

Guidewire Software, Inc.  
Form 10-Q  
March 07, 2018  
Table of Contents

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

---

FORM 10-Q

---

(Mark one)

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

For the quarterly period ended January 31, 2018

OR

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

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

---

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

---

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

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

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

---

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

---

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

Large accelerated filer	<input checked="" type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
-------------------------	-------------------------------------	-------------------	--------------------------

Non-accelerated filer	<input type="checkbox"/>	(do not check if a smaller reporting company)	Smaller reporting company	<input type="checkbox"/>
-----------------------	--------------------------	---	---------------------------	--------------------------

Emerging growth company ..

---

Table of Contents

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

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

On February 28, 2018, the registrant had 77,281,302 shares of common stock issued and outstanding.

---

Table of Contents

Guidewire Software, Inc.  
Index

Part I – Financial Information

Item 1.	<u>Financial Statements (unaudited):</u>	<u>3</u>
	<u>Condensed Consolidated Balance Sheets as of January 31, 2018 and July 31, 2017</u>	<u>3</u>
	<u>Condensed Consolidated Statements of Operations for the Three and Six Months Ended January 31, 2018 and 2017</u>	<u>4</u>
	<u>Condensed Consolidated Statements of Comprehensive Loss for the Three and Six Months Ended January 31, 2018 and 2017</u>	<u>5</u>
	<u>Condensed Consolidated Statements of Cash Flows for the Six Months Ended January 31, 2018 and 2017</u>	<u>6</u>
	<u>Notes to Condensed Consolidated Financial Statements</u>	<u>7</u>
Item 2.	<u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>27</u>
Item 3.	<u>Quantitative and Qualitative Disclosures about Market Risk</u>	<u>43</u>
Item 4.	<u>Controls and Procedures</u>	<u>43</u>
	<u>Part II – Other Information</u>	<u>45</u>
Item 1.	<u>Legal Proceedings</u>	<u>45</u>
Item 1A.	<u>Risk Factors</u>	<u>45</u>
Item 6.	<u>Exhibits</u>	<u>62</u>
	<u>Signatures</u>	<u>63</u>

---

Table of Contents

FORWARD-LOOKING STATEMENTS

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

- growth prospects of the property & casualty (“P&C”) insurance industry and our company;
- the developing market for subscription services and uncertainties attendant on emerging sales and delivery models;
- trends in future sales, including the mix of licensing and subscription models and seasonality;
- our competitive environment and changes thereto;
- competitive attributes of our software applications and delivery models;
- challenges to further increase sales outside of the United States;
- our research and development investment and efforts;
- expenses to be incurred, and benefits to be achieved from our acquisitions;
- our gross and operating margins and factors that affect such margins;
- our provision for tax liabilities and other critical accounting estimates;
- the impact of new accounting standards and any contractual changes we have made in anticipation of such changes;
- our exposure to market risks, including geographical and political events that may negatively impact our customers;
- and
- our ability to satisfy future liquidity requirements.

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

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

---

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



Table of Contents

## PART I – Financial Information

## ITEM 1. Financial Statements (unaudited)

GUIDEWIRE SOFTWARE, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED BALANCE SHEETS

(unaudited, in thousands)

	January 31, 2018	July 31, 2017
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$205,287	\$263,176
Short-term investments	299,891	310,027
Accounts receivable	100,046	79,433
Prepaid expenses and other current assets	33,714	26,604
Total current assets	638,938	679,240
Long-term investments	64,273	114,585
Property and equipment, net	16,205	14,376
Intangible assets, net	110,671	71,315
Deferred tax assets, net	89,701	37,430
Goodwill	343,248	141,851
Other assets	20,658	20,104
<b>TOTAL ASSETS</b>	<b>\$1,283,694</b>	<b>\$1,078,901</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Accounts payable	\$18,570	\$13,416
Accrued employee compensation	33,681	48,882
Deferred revenues, current	109,047	91,243
Other current liabilities	11,431	10,075
Total current liabilities	172,729	163,616
Deferred revenues, non-current	21,845	19,892
Other liabilities	1,631	2,112
Total liabilities	196,205	185,620
<b>STOCKHOLDERS' EQUITY:</b>		
Common stock	8	8
Additional paid-in capital	993,559	830,014
Accumulated other comprehensive loss	(4,778)	(5,796)
Retained earnings	98,700	69,055
Total stockholders' equity	1,087,489	893,281
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b>\$1,283,694</b>	<b>\$1,078,901</b>

See accompanying Notes to Condensed Consolidated Financial Statements.

Table of Contents

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

	Three Months Ended		Six Months Ended	
	January 31,		January 31,	
	2018	2017	2018	2017
Revenues:				
License and other	\$84,221	\$ 64,075	\$114,314	\$102,796
Maintenance	19,110	16,582	38,040	33,114
Services	60,457	34,964	119,605	73,838
Total revenues	163,788	115,621	271,959	209,748
Cost of revenues:				
License and other	9,040	2,781	15,755	5,211
Maintenance	3,593	3,079	7,060	6,404
Services	55,136	34,951	107,848	71,215
Total cost of revenues	67,769	40,811	130,663	82,830
Gross profit:				
License and other	75,181	61,294	98,559	97,585
Maintenance	15,517	13,503	30,980	26,710
Services	5,321	13	11,757	2,623
Total gross profit	96,019	74,810	141,296	126,918
Operating expenses:				
Research and development	43,657	30,025	79,368	60,775
Sales and marketing	31,961	23,520	55,571	49,020
General and administrative	21,066	13,060	39,737	27,220
Total operating expenses	96,684	66,605	174,676	137,015
Income (loss) from operations	(665 )	8,205	(33,380 )	(10,097 )
Interest income	1,566	1,544	3,474	2,886
Other income (expense), net	1,658	335	1,396	(346 )
Income (loss) before income taxes	2,559	10,084	(28,510 )	(7,557 )
Provision for (benefit from) income taxes	48,114	6,110	25,959	(3,673 )
Net income (loss)	\$(45,555)	\$ 3,974	\$(54,469)	\$(3,884)
Net income (loss) per share:				
Basic	\$(0.59 )	\$ 0.05	\$(0.72 )	\$(0.05 )
Diluted	\$(0.59 )	\$ 0.05	\$(0.72 )	\$(0.05 )
Shares used in computing net income (loss) per share:				
Basic	76,859,040	73,738,810	76,023,237	73,516,140
Diluted	76,859,040	74,793,240	76,023,237	73,516,140

See accompanying Notes to Condensed Consolidated Financial Statements.



