SEATTLE GENETICS INC /WA
Form 10-Q
July 26, 2016
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2016

OR

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

For the transition period from __________ to __________

Commission file number 0-32405

SEATTLE GENETICS, INC.

(Exact name of registrant as specified in its charter)

Delaware	**91-1874389**
(State or other jurisdiction of	**(I.R.S. Employer**
incorporation or organization)	**Identification No.)**

21823 30th Drive SE

Bothell, Washington 98021

(Address of principal executive offices, including zip code)

(Registrant s telephone number, including area code): (425) 527-4000

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 x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every

Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

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

Large accelerated filer x	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company ¨

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

As of July 20, 2016, there were 140,516,451 shares of the registrant s common stock outstanding.

Table of Contents

Seattle Genetics, Inc. Quarterly

Report on Form 10-Q

For the Quarter Ended June 30, 2016

INDEX

Table of Contents

PART I. FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements

Seattle Genetics, Inc.

Condensed Consolidated Balance Sheets

(Unaudited)

(In thousands, except par value)

	June 30, 2016	December 31, 2015
Assets		
Current assets		
Cash and cash equivalents	$ 192,088	$ 102,255
Short-term investments	416,857	547,396
Accounts receivable, net	57,742	52,930
Inventories	71,675	56,963
Prepaid expenses and other current assets	12,220	11,515
Total current assets	750,582	771,059
Property and equipment, net	51,052	49,598
Long-term investments	50,541	63,060
Other non-current assets	11,111	11,378
Total assets	$ 863,286	$ 895,095
Liabilities and Stockholders Equity		
Current liabilities		
Accounts payable and accrued liabilities	$ 93,574	$ 88,031
Current portion of deferred revenue	34,140	46,235
Total current liabilities	127,714	134,266
Long-term liabilities		
Deferred revenue, less current portion	63,838	71,249
Deferred rent and other long-term liabilities	3,210	3,669
Total long-term liabilities	67,048	74,918
Commitments and contingencies (note 6)		
Stockholders equity		
Preferred stock, $0.001 par value, 5,000 shares authorized; none issued	0	0

Common stock, $0.001 par value, 250,000 shares authorized; 140,476 shares issued and outstanding at June 30, 2016 and 139,674 shares issued and outstanding at December 31, 2015	140	140
Additional paid-in capital	1,648,166	1,613,383
Accumulated other comprehensive income (loss)	368	(683)
Accumulated deficit	(980,150)	(926,929)
Total stockholders equity	668,524	685,911
Total liabilities and stockholders equity	$ 863,286	$ 895,095

The accompanying notes are an integral part of these condensed consolidated financial statements.

Table of Contents

Seattle Genetics, Inc.

Condensed Consolidated Statements of Comprehensive Loss

(Unaudited)

(In thousands, except per share amounts)

	Three months ended June 30, 2016	Three months ended June 30, 2015	Six months ended June 30, 2016	Six months ended June 30, 2015
Revenues				
Net product sales	$ 66,216	$ 55,095	$ 124,864	$ 103,981
Collaboration and license agreement revenues	19,998	14,386	40,174	36,607
Royalty revenues	9,188	7,615	41,519	18,665
Total revenues	95,402	77,096	206,557	159,253
Costs and expenses				
Cost of sales	6,901	5,940	12,845	11,150
Cost of royalty revenues	3,107	2,639	6,722	5,813
Research and development	85,554	85,737	178,425	149,132
Selling, general and administrative	33,282	30,343	63,029	62,464
Total costs and expenses	128,844	124,659	261,021	228,559
Loss from operations	(33,442)	(47,563)	(54,464)	(69,306)
Investment income	699	61	1,243	114
Net loss	$ (32,743)	$ (47,502)	$ (53,221)	$ (69,192)
Net loss per share basic and diluted	$ (0.23)	$ (0.38)	$ (0.38)	$ (0.55)
Shares used in computation of net loss per share basic and diluted	140,283	125,064	140,086	124,690
Comprehensive loss:				
Net loss	$ (32,743)	$ (47,502)	$ (53,221)	$ (69,192)
Other comprehensive income:				
Unrealized gain on securities available for sale	252	23	1,037	41
Foreign currency translation gain	6	0	14	0
Comprehensive loss	$ (32,485)	$ (47,479)	$ (52,170)	$ (69,151)

The accompanying notes are an integral part of these condensed consolidated financial statements.

Table of Contents

Seattle Genetics, Inc.

Condensed Consolidated Statements of Cash Flows

(Unaudited)

(In thousands)

	Six months ended June 30,	
	2016	**2015**
Operating activities		
Net loss	$ (53,221)	$ (69,192)
Adjustments to reconcile net loss to net cash used in operating activities		
Share-based compensation	24,285	17,572
Depreciation and amortization	8,646	7,035
Amortization of premiums and accretion of discounts	3,747	636
Deferred rent and other long-term liabilities	(459)	(371)
Changes in operating assets and liabilities		
Accounts receivable, net	(4,812)	(6,002)
Inventories	(14,712)	(4,038)
Prepaid expenses and other assets	(807)	(561)
Accounts payable and accrued liabilities	6,511	9,130
Deferred revenue	(19,506)	(27,897)
Net cash used in operating activities	(50,328)	(73,688)
Investing activities		
Purchases of securities available for sale	(329,153)	(121,537)
Proceeds from maturities of securities available for sale	469,500	176,900
Proceeds from sales of securities available for sale	0	30,005
Purchases of property and equipment	(10,684)	(4,957)
Purchase of cost-method investment	(0)	(5,000)
Net cash provided by investing activities	129,663	75,411
Financing activities		
Proceeds from exercise of stock options and employee stock purchase plan	10,498	20,363
Net cash provided by financing activities	10,498	20,363
Net increase in cash and cash equivalents	89,833	22,086
Cash and cash equivalents at beginning of period	102,255	56,927
Cash and cash equivalents at end of period	$ 192,088	$ 79,013

The accompanying notes are an integral part of these condensed consolidated financial statements.

Seattle Genetics, Inc.

Notes to Condensed Consolidated Financial Statements

(Unaudited)

1. Summary of significant accounting policies

Basis of presentation

The accompanying unaudited condensed consolidated financial statements reflect the accounts of Seattle Genetics, Inc. and its wholly-owned subsidiaries (collectively Seattle Genetics or the Company). All intercompany transactions and balances have been eliminated. Management has determined that the Company operates in one segment: the development and sale of pharmaceutical products on its own behalf or in collaboration with others. Substantially all of the Company s assets and revenues are related to operations in the United States; however, the Company also has subsidiaries in the United Kingdom, Switzerland and Canada.

The condensed consolidated balance sheet data as of December 31, 2015 were derived from audited financial statements not included in this quarterly report on Form 10-Q. The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission, or SEC, and generally accepted accounting principles in the United States of America, or GAAP, for unaudited condensed consolidated financial information. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. The accompanying unaudited condensed consolidated financial statements reflect all adjustments consisting of normal recurring adjustments which, in the opinion of management, are necessary for a fair statement of the Company s financial position and results of its operations, as of and for the periods presented.

Unless indicated otherwise, all amounts presented in financial tables are presented in thousands, except for per share and par value amounts.

These unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and accompanying notes included in the Company s Annual Report on Form 10-K for the year ended December 31, 2015, as filed with the SEC.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the condensed consolidated financial statements and accompanying notes. Actual results could differ from those estimates. The results of the Company s operations for the three and six month periods ended June 30, 2016 are not necessarily indicative of the results to be expected for the full year.

Non-cash investing activities

The Company had \$4.5 million and \$5.4 million of accrued capital expenditures as of June 30, 2016 and December 31, 2015, respectively. Accrued capital expenditures have been treated as a non-cash investing activity and, accordingly, have not been included in the statement of cash flows until such amounts have been paid in cash.

