.

Recent Accounting Pronouncements

Under the Jumpstart Our Business Startups Act (the "JOBS Act"), the Company meets the definition of an "emerging growth company." The Company has irrevocably elected to opt out of the extended transition period for complying with new or revised accounting standards pursuant to Section 107(b) of the JOBS Act. As a result, the Company will comply with new or revised accounting standards on the relevant dates on which adoption of such standards is required from non-emerging growth companies.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

In May 2014, the Financial Accounting Standards Board (“FASB”) issued an Accounting Standard Update (“ASU”) amending revenue recognition guidance and requiring more detailed disclosures to enable users of financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. On April 1, 2015, the FASB tentatively decided to defer the effective date of ASU 2014-09. If the proposed changes are finalized, ASU 2014-09 will be effective for fiscal years, and interim periods within those years, beginning after December 15, 2017, but entities will be permitted to early adopt the standard as of the original effective date. The new revenue standard may be applied retrospectively to each prior period presented or retrospectively with the cumulative effect recognized on date of adoption. The Company is currently evaluating the impact this ASU will have on its consolidated financial statements.

In January 2015, the FASB issued an ASU eliminating from U.S. GAAP the concept of extraordinary items, which required that an entity separately classify, present, and disclose extraordinary events and transactions. The guidance is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. A reporting entity may apply the amendments prospectively or retrospectively to all prior periods presented in the financial statements. Early adoption is permitted provided that the guidance is applied from the beginning of the fiscal year of adoption. The Company does not expect the adoption of this ASU to be material to their consolidated financial statements.

In April 2015, the FASB issued an ASU amending existing guidance which clarifies that software licenses contained in a cloud computing arrangement should be capitalized if the customer has the right to take possession of the software and the ability to run the software outside of the cloud computing arrangement. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract under existing guidelines. This guidance is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. A reporting entity may apply the amendments prospectively to all arrangements entered into or materially modified after the effective date or retrospectively. Early adoption is permitted. The Company is currently evaluating the impact this ASU will have on its consolidated financial statements.

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Qualys, Inc.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 2. Fair Value of Financial Instruments

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. For certain of the Company's financial instruments, including certain cash equivalents, accounts receivable, accounts payable, and other current liabilities, the carrying amounts approximate their fair values due to the relatively short maturity of these balances.

The Company measures and reports certain cash equivalents, investments and derivative foreign currency forward contracts at fair value in accordance with the provisions of the authoritative accounting guidance that addresses fair value measurements. This guidance establishes a hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available. The hierarchy is broken down into three levels based on the reliability of inputs as follows:

Level 1—Valuations based on quoted prices in active markets for identical assets or liabilities.

Level 2—Valuations based on other than quoted prices in active markets for identical assets and liabilities, quoted prices for identical or similar assets or liabilities in inactive markets, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3—Valuations based on inputs that are generally unobservable and typically reflect management's estimates of assumptions that market participants would use in pricing the asset or liability.

The Company's financial instruments consist of assets and liabilities measured using Level 1 and 2 inputs. Level 1 assets include highly liquid money market funds, which are valued using unadjusted quoted prices that are available in an active market for an identical asset. Level 2 assets include fixed-income U.S. government agency securities, commercial paper, corporate bonds, asset-backed securities and derivative financial instruments consisting of foreign currency forward contracts. The securities, bonds and commercial paper are valued using prices from independent pricing services based on quoted prices in active markets for similar instruments or on industry models using data inputs such as interest rates and prices that can be directly observed or corroborated in active markets. The foreign currency forward contracts are valued using observable inputs, such as quotations on forward foreign exchange points and foreign interest rates.

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Qualys, Inc.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

The Company's cash and cash equivalents, short-term investments, and long-term investments consist of the following:

	June 30, 2015			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
	(in thousands)			
Cash and cash equivalents:				
Cash	\$41,300	\$—	\$—	\$41,300
Money market funds	21,061	—	—	21,061
Commercial paper	21,694	3	—	21,697
Total	84,055	3	—	84,058
Short-term investments:				
Commercial paper	15,929	7	—	15,936
Corporate bonds	12,688	1	(6	) 12,683
Asset-backed securities	71	—	—	71
U.S. government agencies	45,342	20	—	45,362
Total	74,030	28	(6	) 74,052
Long-term investments:				
Asset-backed securities	9,999	1	—	10,000
U.S. government agencies	11,940	9	(4	) 11,945
Corporate bonds	7,090	1	(5	) 7,086
Total	29,029	11	(9	) 29,031
Total	\$187,114	\$42	\$(15	) \$187,141
	December 31, 2014			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
	(in thousands)			
Cash and cash equivalents:				
Cash	\$36,024	\$—	\$—	\$36,024
Money market funds	39,180	—	—	39,180
U.S. government agencies	300	—	—	300
Commercial paper	1,000	—	—	1,000
Total	76,504	—	—	76,504