Table of Contents

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

	Three Months Ended January 31,		Six Months Ended January 31,	
	2018	2017	2018	2017
Net income (loss)	\$(45,555)	\$3,974	\$(54,469)	\$(3,884)
Other comprehensive income (loss):				
Foreign currency translation adjustments	2,124	14	1,428	(837 )
Unrealized losses on available-for-sale securities, net of tax benefit of \$122 and \$141 for the three months ended January 31, 2018 and 2017, respectively; \$167 and \$275 for the six months ended January 31, 2018 and 2017, respectively	(335 )	(205 )	(425 )	(401 )
Reclassification adjustment for realized losses (gains) included in net loss	—	(32 )	15	(59 )
Other comprehensive income (loss)	1,789	(223 )	1,018	(1,297 )
Comprehensive income (loss)	\$(43,766)	\$3,751	\$(53,451)	\$(5,181)

See accompanying Notes to Condensed Consolidated Financial Statements

Table of Contents

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

	Six Months Ended January 31,	
	2018	2017
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net loss	\$(54,469 )	\$(3,884 )
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	16,315	6,383
Stock-based compensation	44,655	36,464
Deferred income tax	24,287	(5,617 )
Amortization of premium on available-for-sale securities, and other non-cash items	361	868
Changes in operating assets and liabilities:		
Accounts receivable	(16,345 )	(823 )
Prepaid expenses and other assets	(3,139 )	(3,689 )
Accounts payable	4,834	(1,715 )
Accrued employee compensation	(17,547 )	(15,084 )
Other liabilities	804	(615 )
Deferred revenues	16,690	17,361
Net cash provided by operating activities	16,446	29,649
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchases of available-for-sale securities	(110,820 )	(291,611 )
Sales of available-for-sale securities	170,316	298,671
Purchases of property and equipment	(4,620 )	(2,617 )
Capitalized software development costs	(769 )	—
Acquisitions of business, net of acquired cash	(130,376 )	(33,534 )
Net cash used in investing activities	(76,269 )	(29,091 )
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Proceeds from issuance of common stock upon exercise of stock options	727	2,034
Net cash provided by financing activities	727	2,034
Effect of foreign exchange rate changes on cash and cash equivalents	1,207	(811 )
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	<b>(57,889 )</b>	<b>1,781</b>
<b>CASH AND CASH EQUIVALENTS—Beginning of period</b>	<b>263,176</b>	<b>223,582</b>
<b>CASH AND CASH EQUIVALENTS—End of period</b>	<b>\$205,287</b>	<b>\$225,363</b>
<b>SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:</b>		
Cash paid for income taxes, net of tax refunds	\$1,677	\$2,256
<b>SUPPLEMENTAL DISCLOSURES OF NONCASH INVESTING AND FINANCING ACTIVITIES:</b>		
Accruals for purchase of property and equipment	\$1,497	\$521

See accompanying Notes to Condensed Consolidated Financial Statements.

Table of Contents

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

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

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

Basis of Presentation

The accompanying condensed consolidated financial statements and accompanying notes include the Company and its wholly-owned subsidiaries, and reflect all adjustments (all of which are normal and recurring in nature) that, in the opinion of management, are necessary for a fair presentation of the interim periods presented. All inter-company balances and transactions have been eliminated in consolidation. Certain information and note disclosures normally included in annual financial statements prepared in accordance with generally accepted accounting principles in the United States of America (“U.S. GAAP”) have been condensed or omitted under the rules and regulations of the 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, 2017. There have been no changes in the Company’s significant accounting policies from those that were disclosed in the Company’s consolidated financial statements for the fiscal year ended July 31, 2017 included in the Company’s Annual Report on Form 10-K filed with the SEC on September 19, 2017, except changes to the income taxes and stock-based compensation policies resulting from the adoption of Accounting Standards Update (“ASU”) 2016-09 during the first quarter of fiscal year 2018.

Use of Estimates

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

Cash and Cash Equivalents

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

Investments

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

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

7

---

## Table of Contents

### Concentration of Credit Risk

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

No customer individually accounted for 10% or more of the Company's revenues for the three months and six months ended January 31, 2018 and 2017. No customer individually accounted for 10% or more of the Company's total accounts receivable as of January 31, 2018. One customer individually accounted for 11% of the Company's total accounts receivable as of July 31, 2017.

### Revenue Recognition

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

Revenues are derived from three sources:

- (i) License fees related to term (or time-based) licenses, software license subscriptions and cloud-based subscriptions (collectively referred to as "subscriptions"), and perpetual software licenses;
- (ii) Maintenance fees associated with term or perpetual licenses relate to email and phone support, bug fixes and unspecified software updates, and upgrades released when, and if, available during the maintenance term; and
- (iii) Services fees from professional services related to the implementation of the Company's software, reimbursable travel and training expenses.

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

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

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

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

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

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

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

selling prices for a service fall within a reasonably narrow price range.

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

8

---

## Table of Contents

The Company's subscriptions are recognized ratably over the term of the arrangement typically upon provisioning the products.

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

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

In select situations, the Company will contract its professional services on a fixed fee basis. In these situations, if reliable estimates of total project costs are available, the Company recognizes services revenues on a proportional performance basis as the performance obligations are completed by using the ratio of labor hours to date as an input measure compared to total estimated labor hours for the consulting services.

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

If reliable estimates of total project costs cannot be made, the zero gross margin or the completed contract method is applied to revenues and direct costs. Under the zero gross margin method, revenues recognized are limited to the direct costs incurred for the professional services. Under the completed contract method, revenues and direct costs are deferred until the project is complete. When the zero gross margin method is applied for lack of reliable project estimates and subsequently project estimates become reliable, the Company switches to the percentage-of-completion method, resulting in a cumulative effect adjustment for deferred license revenues to the extent of progress toward completion, and the related portion of the deferred professional service margin is recognized in full as revenues.

### Income Taxes

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

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

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

### Stock-Based Compensation

The Company accounts for stock-based compensation using the fair value method, which requires the Company to measure the stock-based compensation based on the grant-date fair value of the awards and recognize the compensation expense over the requisite service period. The Company recognizes compensation expense net of actual forfeitures. To date, the Company has granted stock options, 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”.



## Table of Contents

The fair value of the Company's RSAs, RSUs, and PSUs equal the market value of the Company's common stock on the date of grant. These awards are subject to time-based vesting, which generally occurs over a period of four years. The Company recognizes compensation expense for awards which contain only service conditions on a straight-line basis over the requisite service period, which is generally the vesting period of the respective awards. The Company recognizes the compensation cost for awards that contain either a performance condition, market conditions, or both using the graded vesting method.

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

### Business Combinations

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

### Software Development Costs

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

### Impairment of Long-Lived Assets, Intangible Assets and Goodwill

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

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

Recently Adopted Accounting Pronouncements

Table of Contents

Share-Based Payment Accounting (Topic 718): Improvements on Employee Share-Based Payment Accounting  
In March 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No.2016-09, Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting (“ASU 2016-09”), which simplifies several aspects of the accounting for employee share-based payment transactions for both public and nonpublic entities, including the accounting for income taxes, forfeitures, and statutory tax withholding requirements, as well as classification in the statement of cash flows. The Company adopted ASU No. 2016-09 on August 1, 2017. For the three and six months ended January 31, 2018, the provision for income taxes included tax benefits of \$0.8 million and \$5.2 million, respectively, in tax effects related to settled stock-based awards.

Recent Accounting Pronouncements Not Yet Adopted

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 Cuts and Jobs Act (“Tax Act”). ASU 2018-02 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2018, with early adoption permitted. The Company is currently evaluating the impact of adopting the new standard for its 2019 fiscal year and subsequent periods.

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

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606) (“ASU 2014-09”), which provides guidance for revenue recognition. This ASU affects any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of non-financial assets. This ASU will supersede the revenue recognition requirements in Topic 605, Revenue Recognition, and most industry-specific guidance.

In August 2015, the FASB issued ASU No. 2015-14, Revenue from Contracts with Customers: Deferral of the Effective Date, which deferred the effective date of this standard. As a result, the ASU and related amendments will be effective for the Company for its fiscal year beginning August 1, 2018, including interim periods within that fiscal year.