Other non-current assets

Other non-current assets include a $5.0 million non-controlling investment in a privately-held company that is accounted for under the cost method of accounting. The Company periodically evaluates the carrying value of the investment if significant adverse events or circumstances indicate a possible impairment. As of June 30, 2016, no impairment in value has been observed.

Long-term incentive plans

In May 2016, the Company established a Long-Term Incentive Plan, or LTIP, which provides eligible employees with the ability to receive a performance-based incentive comprised of a cash payment and stock options. The payment of the cash portion and vesting of the stock option portion of the award are contingent upon the achievement of a pre-determined regulatory milestone. The Company records compensation expense for the LTIP over the estimated service period once the achievement of the milestone is considered probable in accordance with the provisions of ASC 450, Contingencies. At each reporting date, the Company assesses whether achievement of the milestone is considered probable, and if so, records compensation expense based on the portion of the service period elapsed to date with a cumulative catch-up, net of estimated forfeitures. The Company recognizes remaining compensation expense, if any, through the end of the estimated service period. As of June 30, 2016, the estimated cash payout was approximately $4.8 million and the unrecognized share based compensation cost for 826,277 performance-based common stock options outstanding was approximately $15.3 million. No compensation expense has been recorded to date under the LTIP.

Table of Contents

Revenue Recognition

The Company s revenues are comprised of ADCETRIS net product sales, amounts earned under its collaboration and licensing agreements and royalties. Revenue recognition is predicated upon persuasive evidence of an agreement existing, delivery of products or services being rendered, amounts payable being fixed or determinable, and collectibility being reasonably assured.

Net product sales

The Company sells ADCETRIS through a limited number of pharmaceutical distributors in the U.S. and Canada. Customers order ADCETRIS through these distributors and the Company typically ships product directly to the customer. The Company records product sales when title and risk of loss pass, which generally occurs upon delivery of the product to the customer. Product sales are recorded net of estimated government-mandated rebates and chargebacks, distribution fees, estimated product returns and other deductions. Accruals are established for these deductions and actual amounts incurred are offset against applicable accruals. The Company reflects these accruals as either a reduction in the related account receivable from the distributor, or as an accrued liability depending on the nature of the sales deduction. Sales deductions are based on management s estimates that consider payer mix in target markets and experience to date. These estimates involve a substantial degree of judgment.

Government-mandated rebates and chargebacks: The Company has entered into a Medicaid Drug Rebate Agreement, or MDRA, with the Centers for Medicare & Medicaid Services. This agreement provides for a rebate based on covered purchases of ADCETRIS. Medicaid rebates are invoiced to the Company by the various state Medicaid programs. The Company estimates Medicaid rebates based on a variety of factors, including its experience to date. The Company has also completed a Federal Supply Schedule, or FSS, agreement under which certain U.S. government purchasers receive a discount on eligible purchases of ADCETRIS. The Company has entered into a Pharmaceutical Pricing Agreement with the Secretary of Health and Human Services, which enables certain entities that qualify for government pricing under the Public Health Services Act, or PHS, to receive discounts on their qualified purchases of ADCETRIS. Under these agreements, distributors process a chargeback to the Company for the difference between wholesale acquisition cost and the applicable discounted price. As a result of the Company s direct-ship distribution model, it can determine the entities purchasing ADCETRIS and this information enables the Company to estimate expected chargebacks for FSS and PHS purchases based on each entity s eligibility for the FSS and PHS programs. The Company also reviews historical rebate and chargeback information to further refine these estimates.

Distribution fees, product returns and other deductions: The Company s distributors charge a volume-based fee for distribution services that they perform for the Company. The Company allows for the return of product that is within 30 days of its expiration date or that is damaged. The Company estimates product returns based on its experience to date. In addition, the Company considers its direct-ship distribution model, its belief that product is typically not held in the distribution channel, and the expected rapid use of the product by healthcare providers. The Company provides financial assistance to qualifying patients that are underinsured or cannot cover the cost of commercial coinsurance amounts through SeaGen Secure. SeaGen Secure is available to patients in the U.S. and its territories who meet various financial and treatment need criteria. Estimated contributions for commercial coinsurance under SeaGen Secure are deducted from gross sales and are based on an analysis of expected plan utilization. These estimates are adjusted as necessary to reflect the Company s actual experience.

Collaboration and license agreement revenues

The Company has developed a proprietary technology for linking cytotoxic agents to monoclonal antibodies called antibody- drug conjugates, or ADCs. This proprietary technology is the basis of ADC collaborations that the Company has entered into in the ordinary course of its business with a number of biotechnology and pharmaceutical companies. Under these ADC collaboration agreements, the Company grants its collaborators research and commercial licenses to the Company s technology and provides technology transfer services, technical advice, supplies and services for a period of time.

If there are continuing performance obligations, the Company uses a time-based proportional performance model to recognize revenue over the Company s performance period for the related agreement. Collaboration and license agreements are evaluated to determine whether the multiple elements and associated deliverables can be considered separate units of accounting. To date, the pre- commercial deliverables under the Company s collaboration and license agreements have not qualified as separate units of accounting. The assessment of multiple element arrangements requires judgment in order to determine the appropriate point in time, or period of time, that revenue should be recognized. The Company believes that the development period in each agreement is a reasonable estimate of the performance obligation period of such agreement. Accordingly, all amounts received or due, including any upfront payments, maintenance fees, development and regulatory milestone payments and reimbursement payments, are recognized as revenue over the performance obligation periods of each agreement. These performance obligation periods typically range from one to three years. The agreements with Takeda Pharmaceutical Company Limited, or Takeda, and Genentech, Inc., a member of the Roche

Table of Contents

Group, or Genentech, have performance obligation periods of ten and eighteen years, respectively. All of the remaining performance obligation periods for our active collaborations are currently expected to be completed in four years or less. When no performance obligations are required of the Company, or following the completion of the performance obligation period, such amounts are recognized as revenue when collectibility is reasonably assured. Generally, all amounts received or due other than sales- based milestones and royalties are classified as collaboration and license agreement revenues as they are earned. Sales-based milestones and royalties are recognized as royalty revenue as they are reported to the Company.

The Company s collaboration and license agreements include contractual milestones. Generally, the milestone events contained in the Company s collaboration and license agreements coincide with the progression of the collaborators product candidates from development, to regulatory approval and then to commercialization and fall into the following categories.

Development milestones in the Company s collaborations may include the following types of events:

- Designation of a product candidate or initiation of preclinical studies. The Company s collaborators must undertake significant preclinical research and studies to make a determination of the suitability of a product candidate and the time from those studies or designation to initiation of a clinical trial may take several years.
- Initiation of a phase 1 clinical trial. Generally, phase 1 clinical trials may take one to two years to complete.
- Initiation of a phase 2 clinical trial. Generally, phase 2 clinical trials may take one to three years to complete.
- Initiation of a phase 3 clinical trial. Generally, phase 3 clinical trials may take two to six years to complete.

Regulatory milestones in the Company s collaborations may include the following types of events:

- Filing of regulatory applications for marketing approval such as a Biologics License Application in the United States or a Marketing Authorization Application in Europe. Generally, it may take up to twelve months to prepare and submit regulatory filings.
- Receiving marketing approval in a major market, such as in the United States, Europe, Japan or other significant countries. Generally it may take up to three years after a marketing application is submitted to obtain approval for marketing and pricing from the applicable regulatory agency.

Commercialization milestones in the Company s collaborations may include the following types of events:

- First commercial sale in a particular market, such as in the United States, Europe, Japan or other significant countries.

Product sales in excess of a pre-specified threshold. The amount of time to achieve this type of milestone depends on several factors, including, but not limited to, the dollar amount of the threshold, the pricing of the product, market penetration of the product and the rate at which customers begin using the product.

The Company s ADC collaborators are solely responsible for the development of their product candidates and the achievement of milestones in any of the categories identified above is based solely on the collaborators efforts.

In the case of the Company s ADCETRIS collaboration with Takeda, the Company may be involved in certain development activities; however, the achievement of milestone events under the agreement is primarily based on activities undertaken by Takeda.

The process of successfully developing a product candidate, obtaining regulatory approval and ultimately commercializing a product candidate is highly uncertain and the attainment of any milestones is therefore uncertain and difficult to predict. In addition, since the Company does not take a substantive role or control the research, development or commercialization of any products generated by its ADC collaborators, the Company is not able to reasonably estimate when, if at all, any milestone payments or royalties may be payable to the Company by its ADC collaborators. As such, the milestone payments associated with its ADC collaborations involve a substantial degree of uncertainty and risk that they may never be received. Similarly, even in those collaborations where the Company may have an active role in the development of the product candidate, such as the Company s ADCETRIS collaboration with Takeda, the attainment of a milestone is based on the collaborator s activities and is generally outside the direction and control of the Company.

The Company generally invoices its collaborators and licensees on a monthly or quarterly basis, or upon the completion of the effort or achievement of a milestone, based on the terms of each agreement. Deferred revenue arises from amounts received in advance of the culmination of the earnings process and is recognized as revenue in future periods when the applicable revenue recognition criteria have been met. Deferred revenue expected to be recognized within the next twelve months is classified as a current liability.

Royalty revenues and cost of royalty revenues

Royalty revenues primarily reflect amounts earned under the ADCETRIS collaboration with Takeda. These royalties include sales royalties, which are based on a percentage of Takeda s net sales at rates that range from the mid-teens to the mid-twenties based on sales volume, and commercial sales-based milestones. Takeda bears a portion of third-party royalty costs owed on its sales of ADCETRIS. This amount is included in royalty revenue in the Company s consolidated financial statements. Cost of royalty revenues reflects amounts owed to the Company s third party licensors related to Takeda s sales of ADCETRIS. These amounts are recognized in the quarter in which Takeda reports its sales activity to the Company, which is the quarter following the related sales. Royalty revenues also include amounts earned in connection with the Company s ADC collaborations.

Recent accounting pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued an Accounting Standards Update entitled ASU 2014-09, Revenue from Contracts with Customers. The standard requires entities to recognize revenue through an evaluation that includes identification of the contract, identification of the performance obligations, determination of the transaction price, allocation of the transaction price to the performance obligations, and recognition of revenue as the entity satisfies the performance obligations. In August 2015, FASB issued an Accounting Standards Update entitled ASU 2015-14, Revenue from Contracts with Customers: Deferral of the Effective Date , which defers the effective date of ASU 2014-09 to the Company s fiscal year beginning January 1, 2018. The FASB has continued to issue accounting standards updates to clarify and provide implementation guidance related to Revenue from Contracts with Customers, including ASU 2016-08, Revenue from Contract with Customers: Principal versus Agent Considerations , ASU 2016-10, Revenue from Contracts with Customers: Identifying Performance Obligations and Licensing , and ASU 2016-12, Revenue from Contracts with Customers: Narrow-Scope Improvements and Practical Expedients. The Company is currently evaluating the guidance to determine the potential impact on its financial condition, results of operations and cash flows, and financial statement disclosures.

In January 2016, FASB issued an Accounting Standards Update entitled ASU 2016-01, Financial Instruments: Overall. The standard addresses certain aspects of recognition, measurement, presentation and disclosure of financial instruments. The standard will become effective for the Company beginning January 1, 2018. The Company is currently evaluating the guidance to determine the potential impact on its financial condition, results of operations and cash flows, and financial statement disclosures.

In February 2016, FASB issued an Accounting Standards Update entitled ASU 2016-02, Leases. The standard requires entities to recognize in the consolidated balance sheet a liability to make lease payments and a right-of-use asset representing its right to use the underlying asset for the lease term. The standard will become effective for the Company beginning January 1, 2019, with early adoption permitted. The Company is currently evaluating the guidance to determine the potential impact on its financial condition, results of operations and cash flows, and financial statement disclosures.

In March 2016, FASB issued an Accounting Standard Update entitled ASU 2016-09, Compensation Stock Compensation. The standard is intended to simplify certain elements of accounting for share-based payment transactions, including the income tax consequences and classification on the statement of cash flows. The standards will become effective for the Company beginning on January 1, 2017, with early adoption permitted. The Company is currently evaluating the guidance to determine the potential impact on its financial condition, results of operations and cash flows, and financial statement disclosures.

In June 2016, FASB issued an Accounting Standard Update entitled ASU 2016-13, Financial Instruments: Credit Losses . The objective of the standard is to provide information about expected credit losses on financial instruments at each reporting date, and to change how other than temporary impairments on investments securities are recorded. The standard will become effective for the Company beginning on January 1, 2020 with early adoption permitted. The Company is currently evaluating the guidance to determine the potential impact on its financial condition, results of operations and cash flows, and financial statement disclosures.

2. Net Loss per share

Basic and diluted net loss per share is computed by dividing net loss by the weighted average number of common shares outstanding during the period. The Company excluded all restricted stock units and options to purchase common stock from the calculation of basic and diluted net loss per share as such securities are anti-dilutive for all periods presented. The weighted-average number of restricted stock units and options to purchase common stock that have been excluded from the number of shares used to calculate basic and diluted net loss per share totaled 12,548,000 and 11,406,000 for the three months ended June 30, 2016 and 2015, and 12,432,000 and 11,803,000 for the six months ended June 30, 2016 and 2015, respectively.

3. Investments

Investments consisted of available-for-sale securities as follows (in thousands):

Table of Contents

	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
June 30, 2016				
U.S. Treasury securities	$ 467,032	$ 378	$ (12)	$ 467,398
Contractual Maturities				
Due in one year or less	$ 241,024			$ 241,071
Due in one to two years	226,008			226,327
Total	$ 467,032			$ 467,398

	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
December 31, 2015				
U.S. Treasury securities	$ 611,128	$ 1	$ (673)	$ 610,456
Contractual Maturities				
Due in one year or less	$ 532,823			$ 532,418
Due in one to two years	78,305			78,038
Total	$ 611,128			$ 610,456

The Company classifies investments maturing within one year of the reporting date as short-term investments. Investments are presented in the accompanying consolidated balance sheets as follows (in thousands):

	June 30, 2016	December 31, 2015
Short-term investments	$ 416,857	$ 547,396
Long-term investments	50,541	63,060
Total	$ 467,398	$ 610,456

The aggregate estimated fair value of the Company s investments with unrealized losses was as follows (in thousands):

	Period of continuous unrealized loss			
	12 Months or less		Greater than 12 months	
	Fair value	Gross unrealized losses	Fair value	Gross unrealized losses
June 30, 2016				
U.S. Treasury securities	$ 65,801	$ (12)	$ NA	$ NA

December 31, 2015				
U.S. Treasury securities	$ 605,457	$ (673)	$ NA	$ NA

4. Fair value

The Company holds short-term and long-term available-for-sale securities that are measured at fair value which is determined on a recurring basis according to a fair value hierarchy that prioritizes the inputs and assumptions used, and the valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are described as follows:

Table of Contents

Level 1: Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.

Level 2: Quoted prices in markets that are not active or financial instruments for which all significant inputs are observable, either directly or indirectly.

Level 3: Prices or valuations that require inputs that are both significant to the fair value measurement and unobservable.

The determination of a financial instrument s level within the fair value hierarchy is based on an assessment of the lowest level of any input that is significant to the fair value measurement. The Company considers observable data to be market data which is readily available, regularly distributed or updated, reliable and verifiable, not proprietary, and provided by independent sources that are actively involved in the relevant market.

Level 1 investments, which include investments that are valued based on quoted market prices in active markets, consisted of U.S. Treasury securities. The Company did not hold any Level 2 or 3 investments as of June 30, 2016 or December 31, 2015 and did not transfer any investments between Levels 1, 2 and 3 during the six month period ended June 30, 2016.