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

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

The Company has evaluated the potential impact of Topic 606 on its revenue recognition policy and practices and has concluded that Topic 606 will impact the pattern of its revenue recognition associated with its term software licenses, software subscriptions, and to a lesser extent, cloud-based subscriptions. The Company’s term licenses require payments to be made annually or quarterly in advance and are subject to extended payment terms. Currently, revenues associated with the payment for term software licenses are recognized in the earlier of the period in which the payments are due or are actually made. Under Topic 606, the Company will be required to recognize the revenue associated with such payments not when they are made or due, but when control of the software license is transferred to the customer, which occurs at or near the time a contract with a customer is executed. As a result, under Topic 606, all contractually obligated payments under a term license that the Company reasonably expects to collect would be recognized upon delivery. In conjunction with its evaluation of this new standard, the Company began revising its contracting practices and amending existing agreements with certain customers primarily by shortening the initial, non-refundable term of its licenses. Since fiscal 2016, a substantial majority of new contracts feature a two-year initial term with subsequent one-year auto renewal options.

The Company currently anticipates that the impact of Topic 606 on its cloud-based subscriptions, will be more modest than for term licenses and will impact, primarily, those subscriptions that contractually provide for increasing annual subscription payments during the term of the arrangement.

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

Table of Contents

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

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

## Leases (Topic 842): Accounting for Leases

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

## 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. The standard will be effective for the Company beginning August 1, 2018. ASU 2016-01 generally requires certain equity investments to be measured at fair value with changes in fair value recognized in net income, and certain other requirements. The Company is currently evaluating the effect the updated standard will have on its consolidated financial statements and related disclosures.

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. Fair Value of Financial Instruments

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

	January 31, 2018			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
	(in thousands)			
U.S. Government agency securities	\$21,369	\$ —	\$ (51 )	\$21,318
Commercial paper	100,010	—	(44 )	99,966
Corporate bonds	230,696	33	(593 )	230,136
U.S. Government bonds	50,159	—	(158 )	50,001
Certificates of deposit	26,747	5	(13 )	26,739
Money market funds	92,380	—	—	92,380
Total	\$521,361	\$ 38	\$ (859 )	\$520,540



Table of Contents

	July 31, 2017			Estimated
	Amortized	Unrealized	Unrealized	Fair
	Cost	Gains	Losses	Value
	(in thousands)			
U.S. Government agency securities	\$22,662	\$ —	\$ (66 )	\$22,596
Commercial paper	147,371	2	(34 )	147,339
Corporate bonds	258,334	157	(146 )	258,345
U.S. Government bonds	67,164	—	(185 )	66,979
Certificate of deposit	27,498	29	—	27,527
Money market funds	96,313	—	—	96,313
Total	\$619,342	\$ 188	\$ (431 )	\$619,099

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

	January 31, 2018					
	Less Than 12 Months		12 Months or Greater		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
	(in thousands)					
U.S. Government agency securities	\$3,796	\$ (1 )	\$17,522	\$ (50 )	\$21,318	\$ (51 )
Commercial paper	37,167	(44 )	—	—	37,167	(44 )
Corporate bonds	172,910	(546 )	25,966	(48 )	198,876	(594 )
U.S. Government bonds	8,468	(12 )	41,534	(145 )	50,002	(157 )
Certificate of deposit	10,236	(13 )	—	—	10,236	(13 )
Total	\$232,577	\$ (616 )	\$85,022	\$ (243 )	\$317,599	\$ (859 )

As of January 31, 2018, the Company had 135 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, 2018 to be other-than-temporarily impaired, nor are any unrealized losses considered to be credit losses. The Company has recorded the securities at fair value in its consolidated balance sheets, with unrealized gains and losses reported as a component of accumulated other comprehensive loss. The amount of realized gains and losses reclassified into earnings are based on the specific identification of the securities sold. The realized gains and losses from sales of securities in the periods presented were not material.

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

	January 31, 2018		
	Less Than 12 Months	12 to 24 Months	Total
	(in thousands)		
U.S. Government agency securities	\$19,588	\$1,730	\$21,318
Commercial paper	99,966	—	99,966
Corporate bonds	174,084	56,052	230,136
U.S. Government bonds	50,001	—	50,001

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

Money market funds	92,380	—	92,380
Certificates of deposit	20,248	6,491	26,739
Total	\$456,267	\$64,273	\$520,540

13

---



Table of Contents

## Fair Value Measurement

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

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

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

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

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

	January 31, 2018			
	Level 1	Level 2	Level 3	Total
	(in thousands)			
Cash equivalents:				
Corporate bonds	\$—	\$4,100	\$	—\$4,100
Commercial paper	—	59,896	—	59,896
Money market funds	92,380	—	—	92,380
Short-term investments:				
U.S. Government agency securities	—	19,588	—	19,588
Commercial paper	—	40,070	—	40,070
U.S. Government bonds	—	50,001	—	50,001
Corporate bonds	—	169,983	—	169,983
Certificates of deposit	—	20,249	—	20,249
Long-term investments:				
U.S. Government agency securities	—	1,730	—	1,730
Certificates of deposit	—	6,490	—	6,490
Corporate bonds	—	56,053	—	56,053
U.S. Government bonds	—	—	—	—
Total	\$92,380	\$428,160	\$	—\$520,540

Table of Contents

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

## 3. Acquisitions

## Cyence Acquisition

On November 1, 2017, the Company completed its 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 including a net working capital adjustment (the “Cyence Acquisition”). Through the acquisition, the Company gained a cloud-based data listening and risk analytics technology offering for the P&C insurance industry which enables underwriting new and evolving risks, such as cyber risk. This acquisition was accounted for as a business combination. The results of Cyence’s operations have been included in the Company’s results of operations since November 1, 2017, the date of acquisition.

As part of the acquisition, the Company assumed certain Cyence compensation agreements, consisting of RSAs, stock options, and cash compensation, with an estimated fair value of \$37.6 million. Based on the period earned prior to the acquisition date, \$18.2 million was allocated to the purchase price, and \$19.4 million relating to post-acquisition services, will be recorded as operating expenses over the remaining requisite service periods. RSAs were valued based on the November 1, 2017 grant date value, and the estimated fair value of the stock options assumed by the Company was determined using the Black-Scholes option pricing model.

The adjustments reflected herein to determine the purchase consideration are preliminary and may change as the Company finalizes these adjustments during the measurement period based on new information as it becomes available. The preliminary purchase consideration is as follows:

	Preliminary Purchase Consideration (in thousands)
Cash consideration paid at close	\$ 146,651
Equity issued to shareholders	102,493

Issuance of replacement awards	11,205
Total preliminary purchase consideration	\$ 260,349

15

---

Table of Contents

In conjunction with the preliminary purchase price allocation, the Company determined that Cyence's separately identifiable intangible assets were developed technology, customer contracts and related relationships, order backlog, and trade names. The Company utilized the discounted cash flow methodology and the profit allocation methodology under the income approach to estimate the fair values of intangible assets. The Company used the cost build-up approach to estimate the fair value of deferred revenue by estimating the costs related to fulfilling the obligation plus an additional markup for an assumed operating margin to reflect the profit a third party would expect to realize on the costs incurred. These fair value measurements were based on significant inputs that were not observable in the market and thus represent a Level 3 measurement. The valuation models were based on estimates of future operating projections of Cyence and rights to sell new products containing the acquired technology as well as judgments on the discount rates used and other variables. The Company developed forecasts based on a number of factors including future revenue and operating cost projections, a discount rate that is representative of the weighted average cost of capital, in addition to royalty and long-term sustainable growth rates based on a market analysis. The Company amortizes the acquired intangibles over their estimated useful lives as set forth in the table below.

The allocation of purchase price is preliminary pending the final valuation of intangible and tangible assets acquired and liabilities assumed, certain acquired deferred tax assets and completion of certain statutory tax filing requirements and is therefore subject to potential future measurement period adjustments. The preliminary allocation of the purchase consideration is as follows:

	Preliminary Purchase Price Allocation (in thousands)	Estimated Useful Lives (in years)
Acquired assets, net of assumed liabilities	\$ 7,470	
Developed technology	28,400	5
Customer contracts and related relationships	17,700	5
Order backlog	3,200	2
Trademarks	2,500	7
Goodwill	201,079	
Total preliminary purchase consideration	\$ 260,349	

The goodwill of \$201.1 million arising from the Cyence Acquisition consists largely of the acquired workforce and the opportunity to expand the Company's customer base. The goodwill recognized is not expected to be deductible for income tax purposes.

For the three and six months ended January 31, 2018, total revenue and net loss attributable to Cyence was approximately \$2.1 million and \$9.7 million, respectively. The Company incurred \$3.8 million and \$5.2 million of total acquisition-related costs for the three months and six months ended January 31, 2018, respectively, that were recognized in general and administrative expenses.

#### Unaudited Pro Forma Financial Information

The following unaudited pro forma financial information presents the combined results of operations for the Company and Cyence for the three and six months ended January 31, 2018 and 2017, after giving effect to the Cyence Acquisition as if it had occurred on August 1, 2016. The unaudited pro forma financial information includes adjustments to give effect to pro forma events that are directly attributable to the business combination and factually supportable. The unaudited pro forma financial information presented includes the business combination accounting effects resulting from the acquisition, including adjustments for the amortization of intangible assets, stock-based compensation, deferred revenue, and transaction costs on August 1, 2016 with a corresponding reduction of these amounts in the period originally recognized.

The unaudited pro forma financial information is presented for illustrative purposes only and is not necessarily indicative of the results of operations that would have been realized if the Cyence acquisition had been completed on August 1, 2016, nor does it purport to project the results of operations of the combined company in future periods. The unaudited pro forma financial information does not give effect to any anticipated integration costs related to the acquired company. Consequently, actual results will differ from the unaudited pro forma financial information. The unaudited pro forma financial information is as follows (in thousands):

16

---

Table of Contents

	Three Months Ended		Six Months Ended	
	January 31,		January 31,	
	2018	2017	2018	2017
Pro forma revenue	\$163,787	\$118,235	\$276,891	\$215,065
Pro forma net loss	\$(38,779)	\$(3,187)	\$(51,329)	\$(24,464)
Pro forma net loss per share -- basic	\$(0.50)	\$(0.04)	\$(0.67)	\$(0.33)
Pro forma net loss per share -- diluted	\$(0.50)	\$(0.04)	\$(0.67)	\$(0.33)

The pro forma revenue and net loss reflects material, nonrecurring adjustments, such as transaction, transition and integration-related charges (including legal, accounting and other professional fees, and retention bonuses) that resulted from the acquisition.

## ISCS Acquisition

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

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

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

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

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

Table of Contents

## 4. Balance Sheet Components

## Property and Equipment, net

Property and equipment consist of the following:

	January 31, 2018	July 31, 2017
	(in thousands)	
Computer hardware	\$23,950	\$21,408
Purchased software	4,111	3,855
Capitalized software development costs	2,125	1,065
Furniture and fixtures	3,684	3,253
Leasehold improvements	9,395	8,251
Total property and equipment	43,265	37,832
(Less) accumulated depreciation	(27,060 )	(23,456 )
Property and equipment, net	\$16,205	\$14,376

As of January 31, 2018 and July 31, 2017, no property and equipment was pledged as collateral. Depreciation expense was \$1.9 million and \$1.7 million for the three months ended January 31, 2018 and 2017, respectively; and was \$3.8 million and \$3.3 million for the six months ended January 31, 2018 and 2017, respectively.

During the third fiscal quarter of 2017, the Company began to capitalize software development costs for technology applications that the Company will offer solely as cloud-based subscriptions. The amounts capitalized as of January 31, 2018 and July 31, 2017 were \$2.1 million and \$1.1 million, respectively, and primarily comprised compensation and related headcount costs for employees who were directly associated with the software development projects. During the fiscal quarter ended January 31, 2018, the first phase of the Company's technology platform became ready for its intended use and, accordingly, approximately \$1.5 million in previously capitalized costs began amortization over the estimated useful life of 3 years. The Company recognized approximately \$0.1 million in amortization expense in cost of revenues, license and other on the accompanying condensed consolidated statements of operations during the three and six months ended January 31, 2018. There was no such amortization during the three and six months ended January 31, 2017.

## Other Assets

The Company's other assets of \$20.7 million and \$20.1 million at January 31, 2018 and at July 31, 2017, respectively, include a strategic equity investment in a privately-held company of \$10.7 million, which was accounted for using the cost method of accounting. Strategic investments are non-marketable equity securities, in which the Company does not have a controlling interest or the ability to exert significant influence. These investments do not have a readily determinable market value. Under the cost method of accounting, the non-marketable securities are carried at cost and are adjusted only for other-than temporary impairments, certain distributions, and additional investments.

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

As of January 31, 2018 and July 31, 2017, there were no indicators that the investment with carrying value of \$10.7 million was impaired.

## Goodwill and Intangible Assets

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

	(in thousands)
Goodwill, July 31, 2017	\$ 141,851
Acquisition - Cyence	201,079
Changes in carrying value	318
Goodwill, January 31, 2018	\$ 343,248





Table of Contents

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

	January 31, 2018 (in thousands)			July 31, 2017		
	Cost	Accumulated Amortization	Net Book Value	Cost	Accumulated Amortization	Net Book Value
Amortized intangible assets:						
Acquired technology	\$93,600	\$ 23,900	\$69,700	\$65,200	\$ 14,710	\$50,490
Customer contracts and related relationships	35,700	3,666	32,034	18,000	1,683	16,317
Partner relationships	200	41	159	200	30	170
Trademarks	2,500	89	2,411	—	—	—
Order backlog	8,700	2,333	6,367	5,500	1,162	4,338
Total amortized intangible assets	\$140,700	\$ 30,029	\$110,671	\$88,900	\$ 17,585	\$71,315

Amortization expense was \$7.6 million and \$1.7 million for the three months ended January 31, 2018 and 2017, respectively, and was \$12.4 million and \$3.1 million for the six months ended January 31, 2018 and 2017, respectively. The estimated aggregate amortization expense for existing intangible assets as of January 31, 2018, based on their current useful lives, is estimated as follows:

	Future Amortization (in thousands)
Fiscal year ending July 31,	
2018 (remainder of fiscal year)	\$ 15,017
2019	29,112
2020	26,834
2021	19,965
2022	11,143
Thereafter	8,600
Total future amortization expense	\$ 110,671

## Accrued Employee Compensation

Accrued employee compensation expense consists of the following:

	January 31, 2018	July 31, 2017
	(in thousands)	
Accrued bonuses	\$13,929	\$26,581
Accrued commission	1,960	5,228
Accrued vacation	11,190	10,873
Accrued salaries, payroll taxes and benefits	6,602	6,200
Total accrued employee compensation	\$33,681	\$48,882

Table of Contents

## Deferred Revenues

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

	January 31, 2018	July 31, 2017
	(in thousands)	
Deferred license and other revenues	\$38,921	\$23,727
Deferred maintenance revenues	45,109	47,727
Deferred services revenues	46,862	39,681
Total deferred revenues	\$130,892	\$111,135