The following table presents the Company s available-for-sale securities by level within the fair value hierarchy for the periods presented (in thousands):

	Fair value measurement using:			
	Quoted prices in active markets for identical assets (Level 1)	**Other observable inputs (Level 2)**	**Significant unobservable inputs (Level 3)**	**Total**
As of June 30, 2016				
Short-term investments U.S. Treasury securities	$ 416,857	$ 0	$ 0	$ 416,857
Long-term investments U.S. Treasury securities	50,541	0	0	50,541
Total	$ 467,398	$ 0	$ 0	$ 467,398

	Fair value measurement using:			
	Quoted prices in active markets for identical assets (Level 1)	**Other observable inputs (Level 2)**	**Significant unobservable inputs (Level 3)**	**Total**

As of December 31, 2015								
Short-term investments	U.S. Treasury securities	$ 547,396	$	0	$	0	$ 547,396
Long-term investments	U.S. Treasury securities	63,060		0		0	63,060
Total		$ 610,456	$	0	$	0	$ 610,456

5. Inventories

The following table presents the Company s inventories of ADCETRIS (in thousands):

	June 30, 2016		December 31, 2015
Raw materials	$ 43,967	$	50,501
Work in process	21,167		1,693
Finished goods	6,541		4,769
Total	$ 71,675	$	56,963

Table of Contents

The Company capitalizes ADCETRIS inventory costs. ADCETRIS inventory that is deployed into clinical, research or development use is charged to research and development expense when it is no longer available for use in commercial sales. The Company does not capitalize manufacturing costs for any of its product candidates.

6. Legal matters

The Company is involved in various legal proceedings in the normal course of its business. The Company does not expect any current legal proceedings to have a material adverse effect on the Company s business. Legal fees incurred as a result of the Company s involvement in legal procedures are expensed as incurred.

7. Subsequent events

In July 2016, the Company established a second Long Term Incentive Plan, or the Second LTIP, which provides eligible employees with performance-based cash and restricted stock unit award incentives contingent upon the achievement of pre-determined regulatory milestones. The estimated value to be delivered in cash and restricted stock units under this plan at its inception was approximately $19.9 million. The Company will record compensation expense for the Second LTIP over the estimated service period for each milestone if the achievement of the milestone is considered probable in accordance with the provisions of ASC 450, Contingencies. At each reporting date, the Company will assess whether achievement of a milestone is considered probable, and if so, will record compensation expense for the Second LTIP based on the portion of the service period elapsed to date with respect to that milestone, with a cumulative catch-up, net of estimated forfeitures. The Company will recognize remaining compensation expense for the Second LTIP, if any, with respect to that milestone, through the end of the estimated service period.

Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations
Forward-Looking Statements

The following discussion of our financial condition and results of operations contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Forward-looking statements are based on our management s beliefs and assumptions and on information currently available to our management. All statements other than statements of historical facts are forward-looking statements for purposes of these provisions, including those relating to future events or our future financial performance and financial guidance. In some cases, you can identify forward-looking statements by terminology such as may, might, will, should, expect, plan, anticipate, project, believe, estimate, predict, potential, intend or continue, the negative of terms like these or other comparable terminology, and other words or terms of similar meaning in connection with any discussion of future operating or financial performance. These statements are only predictions. All forward-looking statements included in this Quarterly Report on Form 10-Q are based on information available to us on the date hereof, and we assume no obligation to update any such forward-looking statements except as required by law. Any or all of our forward-looking statements in this document may turn out to be incorrect. Actual events or results may differ materially. Our forward-looking statements can be affected by inaccurate assumptions we might make or by known or unknown risks, uncertainties and other factors. We discuss many of these risks, uncertainties and other factors in this Quarterly Report on Form 10-Q in greater detail under the heading Item 1A Risk Factors. We caution investors that our business and financial performance are subject to substantial risks and uncertainties.

Overview

Seattle Genetics is a biotechnology company focused on the development and commercialization of targeted therapies for the treatment of cancer. Our marketed product ADCETRIS®, or brentuximab vedotin, is now approved by the United States Food and Drug Administration, or FDA, and the European Commission for three indications, encompassing several settings for the treatment of relapsed Hodgkin lymphoma and relapsed systemic anaplastic large cell lymphoma, or sALCL. ADCETRIS is commercially available in 65 countries around the world, including in the United States, Canada, members of the European Union and Japan. We are collaborating with Takeda Pharmaceutical Company Limited, or Takeda, to develop and commercialize ADCETRIS on a global basis. Under this collaboration, Seattle Genetics retains commercial rights for ADCETRIS in the United States and its territories and in Canada, and Takeda has commercial rights in the rest of the world.

Beyond our current labeled indications, we and Takeda have a broad development strategy for ADCETRIS evaluating its therapeutic potential in earlier lines of therapy for patients with Hodgkin lymphoma or mature T-cell lymphoma, or MTCL, including sALCL, and in other CD30-expressing malignancies. We and Takeda are currently conducting three phase 3 clinical trials of ADCETRIS: ALCANZA, ECHELON-1 and ECHELON-2, which are being conducted in relapsed CD30-expressing cutaneous T-cell lymphoma, or CTCL, frontline classical Hodgkin lymphoma, and frontline CD30-expressing MTCL, respectively. All of these trials are being conducted under Special Protocol Assessment, or SPA, agreements with the FDA and pursuant to scientific advice from the European Medicines Agency. An SPA is an agreement with the FDA regarding the design of the clinical trial, including size and clinical endpoints, to support an efficacy claim in a Biologics License Application, or BLA, submission to the FDA if the trial achieves its primary endpoints. We expect to report data from the ALCANZA trial in the third quarter of 2016, from the ECHELON-1 trial in the 2017 through mid-2018 timeframe, and from the ECHELON-2 trial in the 2017 to 2018 timeframe.

In addition to our continued development of ADCETRIS, we are also advancing the development of SGN-CD33A, or vadastuximab talirine. A phase 3 clinical trial, called the CASCADE trial, was initiated in the second quarter of 2016 based on data from our ongoing phase 1 clinical trial. The CASCADE trial is evaluating SGN-CD33A in combination with hypomethylating agents, or HMAs, in previously untreated older acute myeloid leukemia, or AML, patients who are not candidates for intensive induction chemotherapy. We are also evaluating SGN-CD33A broadly across multiple lines of therapy in patients with myeloid malignancies, including in ongoing phase 1 and 2 clinical trials for newly diagnosed or relapsed AML patients and for previously untreated myelodysplastic syndrome, or MDS, patients.

Our clinical-stage pipeline also includes six other antibody-drug conjugate, or ADC, programs consisting of SGN-CD19A, or denintuzumab mafodotin, SGN-LIV1A, ASG-22ME or enfortumab vedotin, ASG-15ME, SGN-CD70A and SGN-CD19B, and an immuno-oncology agent called SEA-CD40, which is based on our sugar-engineered antibody, or SEA, technology. In addition, we have multiple preclinical and research-stage programs that employ our proprietary technologies, including SGN-CD123A and SGN-CD352A, two preclinical ADC product candidates that we expect to enter clinical trials during 2016.

We have collaborations for our ADC technology with a number of biotechnology and pharmaceutical companies, including AbbVie Biotechnology Ltd., or AbbVie; Bayer Pharma AG, or Bayer; Celldex Therapeutics, Inc., or Celldex; Genentech, Inc., a member of the Roche Group, or Genentech; GlaxoSmithKline LLC, or GSK; Pfizer, Inc., or Pfizer; PSMA Development

Table of Contents

Company LLC, a subsidiary of Progenics Pharmaceuticals Inc., or Progenics; and Takeda; as well as ADC co-development agreements with Astellas Pharma, Inc., or Astellas; and Genmab A/S, or Genmab. We also have a collaboration with Unum Therapeutics, Inc., or Unum, to develop and commercialize novel antibody-coupled T-cell receptor, or ACTR, therapies incorporating our antibodies for the treatment of cancer.