## Accumulated Other Comprehensive Loss

Changes in accumulated other comprehensive loss by component during the six months ended January 31, 2018 were as follows:

	Foreign Currency (Loss) on Translation Adjustments (in thousands)	Unrealized Gain Available-for-Sale Securities	Total
Balance as of July 31, 2017	\$(5,630)	\$ (166 )	\$(5,796)
Other comprehensive income (loss) before reclassification	1,428	(592 )	836
Amounts reclassified from accumulated other comprehensive loss to earnings	—	15	15
Tax effect	—	167	167
Balance as of January 31, 2018	\$(4,202)	\$ (576 )	\$(4,778)

## 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:

	Three Months Ended January 31, 2018		Six Months Ended January 31, 2018	
	2018	2017	2018	2017
	(in thousands, except share and per share amounts)			
Numerator:				
Net income (loss)	\$(45,555)	\$ 3,974	\$(54,469)	\$(3,884 )
Net income (loss) per share:				
Basic	\$(0.59 )	\$ 0.05	\$(0.72 )	\$(0.05 )
Diluted	\$(0.59 )	\$ 0.05	\$(0.72 )	\$(0.05 )
Denominator:				
Weighted average shares used in computing net income (loss) per share:				
Basic	76,859,040	73,738,810	76,023,237	73,516,140
Weighted average effect of dilutive stock options	—	602,839	—	—
Weighted average effect of dilutive restricted stock units	—	451,591	—	—
Diluted	76,859,040	74,793,240	76,023,237	73,516,140

Table of Contents

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,		January 31,	
	2018	2017	2018	2017
Stock options to purchase common stock	657,271	59,323	601,370	1,009,969
Restricted stock units	3,474,549	832,650	3,222,956	3,119,079

#### 6. Commitments and Contingencies

There has been no material change in the Company's contractual obligations and commitments other than in the ordinary course of business since the Company's fiscal year ended July 31, 2017. See the Annual Report on Form 10-K for the fiscal year ended July 31, 2017 for additional information regarding the Company's contractual obligations.

#### Leases

The Company leases certain facilities and equipment under operating leases. Lease expense for all worldwide facilities and equipment, which is being recognized on a straight-line basis over terms of the various leases, was \$2.1 million and \$1.6 million for the three months ended January 31, 2018 and 2017, respectively, and was \$4.0 million and \$3.1 million for the six months ended January 31, 2018 and 2017, respectively.

In December 2017, the Company entered into a new lease agreement for its potential future headquarter facility. The lease term is expected to commence on December 1, 2018, for a period of 10.5 years. Total payments committed under the lease is \$132.1 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, 2018 or July 31, 2017. The Company expenses legal fees in the period in which they are incurred.

#### Indemnification

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

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, 2018 or July 31, 2017. For several reasons, including the lack of prior indemnification claims and the lack of a monetary liability limit for certain infringement cases under various Software Licenses, the Company cannot estimate the amount of potential future payments, if any, related to indemnification provisions.

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



Table of Contents

## 7. Stock-Based Compensation Expense and Shareholders' Equity

## Stock-Based Compensation Expense

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

	Three Months Ended January 31,		Six Months Ended January 31,	
	2018	2017	2018	2017
	(in thousands)			
Total stock-based compensation	\$25,035	\$18,807	\$44,649	\$36,911
Net impact of capitalized stock-based compensation	(3 )	(220 )	6	(447 )
Total stock-based compensation expense	\$25,032	\$18,587	\$44,655	\$36,464

Stock-based compensation expense was charged to the following categories:

Cost of license and other revenues	\$258	\$90	\$432	\$141
Cost of maintenance revenues	481	436	936	849
Cost of services revenues	5,446	4,815	10,672	9,510
Research and development	7,697	4,650	12,609	9,117
Sales and marketing	5,024	4,283	9,241	8,506
General and administrative	6,126	4,313	10,765	8,341
Total stock-based compensation expense	\$25,032	\$18,587	\$44,655	\$36,464

As of January 31, 2018, total unamortized stock-based compensation cost for our options and Stock Awards were as follows:

	As of January 31, 2018	
Unrecognized Expense (in thousands)	Weighted Average Expected Recognition Period (in years)	
Stock Options	\$7,964	2.3
Stock Awards	186,232	2.5
	\$194,196	

## 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)
Balance as of July 31, 2017	2,634,085	\$ 56.62	\$ 190,076
Granted	1,571,536	\$ 78.10	
Released	(643,219 )	\$ 55.01	\$ 48,777
Canceled	(151,655 )	\$ 61.54	
Balance as of January 31, 2018	3,410,747	\$ 66.61	\$ 270,984
Expected to vest as of January 31, 2018	3,410,747	\$ 66.61	\$ 270,984

(1)

Aggregate intrinsic value at each period end represents the total market value of Stock Awards at the Company's closing stock price of \$79.45 and \$72.16 on January 31, 2018 and July 31, 2017, respectively. Aggregate intrinsic value for released RSUs represents the total market value of released Stock Awards at date of release.

Table of Contents

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 and achievement of certain milestones. The weighted average grant date fair value is based on the market value of our common stock on the date of grant.

**Stock Options**

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

	Number of Stock Options Outstanding	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (in years)	Aggregate Intrinsic Value (1) (in thousands)
Balance as of July 31, 2017	555,636	\$ 22.17	4.0	\$ 27,777
Granted	137,057			
Exercised	(59,078 )	\$ 12.31		\$ 3,792
Canceled	(1,441 )			
Balance as of January 31, 2018	632,174	\$ 20.48	4.8	\$ 37,279
Vested and expected to vest as of January 31, 2018	632,174	\$ 20.48	4.8	\$ 37,279
Exercisable as of January 31, 2018	481,304	\$ 21.39	3.6	\$ 27,945

Aggregate intrinsic value at each period end represents the difference between the Company's closing stock prices of \$79.45 and \$72.16 on January 31, 2018 and July 31, 2017, respectively, and the exercise price of outstanding options. Aggregate intrinsic value for exercised options represents the difference between the Company's stock price at date of exercise and the exercise price.

**Valuation of Awards****TSR PSUs**

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, 2018	Three Months Ended January 31, 2017	Six Months Ended January 31, 2018	Six Months Ended January 31, 2017
Expected term (in years)	* 2.66	2.66	2.88	2.66-2.88
Risk-free interest rate	* 1.34%	1.34%	1.44%	0.89%-1.34%
Expected volatility of the Company	* 30.2%	30.2%	28.0%	30.2%-31.5%
Average expected volatility of the peer companies in the S&P Index	* 36.9%	36.9%	34.7%	36.9%-37.0%
Expected dividend yield	* —%	—%	—%	—%

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



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

Table of Contents

regardless of the ultimate achievement of the plan's performance metrics. The expense will be reversed only in the event that a grantee is terminated prior to satisfying the requisite service period.