Our ongoing research, development and commercial activities will require substantial amounts of capital and may not ultimately be successful. Over the next several years, we expect that we will incur substantial expenses, primarily as a result of activities related to the commercialization of ADCETRIS, and the continued development of ADCETRIS and SGN-CD33A. Our other product candidates are in relatively early stages of development; SGN-CD33A and our other product candidates will require significant further development, financial resources and personnel to pursue and obtain regulatory approval and develop into commercially viable products, if at all. Our commitment of resources to the continuing development, regulatory and commercialization activities for ADCETRIS and the research, continued development and manufacturing of our product candidates may require us to raise substantial amounts of additional capital and our operating expenses will fluctuate as a result of such activities. In addition, we may incur significant milestone payment obligations to certain of our licensors as our product candidates progress through clinical trials towards potential commercialization.

We recognize revenue from ADCETRIS product sales in the United States and Canada. Our future ADCETRIS product sales will be difficult to accurately predict from period to period. In this regard, our product sales have varied, and may continue to vary, significantly from period to period and may be affected by a variety of factors. Such factors include the incidence rate of new patients in ADCETRIS approved indications, customer ordering patterns, the overall level of demand for ADCETRIS, the duration of therapy for patients receiving ADCETRIS, and the extent to which coverage and reimbursement for ADCETRIS is available from government and other third-party payers. Obtaining and maintaining appropriate coverage and reimbursement for ADCETRIS is increasingly challenging due to, among other things, the attention being paid to healthcare cost containment and other austerity measures in the U.S. and worldwide, as well as increasing legislative and enforcement interest in the United States with respect to pharmaceutical drug pricing practices. We also believe that the level of our current ADCETRIS sales in the United States has been attributable to the incidence flow of patients eligible for treatment with ADCETRIS, which can vary significantly from period to period. Moreover, we believe that the incidence rate in ADCETRIS approved indications is relatively low, particularly when compared to many other oncology indications. In addition, we expect only modest sales growth in the near term as a result of the approval by the FDA in August 2015 of ADCETRIS for post-autologous hematopoietic stem cell transplantation, or auto-HSCT, consolidation treatment in classical Hodgkin lymphoma patients with high risk of relapse or progression, subject to our ability to effectively commercialize ADCETRIS in this indication. For these and other reasons, we expect that our ability to accelerate ADCETRIS sales growth, if at all, will depend primarily on our ability to continue to expand ADCETRIS labeled indications of use. Our efforts to continue to expand ADCETRIS labeled indications of use will continue to require additional time and investment in clinical trials to complete and may not be successful. Our ability to successfully commercialize ADCETRIS and to continue to expand its labeled indications of use are subject to a number of risks and uncertainties, including those discussed in Part II, Item 1A of this Quarterly Report on Form 10-Q. In particular, negative or inconclusive results in our ALCANZA, ECHELON-1, and ECHELON-2 trials would negatively impact, or preclude altogether, our ability to obtain regulatory approval in the relapsed CTCL, frontline Hodgkin lymphoma, and frontline MTCL indications, respectively, any of which could limit our sales of, and the commercial potential of, ADCETRIS. In addition, the ECHELON-2 trial is a post-approval commitment trial for the ADCETRIS label in sALCL. We also expect that amounts earned from our collaboration agreements, including royalties, will continue to be an important source of our revenues and cash flows. These revenues will be impacted by future development funding and the achievement of development, clinical and commercial success by our collaborators under our existing collaboration and license agreements, including, in particular, our ADCETRIS collaboration with Takeda, as well as entering into new collaboration and license agreements. Our results of operations may vary substantially from year to year and from quarter to quarter and, as a result, we believe that period to period comparisons of our operating results may not be meaningful and should not be relied upon as being indicative of our future performance.

Financial summary

For the six months ended June 30, 2016, total revenues increased to $206.6 million, compared to $159.3 million for the same period in 2015. This increase was driven primarily by increased royalty revenues and ADCETRIS net product sales. During the first quarter of 2016, royalty revenues included a one-time $20.0 million milestone payment triggered by Takeda exceeding $200 million in annual net sales of ADCETRIS in its territory during 2015. Net product sales of ADCETRIS were $124.9 million for the six months ended June 30, 2016, compared to $104.0 million for the six months ended June 30, 2015. For the six months ended June 30, 2016, total costs and expenses increased to $261.0 million, compared to $228.6 million for the same period in 2015. This primarily reflects increased investment in ADCETRIS and SGN-CD33A, as well as investment in our growing pipeline of preclinical and clinical-stage programs. As of June 30, 2016, we had $659.5 million in cash equivalents and investments, and $668.5 million in total stockholders equity.

Table of Contents

Results of operations

Three months and six months ended June 30, 2016 and 2015

Net product sales

We sell ADCETRIS in the U.S. and Canada. Our net product sales were as follows:

	Three months ended June 30,			Six months ended June 30,		
	2016	2015	% Change	2016	2015	% Change
Net product sales	$ 66,216	$ 55,095	20%	$ 124,864	$ 103,981	20%

The increase in net product sales for the three and six months ended June 30, 2016 over the comparable periods in 2015 primarily resulted from an increase in sales volume in the 2016 periods and, to a lesser extent, from the effect of price increases instituted since the 2015 periods. The increase in sales volume in 2016 was primarily driven by increased use of ADCETRIS across multiple lines of therapy for the treatment of Hodgkin lymphoma including the post-auto-HSCT consolidation indication and for treatment of other CD30-expressing malignancies. ADCETRIS received approval from the FDA in 2011 for the treatment of patients with classical Hodgkin lymphoma after failure of auto-HSCT or after failure of at least two prior multi-agent chemotherapy regimens in patients who are not auto-HSCT candidates, and for the treatment of patients with sALCL, after failure of at least one prior multi-agent chemotherapy regimen. In August 2015, ADCETRIS was approved by the FDA for the treatment of patients with classical Hodgkin lymphoma at high risk of relapse or progression as post-auto-HSCT consolidation.

While we expect modest growth in ADCETRIS sales in 2016 as compared to 2015, our ability to accelerate the rate of ADCETRIS sales growth in future periods, if at all, will be primarily dependent on our ability to continue to expand ADCETRIS labeled indications of use. Our efforts to expand ADCETRIS labeled indications of use will continue to require additional time and investment in clinical trials to complete and may not be successful.

We sell ADCETRIS through a limited number of pharmaceutical distributors. Customers order ADCETRIS through these distributors and we typically ship product directly to the customer. We record product sales when title and risk of loss pass, which generally occurs upon delivery of the product to the customer. Product sales are recorded net of estimated government-mandated rebates and chargebacks, distribution fees, estimated product returns and other deductions. These are generally referred to as gross-to- net deductions. Accruals are established for these deductions and actual amounts incurred are offset against applicable accruals. We reflect these accruals as either a reduction in the related account receivable from the distributor, or as an accrued liability depending

on the nature of the sales deduction. Sales deductions are based on our estimates that consider payer mix in target markets and our experience to date. These estimates involve a substantial degree of judgment.

Government-mandated rebates and chargebacks: We have entered into a Medicaid Drug Rebate Agreement with the Centers for Medicare & Medicaid Services. This agreement provides for a rebate to participating states based on covered purchases of ADCETRIS. Medicaid rebates are invoiced to us by the various state Medicaid programs. We estimate Medicaid rebates based on a variety of factors, including our experience to date. We also have completed our Federal Supply Schedule, or FSS, agreement under which certain U.S. government purchasers receive a discount on eligible purchases of ADCETRIS. We have entered into a Pharmaceutical Pricing Agreement with the Secretary of

Health and Human Services which enables certain entities that qualify for government pricing under the Public Health Services Act, or PHS, to receive discounts on their qualified purchases of ADCETRIS. Under these agreements, distributors process a chargeback to us for the difference between wholesale acquisition cost and the applicable discounted price. As a result of our direct-ship distribution model, we can identify the entities purchasing ADCETRIS and this information enables us to estimate expected chargebacks for FSS and PHS purchases based on each entity s eligibility for the

FSS and PHS programs. We also review actual rebate and chargeback information to further refine these estimates.