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

**Common Stock Reserved for Issuance**

As of January 31, 2018 and July 31, 2017, the Company was authorized to issue 500,000,000 shares of common stock with a par value of \$0.0001 per share and, of these, 77,279,160 and 75,007,625 shares of common stock were issued and outstanding, respectively. As of January 31, 2018 and July 31, 2017, the Company had reserved shares of common stock for future issuance as follows:

	January 31, 2018	July 31, 2017
Exercise of stock options to purchase common stock	632,174	555,636
Vesting of restricted stock awards	3,160,747	2,634,085
Shares available under stock plans	21,728,177	18,453,674
Total common stock reserved for issuance	25,521,098	21,643,395

Table of Contents

## 8. Income Taxes

On December 22, 2017, the Tax Cuts and Jobs Act (“Tax Act”) was enacted into law which changed U.S. tax law, including, but not limited to: (1) reducing the U.S. federal corporate income tax rate from 35.0% to 21%; (2) requiring companies to pay a one-time transition tax on certain unrepatriated earnings of foreign subsidiaries; (3) generally eliminating U.S. federal corporate income taxes on dividends from foreign subsidiaries; (4) capitalizing R&D expenses which are amortized over five to 15 years; and (5) other changes to how foreign and domestic earnings are taxed.

As a result of the Company’s fiscal non-calendar year end, the lower U.S. statutory federal income tax rate will result in a blended U.S. Federal statutory rate of 26.9% for the Company’s fiscal year 2018. During the quarter ended January 31, 2018, the Company remeasured deferred tax assets and liabilities based on the rates at which they are expected to reverse and recorded a provisional net charge of \$34.0 million based on preliminary estimates of the tax effects. In addition, as a result of changes in tax law under the Tax Act, the Company recorded a provisional benefit of \$5.4 million related to the release of valuation allowance against certain deferred tax assets that are more likely than not to be realized. The provisional net charge and provisional benefit are subject to revisions as the Company completes its analysis of the Tax Act. The Company estimates that no tax will be due related to the one-time transition tax on the deemed repatriation of deferred foreign income.

The Tax Act includes a provision to tax global intangible low-taxed income of foreign subsidiaries and a base erosion abuse tax measure that taxes certain payments between a U.S. corporation and its foreign subsidiaries. These provisions of the Tax Act will be effective for the Company beginning August 1, 2018. The Company is in the process of completing its analysis of the deferred tax accounting on global intangible low-taxed income and has not recorded provisional amounts. The Company is still evaluating an accounting policy to record amounts as deferred taxes or as period costs related to this provision. The SEC staff issued Staff Accounting Bulletin No. 118 which provides for a measurement period of up to one year after the enactment date of the Tax Act to finalize the related income tax impacts. The Company expects to complete the accounting for the Tax Act during this measurement period. The Company recognized income tax expense of \$48.1 million and \$6.1 million for the three months ended January 31, 2018 and 2017, respectively. The increase in tax expense for the three months ended January 31, 2018 was primarily due to the impact of the Tax Act, including discrete tax expense of \$34.0 million related to the remeasurement of net deferred tax assets offset by the discrete tax benefit of \$5.4 million noted above. The effective tax rate of 1,880% for the three months ended January 31, 2018, differs from the statutory U.S. federal income tax rate of 26.9% mainly due to the tax expense recorded as a result of the remeasurement of deferred tax assets and release of valuation allowance, as well as 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, and acquisition-related expenses.

During the three months ended January 31, 2018, the increase in unrecognized tax benefits from the beginning of the period was \$3.7 million. Accordingly, as of January 31, 2018, the Company had unrecognized tax benefits of \$6.4 million that, if recognized, would affect the Company’s effective tax rate.

## 9. Segment Information

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

Table of Contents

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

	Three Months		Six Months Ended	
	Ended January 31,		January 31,	
	2018	2017	2018	2017
	(in thousands)			
United States	\$104,422	\$64,506	\$174,256	\$111,355
Canada	16,458	14,355	26,653	28,849
Other Americas	3,418	3,872	8,160	9,096
Total Americas	124,298	82,733	209,069	149,300
United Kingdom	9,315	9,574	18,652	17,964
Other EMEA	10,554	8,809	17,178	17,750
Total EMEA	19,869	18,383	35,830	35,714
Total APAC	19,621	14,505	27,060	24,734
Total revenues	\$163,788	\$115,621	\$271,959	\$209,748

No country or region, other than those presented above, accounted for more than 10% of revenues during the three and six months ended January 31, 2018 and 2017.

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

	January	July 31,
	31, 2018	2017
	(in thousands)	
Americas	\$466,943	\$224,667
EMEA	3,121	2,747
APAC	60	128
Total	\$470,124	\$227,542

Table of Contents

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

The following discussion and analysis should be read in conjunction with our condensed consolidated financial statements and the notes thereto included elsewhere in this document and the Risk Factors included in Item 1A of Part II of this Quarterly Report on Form 10-Q. All information presented herein is based on our fiscal calendar. Unless otherwise stated, references in this report to particular years or quarters refer to our fiscal years ended in July and the associated quarters of those fiscal years. We assume no obligation to revise or update any forward-looking statements for any reason, except as required by law.

Overview

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

We sell our products to a wide variety of global P&C insurers ranging from some of the largest global insurance carriers or their subsidiaries to national and regional carriers. Our customer engagement is led by our direct sales 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 licenses for both recurring term license and maintenance fees are typically invoiced annually in advance or, in certain cases, quarterly. Term licenses that are greater than one year are characterized by extended payment terms. We assess whether a fee is fixed or determinable at the outset of the arrangement, primarily based on the payment terms associated with the transaction. For term licenses with extended payment terms, term license fees are not considered to be fixed and

determinable until they become due or payment is received, resulting in a deferral of the related revenues until this revenue recognition criteria is met, assuming all other revenue recognition criteria are satisfied. In preparing for our adoption of the new revenue recognition standard, we began revising our contracting practices in fiscal 2016 by selling substantially all term licenses with an initial two-year committed term and optional annual renewals. We also began a program to amend existing long-term contracts to the same committed term of two-years with optional annual renewals. A small portion of our revenues are derived from perpetual licenses, for which license revenues are typically recognized upon delivery of the software, provided that all revenue recognition criteria have been met.

We also offer cloud-based subscriptions. Currently, these subscriptions may be for terms greater than two years, and we anticipate that a majority of these arrangements will be billed annually or quarterly in advance, although in some instances additional

## Table of Contents

fees may be assessed in arrears as customers increase their DWP. Revenues 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 sales as we sell more cloud-based services. As a result of the ratable recognition of revenues associated with subscriptions, a significant shift from term licenses to subscriptions 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.

To extend our technology leadership in the global market, we continue to invest in research and development 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 in their IT goals, maintain our competitive advantage, grow our revenues, 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 allows us to increase efficiency and scale while reducing customer implementation costs. Our extensive relationships with SIs and industry partners have strengthened and expanded in line with the interest in and adoption of our products. We encourage our partners to co-market, pursue joint sales initiatives, and drive broader adoption of our technology, helping us grow our business more efficiently. We continue to grow our services organization and invest time and resources in increasing the number of qualified consultants employed by our SI partners, develop relationships with new SIs in existing and new markets, and ensure that all partners are ready to assist with implementing our products.

We face a number of risks in the execution of our strategy including risks related to expanding to new markets, managing lengthy sales cycles, competing effectively in the global market, relying on sales to a relatively small number of large customers, developing new or acquiring existing products successfully, migrating a portion of our business to a more ratable revenue recognition model as we bring to market more cloud-based solutions, and increasing the overall adoption of our products. In response to these and other risks we might face, we continue to invest in many areas of our business. Our investments in sales and marketing align with our goal of winning new customers in both existing and new markets, and enable us to maintain a persistent, consultative relationship with our existing customers. Our investments in product development are designed to meet the evolving needs of our customers. Our investments in services are designed to ensure customer success, both with on-premise and cloud-based solutions.