Distribution fees, product returns and other deductions: Our distributors charge a volume-based fee for distribution services that they perform for us. We allow for the return of product that is within 30 days of its expiration date or that is damaged. We estimate product returns based on our experience to date. In addition, we consider our direct-ship distribution model, our belief that product is typically not held in the distribution channel, and the expected rapid use of the product by healthcare providers. We provide financial assistance to qualifying patients that are underinsured or cannot cover the cost of commercial coinsurance amounts through SeaGen Secure. SeaGen Secure is available to patients in the U.S. and its territories who meet various financial and treatment need criteria. Estimated contributions for commercial coinsurance under SeaGen Secure are deducted from gross sales and are based on an analysis of expected plan utilization. These estimates are adjusted as necessary to reflect our actual experience.

Table of Contents

Gross-to-net deductions, net of related payments and credits, are summarized as follows (in thousands):

	Rebates and chargebacks	Distribution fees, product returns and other	Total
Balance as of December 31, 2015	$ 7,111	$ 2,359	$ 9,470
Provision related to current period sales	33,091	3,022	36,113
Adjustment for prior period sales	(506)	(31)	(537)
Payments/credits for current period sales	(27,178)	(2,001)	(29,179)
Payments/credits for prior period sales	(3,867)	(809)	(4,676)
Balance as of June 30, 2016	$ 8,651	$ 2,540	$ 11,191

Mandatory government discounts are the most significant component of our total gross to net deductions and the discount percentage has been increasing. These discount percentages increased during the three and six months ended June 30, 2016 over the comparable periods in 2015 as a result of price increases we instituted that exceeded the rate of inflation, and to a lesser extent, as a result of an increase in sales eligible for government mandated rebates or chargebacks. Generally, the change in government prices is limited to the rate of inflation. We expect future gross-to-net deductions to fluctuate based on the volume of purchases eligible for government mandated discounts and rebates, as well as changes in the discount percentage which is impacted by potential future price increases, the rate of inflation, and other factors.

Collaboration and license agreement revenues

Our proprietary ADC technologies are the basis of our ADC collaborations that we have entered into in the ordinary course of business with a number of biotechnology and pharmaceutical companies. Under these ADC collaboration agreements, we grant our collaborators research and commercial licenses to our technology and typically provide technology transfer services, technical advice, supplies and services for a period of time.

If there are continuing performance obligations, we use a time-based proportional performance model to recognize revenue over our performance period for the related agreement. Collaboration and license agreements are evaluated to determine whether the multiple elements and associated deliverables can be considered separate units of accounting. To date, the pre-commercial deliverables under our collaboration and license agreements have not qualified as separate units of accounting. The assessment of multiple element arrangements requires judgment in order to determine the appropriate point in time, or period of time, that revenue should be recognized. We believe that the development period in each agreement is a reasonable estimate of the performance obligation period of such agreement. Accordingly, all amounts received or due, including any upfront payments, maintenance fees, development and regulatory milestone payments and reimbursement payments, are recognized as revenue over the performance obligation periods of each agreement. These performance obligation periods typically range from one to three years. The agreements with Takeda and Genentech have performance obligation periods of ten and eighteen years, respectively. All of the remaining performance obligation periods for our active collaborations are currently expected to be completed in four years or less. When we have no further performance obligations or following the completion of the performance obligation period, such amounts are recognized as revenue when collectibility is reasonably assured. Generally, all amounts received or due other than sales-based milestones and royalties are classified as collaboration and license agreement revenues as they are earned. Sales-based milestones and royalties are recognized as royalty revenue as they are reported to us.

Our collaboration and license agreements include contractual milestones. Generally, the milestone events contained in our collaboration and license agreements coincide with the progression of the collaborators product candidates from development to regulatory approval and then to commercialization.

Development milestones in our collaborations may include the following types of events:

Designation of a product candidate or initiation of preclinical studies. Our collaborators must undertake significant pre- clinical research and studies to make a determination of the suitability of a product candidate and the time from those studies or designation to initiation of a clinical trial may take several years.

Initiation of a phase 1 clinical trial. Generally, phase 1 clinical trials may take one to two years to complete.

Initiation of a phase 2 clinical trial. Generally, phase 2 clinical trials may take one to three years to complete.

Initiation of a phase 3 clinical trial. Generally, phase 3 clinical trials may take two to six years to complete.

Table of Contents

Regulatory milestones in our collaborations may include the following types of events:

- Filing of regulatory applications for marketing approval such as a BLA in the United States or a Marketing Authorization Application in Europe. Generally, it may take up to twelve months to prepare and submit regulatory filings.

- Receiving marketing approval in a major market, such as in the United States, Europe, Japan or other significant countries. Generally it may take up to three years after a marketing application is submitted to obtain approval for marketing and pricing from the applicable regulatory agency.

Commercialization milestones in our collaborations may include the following types of events:

- First commercial sale in a particular market, such as in the United States, Europe, Japan or other significant countries.

- Product sales in excess of a pre-specified threshold. The amount of time to achieve this type of milestone depends on several factors, including, but not limited to, the dollar amount of the threshold, the pricing of the product, market penetration of the product and the rate at which customers begin using the product.

Our ADC collaborators are solely responsible for the development of their product candidates and the achievement of milestones in any of the categories identified above is based solely on the collaborators efforts.

In the case of our ADCETRIS collaboration with Takeda, we may be involved in certain development activities; however, the achievement of development, regulatory and commercial milestone events under the agreement is primarily based on activities undertaken by Takeda.

The process of successfully developing a product candidate, obtaining regulatory approval and ultimately commercializing a product candidate is highly uncertain and the attainment of any milestones is therefore uncertain and difficult to predict. In addition, since we do not take a substantive role or control the research, development or commercialization of any products generated by our ADC collaborators, we are not able to reasonably estimate when, if at all, any milestone payments or royalties may be payable to us by our ADC collaborators. As such, the milestone payments associated with our ADC collaborations involve a substantial degree of uncertainty and risk that they may never be received. Similarly, even in those collaborations where we may have an active role in the development of the product candidate, such as our ADCETRIS collaboration with Takeda, the attainment of a milestone is based on the collaborator s activities and is generally outside our direction and control.

We generally invoice our collaborators and licensees on a monthly or quarterly basis, or upon the completion of the effort or achievement of a milestone, based on the terms of each agreement. Any deferred revenue arising from amounts received in advance of the culmination of the earnings process is recognized as revenue in future periods when the applicable revenue recognition criteria have been met. Deferred revenue expected to be recognized within the next twelve months is classified as a current liability.

Collaboration and license agreement revenues by collaborator are summarized as follows:

	Three months ended June 30,			Six months ended June 30,		
oration and license agreement revenue by collaborator ($ in thousands)	**2016**	**2015**	**% Change**	**2016**	**2015**	**% C**
a	$ 9,556	$ 1,670	472%	$ 22,442	$ 6,563	2
e	6,289	6,899	(9%)	10,494	17,849	
tech	926	1,710	(46%)	2,331	3,255	
	0	2,000	(100%)	251	2,001	
	3,227	2,107	53%	4,656	6,939	
	$ 19,998	$ 14,386	39%	$ 40,174	$ 36,607	

Collaboration revenues earned under our ADCETRIS and ADC collaborations with Takeda increased during the three and six months ended June 30, 2016 from the comparable periods in 2015, primarily driven by an increase in development cost reimbursement funding under the ADCETRIS collaboration. The higher reimbursement primarily reflects a decrease in clinical trial costs related to activity performed by Takeda as the ALCANZA and ECHELON-1 studies advanced, and an increase in drug product supply activities to Takeda.