### Acquisitions

On November 1, 2017, we completed the acquisition of Cyence, Inc. ("Cyence"), for an aggregate consideration of approximately \$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. This acquisition was accounted for as a business combination. The results of Cyence's operations have been included in our results of operations since November 1, 2017, the date of acquisition.

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

operations have been included in our results of operations since February 16, 2017, the date of acquisition.

#### Seasonality

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



Table of Contents

increase as a percentage of total sales, the revenues we can recognize in the fiscal year will be reduced, and our reported revenue growth will be adversely affected. The seasonal nature of our sales and the concentration of such sales in our fiscal fourth quarter increases this impact.

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

**Key Business Metrics**

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

**Four-Quarter Recurring Revenues**

We measure four-quarter recurring revenues by adding the total term license and other revenues and total maintenance revenues recognized under GAAP in the preceding four quarters ended in the stated period. This metric excludes perpetual license revenues, revenues from perpetual buyout rights, and services revenues. This metric allows us to better understand the trends in our recurring revenues because it reduces the variations in any particular quarter caused by seasonality. However, the effects of the annual invoicing of our term licenses, and certain effects of contractual provisions that may accelerate or delay revenue recognition in some cases can impact this metric. In addition, this metric will be adversely impacted during periods in which subscriptions increase as a percentage of total customer orders, as more of the revenue under those agreements will be deferred to future periods. This metric applies revenue recognition rules under GAAP and does not substitute individually tailored revenue recognition and measurement methods. The relevance and value of this metric may be impacted by our transition to a new revenue standard in fiscal year 2019. Our four-quarter recurring revenues for each of the eight periods presented were:

	Four quarters ended							
	January 31, 2018	October 31, 2017	July 31, 2017	April 30, 2017	January 31, 2017	October 31, 2016	July 31, 2016	April 30, 2016
	(in thousands)							
Term license and other revenues	\$272,328	\$253,792	\$258,322	\$237,919	\$220,494	\$210,278	\$208,430	\$194,458
Maintenance revenues	73,568	71,041	68,643	66,958	64,776	62,451	59,931	56,103
Total four-quarter recurring revenues	\$345,896	\$324,833	\$326,965	\$304,877	\$285,270	\$272,729	\$268,361	\$250,561

**Operating Cash Flows and Capital Expenditures**

We monitor our cash flows from operating activities and cash used for capital expenditures, as a key measure of our overall business performance, which enables us to analyze our financial performance without the effects of certain non-cash items such as depreciation and amortization and stock-based compensation expenses. Additionally, operating cash flows takes into account the impact of changes in deferred revenues, which reflects the receipt of cash payment for products before they are recognized as revenues. Our operating cash flows are significantly impacted by the timing of invoicing and collections of accounts receivable, the size of annual bonus payment, as well as payments of payroll and other taxes. As a result, our operating cash flows fluctuate significantly on a year over year basis. Cash provided by our operations was \$16.4 million and \$29.6 million for the six months ended January 31, 2018 and 2017, respectively. Additionally, cash used for capital expenditures was \$5.4 million and \$2.6 million for the six months ended January 31, 2018 and 2017, respectively. Our capital expenditures consisted of purchases of property and equipment, most of which was 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." Critical Accounting Policies and Estimates

Our condensed consolidated financial statements are prepared in accordance with generally accepted accounting principles in the United States of America (“U.S. GAAP”). Accounting policies, methods, and estimates are an integral part of the preparation of condensed consolidated financial statements in accordance with U.S. GAAP and, in part, are based upon management’s current

Table of Contents

judgments. Those judgments are normally based on knowledge and experience with regard to past and current events and assumptions about future events. Certain accounting policies, methods and estimates are particularly sensitive because of their significance to the condensed consolidated financial statements and because of the possibility that future events affecting them may differ markedly from management's current judgments. While there are a number of accounting policies, methods, and estimates affecting our condensed consolidated financial statements, areas that are particularly significant include:

• Revenue recognition policies;

• Stock-based compensation;

• Income taxes;

• Business combinations; and

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

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

Table of Contents

## Results of Operations

The following tables set forth our results of operations for the periods presented. The data has been derived from the unaudited Condensed Consolidated Financial Statements contained in this Quarterly Report on Form 10-Q which, in the opinion of our management, reflect all adjustments, consisting only of normal recurring adjustments, necessary to present fairly the financial position and results of operations for the interim periods presented. The operating results for any period should not be considered indicative of results for any future period. This information should be read in conjunction with the Consolidated Financial Statements and Notes thereto included in our Annual Report on Form 10-K filed with the SEC on September 19, 2017.

	Three Months Ended January 31,				Six Months Ended January 31,			
	2018	As a % of total revenues	2017	As a % of total revenues	2018	As a % of total revenues	2017	As a % of total revenues
	(in thousands)							
Revenues:								
License and other	\$84,221	51 %	\$64,075	56 %	\$114,314	42 %	\$102,796	49 %
Maintenance	19,110	12	16,582	14	38,040	14	33,114	16
Services	60,457	37	34,964	30	119,605	44	73,838	35
Total revenues	163,788	100	115,621	100	271,959	100	209,748	100
Cost of revenues:								
License and other	9,040	5	2,781	2	15,755	5	5,211	3
Maintenance	3,593	2	3,079	3	7,060	3	6,404	3
Services	55,136	34	34,951	30	107,848	40	71,215	34
Total cost of revenues	67,769	41	40,811	35	130,663	48	82,830	40
Gross profit:								
License and other	75,181	46	61,294	54	98,559	37	97,585	46
Maintenance	15,517	10	13,503	11	30,980	11	26,710	13
Services	5,321	3	13	0	11,757	4	2,623	1
Total gross profit	96,019	59	74,810	65	141,296	52	126,918	60
Operating expenses:								
Research and development	43,657	26	30,025	26	79,368	29	60,775	29
Sales and marketing	31,961	20	23,520	21	55,571	20	49,020	23
General and administrative	21,066	13	13,060	11	39,737	15	27,220	13
Total operating expenses	96,684	59	66,605	58	174,676	64	137,015	65
Income (loss) from operations	(665 )	0	8,205	7	(33,380 )	(12 )	(10,097 )	(5 )
Interest income	1,566	1	1,544	2	3,474	1	2,886	1
Other income (expense), net	1,658	1	335	0	1,396	1	(346 )	0
Income (loss) before income taxes	2,559	2	10,084	9	(28,510 )	(10 )	(7,557 )	(4 )
Provision for (benefit from) income taxes	48,114	30	6,110	5	25,959	10	(3,673 )	(2 )
Net income (loss)	\$(45,555)	(28 )%	\$3,974	4 %	\$(54,469)	(20 )%	\$(3,884)	(2 )%

Table of Contents

## Revenues

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

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

## Licenses and Other

A substantial majority of our license and other revenues consist of term license fees. We also recognize revenue from sales of subscriptions and perpetual licenses. Our term license revenues are primarily generated through annual license fees that recur during the term of the contract. Since fiscal year 2016, a substantial majority of our term licenses have been sold with a contract of a two year committed term with optional annual renewals. Term license revenues are generally recognized upon the earlier of when payment is due or cash is received from our customers.

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

In a limited number of cases, we license our software on a perpetual basis or our term licenses provide the customer with the option to purchase a perpetual license at the end of the initial contract term, which we refer to as a perpetual buyout right. Perpetual license revenues are generally recognized upon delivery.