Changes in revenues recognized from our AbbVie, Bayer and other collaboration agreements, which include our ADC collaborations and our co-development collaborations, reflect the timing of development milestones and licensing fees.

Table of Contents

Our collaboration and license agreement revenues are impacted by the term and duration of our collaboration agreements and by progress-dependent milestones, annual maintenance fees and reimbursement of materials and support services. Collaboration and license agreement revenues may vary substantially from year to year and quarter to quarter depending on the progress made by our collaborators with their product candidates, the level of support we provide to our collaborators, specifically to Takeda under our ADCETRIS collaboration, the timing of milestones achieved and our ability to enter into additional collaboration and co-development agreements. We expect our collaboration and license agreement revenues to increase in 2016, primarily from an increase in development funding from Takeda resulting from development and product supply activities expected to be performed by us under the ADCETRIS collaboration. We have a significant balance of deferred revenue, representing prior payments from our collaborators that have not yet been recognized as revenue. This deferred revenue will be recognized as revenue in future periods using a time-based approach as we fulfill our performance obligations.

Collaboration Agreements

Takeda

Our ADCETRIS collaboration with Takeda provides for the global co-development of ADCETRIS by the companies and the commercialization of ADCETRIS by Takeda in its territory. We received an upfront payment and have received and are entitled to receive progress-dependent milestone payments based on Takeda s achievement of certain events related to ADCETRIS development. Additionally, the companies equally co-fund the cost of development activities conducted under the collaboration. We recognize as collaboration revenue the upfront payment, progress-dependent development and regulatory milestone payments, and net development cost reimbursement payments from Takeda over the ten-year development period of the collaboration, which began in December 2009. When the performance of development activities under the collaboration results in us making a reimbursement payment to Takeda, the effect is to reduce the amount of collaboration revenue that we record. We also receive reimbursement for the cost of drug product supplied to Takeda for its use and, in some cases, pay Takeda for drug product they supply to us. The earned portion of net collaboration payments is reflected as a component of collaboration revenue.

As of June 30, 2016, future potential milestone payments to us under the ADCETRIS collaboration could total approximately $165 million. Of the remaining amount, up to approximately $7 million relates to the achievement of development milestones, up to approximately $118 million relates to the achievement of regulatory milestones and up to approximately $40 million relates to the achievement of a commercial milestone. To date, $70 million in milestones have been achieved as a result of regulatory and commercial progress by Takeda.

Astellas Co-development Agreement

In January 2007, we entered into an agreement with Astellas to jointly research, develop and commercialize ADCs for the treatment of several types of cancer. The collaboration encompasses combinations of our ADC technology with fully-human antibodies developed by Astellas to proprietary cancer targets. Under this collaboration, Astellas conducted research and development aimed at identifying ADC product candidates for multiple designated antigens and is now conducting clinical trials on various ADC product candidates.

Under the collaboration agreement, we and Astellas are co-funding all development and commercialization costs for ASG-22ME and ASG-15ME, and will share equally in any profits that may come from these product candidates if successfully commercialized. Costs associated with co-development activities are included in research and development expense.

Astellas is developing other ADC product candidates on its own, subject to paying us annual maintenance fees, milestones, royalties and support fees for research and development services and material provided under the collaboration agreement. Amounts received for product candidates being developed solely by Astellas are recognized as revenue.

ADC Collaboration Agreements

We have other active collaborations with a number of companies to allow them to use our proprietary ADC technology. Under our ADC collaborations, which we enter into in the ordinary course of business, we typically receive or are entitled to receive upfront cash payments, progress-dependent milestones and royalties on net sales of products incorporating our ADC technology, as well as annual maintenance fees and support fees for research and development services and materials provided under the agreements. These amounts are recognized as revenue as they are realized, or over the performance obligation period of the agreements during which we provide limited support to the collaborator. Our ADC collaborators are responsible for development, manufacturing and commercialization of any ADC product candidates that result from the collaborations and are solely responsible for the achievement of the potential milestones under these collaborations.

Table of Contents

As of June 30, 2016, our ADC collaborations and co-development agreements had generated more than $325 million, primarily in the form of upfront payments. Total milestone payments to us under our current ADC collaboration and co-development agreements could total up to approximately $4.1 billion if all potential product candidates achieved all of their milestone events. Of this amount, approximately $0.7 billion relates to the achievement of development milestones, approximately $1.6 billion relates to the achievement of regulatory milestones and approximately $1.8 billion relates to the achievement of commercial milestones. Since we do not control the research, development or commercialization of any of the products that would generate these milestones, we are not able to reasonably estimate when, if at all, any milestone payments or royalties may be payable by our collaborators. In addition, most of our current ADC collaborations are at early stages of development. Successfully developing a product candidate, obtaining regulatory approval and ultimately commercializing it is a significantly lengthy and highly uncertain process which entails a significant risk of failure. In addition, business combinations, changes in a collaborator s business strategy and financial difficulties or other factors could result in a collaborator abandoning or delaying development of its product candidates. As such, the milestone payments associated with our ADC collaborations and co-development agreements involve a substantial degree of risk and may never be received. Accordingly, we do not expect, and investors should not assume, that we will receive all of the potential milestone payments described above and it is possible that we may never receive any significant milestone payments under these agreements.

Unum Therapeutics Collaboration

We have a strategic collaboration and license agreement with Unum to develop and commercialize novel ACTR therapies incorporating our antibodies for cancer. We and Unum will initially develop two ACTR product candidates that combine Unum s ACTR technology with our antibodies, and we have an option to expand the collaboration to include a third ACTR product candidate upon payment of an additional fee. Unum is obligated to conduct preclinical research and clinical development activities through phase 1 and we are obligated to provide funding for these activities. The agreement calls for us to work together to co-develop and jointly fund programs after phase 1 unless either company opts out. Costs associated with co-development activities are included in research and development expense.

We and Unum would co-commercialize any successfully developed product candidates and share any profits 50/50 on any co- developed programs in the United States. We retain exclusive commercial rights outside of the United States, paying Unum a royalty that is a high single digit to mid-teens percentage of ex-U.S. sales, if any. The potential future licensing and progress-dependent milestone payments to Unum under the collaboration may total up to $615 million across all three ACTR programs, payment of which is triggered by the achievement of development, regulatory and commercial milestones.

Royalty Revenues and Cost of Royalty Revenues

Royalty revenues primarily reflect royalties paid to us by Takeda under the ADCETRIS collaboration. These royalties include commercial sales-based milestones and sales royalties. The royalty rate paid by Takeda is calculated as a percentage of Takeda s net sales of ADCETRIS, ranges from the mid-teens to the mid-twenties depending on sales volumes, and resets annually. Takeda bears a portion of third-party royalty costs owed on sales of ADCETRIS in its territory. This amount is included in our royalty revenues.quisition of business, net of acquired cash

(39,530
)

—

Net cash provided by (used in) investing activities
(62,950
)

3,848

CASH FLOWS FROM FINANCING ACTIVITIES:

Proceeds from issuance of common stock upon exercise of stock options
5,421

4,795

Taxes remitted on RSU awards vested
(1,488
)

(26,402
)
Excess tax benefit from exercise of stock options and vesting of restricted stock units
566

—

Net cash provided by (used in) financing activities
4,499

(21,607
)
Effect of foreign exchange rate changes on cash and cash equivalents
53

(4,064
)
NET CHANGE IN CASH AND CASH EQUIVALENTS
(7,757
)

8,841

CASH AND CASH EQUIVALENTS—Beginning of period
212,362

148,101

CASH AND CASH EQUIVALENTS—End of period	$ 204,605	$ 156,942
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid for income taxes	$ 3,219	$ 2,458
SUPPLEMENTAL DISCLOSURES OF NONCASH INVESTING AND FINANCING ACTIVITIES:		
Accruals for purchase of property and equipment	$ 802	$ 378

See accompanying Notes to Condensed Consolidated Financial Statements.