We generally price our software based on the amount of direct written premiums, or 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 cloud-based subscription customers similarly, but terms may change as our cloud business matures and the market develops. We invoice our perpetual license customers either in full at contract signing or on an installment basis.

## Maintenance

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

## Professional Services

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

Three Months Ended January 31,

	2018		2017		Change
	Amount	% of total revenues	Amount	% of total revenues	(\$)
					(%)
	(in thousands, except percentages)				

## Revenues:

License and other	\$84,221	51 %	\$64,075	56 %	\$20,146	31 %
Maintenance	19,110	12 %	16,582	14 %	2,528	15 %
Services	60,457	37 %	34,964	30 %	25,493	73 %
Total revenues	\$163,788	100 %	\$115,621	100 %	\$48,167	42 %



Table of Contents

	Six Months Ended January 31, 2018		2017		Change	
	Amount	% of total revenues	Amount	% of total revenues	(\$)	(%)

(in thousands, except percentages)

## Revenues:

License and other	\$114,314	42 %	\$102,796	49 %	\$11,518	11 %
Maintenance	38,040	14 %	33,114	16 %	4,926	15 %
Services	119,605	44 %	73,838	35 %	45,767	62 %
Total revenues	\$271,959	100 %	\$209,748	100 %	\$62,211	30 %

## License and Other Revenues

License and other revenues increased \$20.1 million and \$11.5 million during the three and six months ended January 31, 2018, respectively, as compared to the same periods a year ago. These increases were primarily driven by additional software licenses and subscriptions to new and existing customers.

Our license and other revenues are primarily comprised of term license revenues. Term licenses remain our predominant licensing model, although we anticipate subscriptions to grow as a percentage of annual sales in future periods. Due to the delayed and ratable recognition of subscription revenues, growth in subscription revenues will lag behind the growth of subscription sales and will impact the comparative growth of our reported revenues.

	Three Months Ended January 31, 2018		2017		Change	
	Amount	% of License and other revenues	Amount	% of License and other revenues	(\$)	(%)

(in thousands, except percentages)

## License and other revenues:

Term and other	\$81,404	97 %	\$62,868	98 %	\$18,536	29 %
Perpetual	2,817	3 %	1,207	2 %	1,610	133 %
Total license and other revenues	\$84,221	100 %	\$64,075	100 %	\$20,146	31 %

## Six Months Ended January 31,

	2018		2017		Change	
	Amount	% of License and other revenues	Amount	% of License and other revenues	(\$)	(%)

(in thousands, except percentages)

## License and other revenues:

Term and other	\$111,374	97 %	\$97,368	95 %	\$14,006	14 %
Perpetual	2,940	3 %	5,428	5 %	(2,488 )	(46)%
Total license and other revenues	\$114,314	100 %	\$102,796	100 %	\$11,518	11 %

Term license and other revenues increased by \$18.5 million during the three months ended January 31, 2018, compared to the same period a year ago, due primarily to the addition of new term license and subscription orders

from new and existing customers. As we have noted, our reported results in any given period may be positively impacted by early payments due in future periods and negatively impacted by early payments made in preceding periods. During the quarter, we recognized \$4.6 million from early payments due in the third quarter, offset in part by \$1.3 million of payments due in the second quarter that were paid in the first quarter, resulting in a net benefit to the second quarter of \$3.2 million.

Term license and other revenues increased by \$14.0 million during the six months ended January 31, 2018, compared to the same period a year ago, due primarily to the addition of new term license and subscription orders from new and existing customers. Results for the six month period, benefited by the early payments of \$4.6 million previously noted, offset by \$6.1 million in



Table of Contents

payments due in the first quarter but received in the fourth quarter of 2017, resulting in a decrease to recognized revenue of approximately \$1.5 million during the six months ended January 31, 2018.

Perpetual license revenues accounted for approximately 3% and 2% of total license and other revenue during the three months ended January 31, 2018 and 2017, respectively, and 3% and 5% during the six months ended January 31, 2018 and 2017. We anticipate that revenues from the sale and delivery of perpetual licenses will continue to represent a small percentage of our total license and other revenues. Nevertheless, we expect perpetual license revenues to remain volatile across quarters due to the large amount of perpetual revenue that may be generated from a single customer order.

**Maintenance Revenues**

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

**Services Revenues**

Services revenues increased \$25.5 million and \$45.8 million during the three and six months ended January 31, 2018, primarily as a result of a net increase in billings from new and existing customer engagements performed during the period, and billings associated with engagements relating to the implementation of previously acquired products, such as InsuranceNow.

Historically, we have relied on our network of third-party SI partners to facilitate new sales and implementations of our 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 trained consultants with whom we work.

While not essential to the functionality of the service, for a period of time implementations of InsuranceNow or InsuranceSuite Cloud will require significantly greater levels of participation by our services professionals than is currently necessary for on-premise versions of our products. With respect to InsuranceSuite Cloud, our obligation to manage the platform in production requires us to have a much greater familiarity with its configuration and integrations. As a result, we intend to control implementation work until effective processes have been established to reduce any risk we face in managing a production environment for a system we have not implemented. At the time of acquisition, ISCS had few third-party resources to assist with implementations of InsuranceNow. While we are actively qualifying and training consultants from existing and new partners to assist with such implementations, we have taken, and for the foreseeable future we expect to take, primary responsibility for InsuranceNow implementations. As we gain experience with the deployment and maintenance of cloud solutions, we hope to leverage our SI partners more effectively and replicate more closely our current division of labor applicable with on-premise implementations. During this period, however, we anticipate higher levels of growth for our service revenues.

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

**Deferred Revenues**

	As of			
	January 31, 2018	July 31, 2017	Change	
	Amount	Amount	(\$)	(%)
	(in thousands, except percentages)			

**Deferred revenues:**

Deferred license and other revenues	\$38,921	\$23,727	\$15,194	64 %
-------------------------------------	----------	----------	----------	------

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

Deferred maintenance revenues	45,109	47,727	(2,618 )	(5 )%
Deferred services revenues	46,862	39,681	7,181	18 %
Total deferred revenues	\$130,892	\$111,135	\$19,757	18 %

Deferred License and Other Revenues

34

---

Table of Contents

The \$15.2 million increase in deferred license and other revenues was primarily a result of the combined effect of net increases in deferrals associated with subscription contracts that are recognized on a ratable basis in addition to net increases in term license billings related to new and existing contracts which will be recognized when all revenue recognition criteria are met.

Deferred Maintenance Revenues

The \$2.6 million decrease in deferred maintenance revenues was primarily driven by the impact from revenues recognized in excess of new billings during the three months ended January 31, 2018, and reflects the seasonal nature of the billings of maintenance revenues. Additionally, subscription arrangements include maintenance as part of the subscription service and are not priced or reported separately. As a result, an increase in the mix of subscription orders in the future will reduce the growth in maintenance revenues and may impact the growth in deferred maintenance revenues.

Deferred Services Revenues

The \$7.2 million increase in deferred services revenues was primarily driven by increased services billings, mainly composed of ongoing InsuranceNow implementations related to acquired contracts which are being deferred until go-live. The increase was partially offset by net recognition in previously deferred billings.

Generally, our deferred revenues consist only of amounts that have been invoiced, but not yet recognized as revenues. As a result, deferred revenues and change in deferred revenues represent incomplete measures of the strength of our business and are not necessarily indicative of our future performance. However, the transition to a greater mix of subscription orders will likely result in higher deferred revenues.

Cost of Revenues and Gross Profit

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

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

Cost of Revenues:

Three  
Months  
Ended  
January  
31,