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

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

Business

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

Basis of Presentation

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

These unaudited interim condensed consolidated financial statements should be read in conjunction with the Company’s financial statements and related notes, together with management’s discussion and analysis of financial condition and results of operations, presented in the Company’s Annual Report on Form 10-K for the fiscal year ended July 31, 2015. There have been no changes in the Company’s significant accounting policies from those that were disclosed in the Company’s consolidated financial statements for the fiscal year ended July 31, 2015 included in the Company’s Annual Report on Form 10-K except for the business combinations policy which has been added in the third quarter of fiscal 2016.

Use of Estimates

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

Cash and Cash Equivalents

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

Investments

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

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

Table of Contents

Business Combinations, Intangible Assets and Goodwill Impairment

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

The Company evaluates its acquired 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 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.

Concentration of Credit Risk

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

No customer individually accounted for 10% or more of the Company's revenues for the three and nine months ended April 30, 2016 or 2015. One customer individually accounted for 10% or more of the Company's total accounts receivable as of April 30, 2016. No customer individually accounted for 10% or more of the Company's total accounts receivable as of July 31, 2015.

Revenue Recognition

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

Revenues are derived from three sources:

(i) License fees related to term (or time-based) licenses, perpetual software licenses, and other;

(ii) Maintenance fees related to email and phone support, bug fixes and unspecified software updates and upgrades released when, and if, available during the maintenance term; and

(iii) Services fees related to professional services related to implementation of our software, reimbursable travel and training.

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

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

- Delivery or performance has occurred. The Company’s software is delivered electronically to the customer. Delivery is considered to have occurred when the Company provides the customer access to the software along with login credentials.
- Fees are fixed or determinable. The Company assesses whether a fee is fixed or determinable at the outset of the arrangement, primarily based on the payment terms associated with the transaction. Term and perpetual license fees are not considered to be fixed or determinable until they become due. Fees from term licenses are invoiced in annual or quarterly installments over the term of the agreement beginning on the effective date of the license. A significant majority are invoiced annually. Perpetual license fees are generally due between 30 and 60 days from delivery of software, however in certain cases extended payment terms may be offered.
- Collectability is probable. Collectability is assessed on a customer-by-customer basis, based primarily on creditworthiness as determined by credit checks and analysis, as well as customer payment history. Payment terms generally range from 30 to 90 days from invoice date. If it is determined prior to revenue recognition that collection of an arrangement fee is not probable, revenues are deferred until collection becomes probable or cash is collected, assuming all other revenue recognition criteria are satisfied.

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

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

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

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

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

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

Income Taxes

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

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

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

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

Stock-Based Compensation

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

Recent Accounting Pronouncements

Improvements on Employee Share-Based Payment Accounting

In March 2016, the FASB issued Accounting Standards Update No. 2016-09, “Improvements on Employee Share-Based Payment Accounting (Topic 718)” (“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 new standard is effective for annual periods beginning after December 15, 2016 and interim periods within those years. Early adoption is permitted. The standard will be effective for the Company beginning August 1, 2017. The Company is currently evaluating the impact to its consolidated financial statements.

Accounting for Leases

In February 2016, the FASB issued Accounting Standards Update 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 new standard is effective for annual periods beginning after December 15, 2018 and interim periods within those years. Early adoption is permitted. The standard will be effective for the Company beginning August 1, 2019. The Company is currently evaluating the impact to its consolidated financial statements.

Simplifying the Accounting for Measurement-Period Adjustments

In September 2015, the FASB issued Accounting Standards Update No. 2015-16, “Simplifying the Accounting for Measurement-Period Adjustments (Topic 805)” (“ASU 2015-16”), which eliminates the requirement to restate prior period financial statements for measurement period adjustments in business combinations. ASU 2015-16 requires that the cumulative impact of a measurement period adjustment (including the impact on prior periods) be recognized in the reporting period in which the adjustment is identified. The new standard is effective for annual periods beginning after December 15, 2015 and interim periods within those years. Early adoption is permitted. The Company early adopted this guidance effective February 1, 2016 and the adoption has no material impact to its consolidated financial statements.

Revenue from Contracts with Customers

In May 2014, the FASB issued ASU No. 2014-09, “Revenue from Contracts with Customers (Topic 606)”, which provides guidance for revenue recognition. This ASU affects any entity that either enters into contracts with customers to

Table of Contents

transfer goods or services or enters into contracts for the transfer of non-financial assets. This ASU will supersede the revenue recognition requirements in Topic 605, Revenue Recognition, and most industry-specific guidance. This ASU also supersedes some cost guidance included in Subtopic 605-35, Revenue Recognition-Construction-Type and Production-Type Contracts. In July 2015, the FASB deferred the effective date to annual reporting periods and interim periods within fiscal years beginning after December 15, 2017. Early adoption is permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period. In April 2016, the FASB issued ASU No. 2016-10, Identifying Performance Obligations and Licensing, which amends certain aspects of ASU No. 2014-09, specifically on identifying performance obligations and the implementation guidance on licensing. ASU No. 2016-10's effective date and transition provisions are aligned with the requirements in ASU No. 2014-09. The standard will be effective for the Company beginning August 1, 2018 and permits the use of either the retrospective or cumulative effect transition method. We have not yet selected a transition method and continue to evaluate all the potential impacts that this guidance will have on our consolidated financial statements. We have, however, begun modifying the way we engage with customers to reduce the impact we currently believe is likely to occur under the new standard which will be effective in fiscal 2019.

2. Fair Value of Financial Instruments

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

	April 30, 2016			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
	(in thousands)			
U.S. agency securities	$66,268	$ 15	$ (5)	$66,278
Commercial paper	140,574	12	—	140,586
Corporate bonds	256,090	241	(80)	256,251
U.S. government bonds	104,560	48	(11)	104,597
Foreign government bonds	5,914	—	—	5,914
Money market funds	68,417	—	—	68,417
Total	$641,823	$ 316	$ (96)	$642,043

	July 31, 2015			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
	(in thousands)			
U.S. agency securities	$82,946	$ 21	$ (4)	$82,963
Commercial paper	142,822	13	(4)	142,831
Corporate bonds	281,942	47	(216)	281,773
U.S. government bonds	32,529	13	(2)	32,540
Foreign government bonds	8,663	7	(2)	8,668
Certificate of deposit	2,700	—	—	2,700
Money market funds	88,319	—	—	88,319
Total	$639,921	$ 101	$ (228)	$639,794

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

Table of Contents

	April 30, 2016					
	Less Than 12 Months		12 Months or Greater		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
	(in thousands)					
Commercial paper	$15,247	*	$—	$ —	$15,247	*
U.S. agency securities	15,983	(5)	—	—	15,983	(5)
Corporate bonds	85,077	(78)	2,612	(2)	87,689	(80)
U.S. government bonds	15,049	(11)	—	—	15,049	(11)
Foreign government bonds	2,900	*	—	—	2,900	*
Total	$134,256	$ (94)	$2,612	$ (2)	$136,868	$ (96)

* Amounts are less than one thousand dollars.

As of April 30, 2016, the Company had 51 investments in a gross unrealized loss position. The unrealized losses on its available-for-sale securities were primarily a result of changes in interest rates subsequent to the initial purchase of these securities. The Company does not intend to sell, nor believe it will need to sell, these securities before recovering the associated unrealized losses. The Company does not consider any portion of the unrealized losses at April 30, 2016 to be an other-than-temporary impairment, nor are any unrealized losses considered to be credit losses. The Company has recorded the securities at fair value in its condensed consolidated balance sheets, with unrealized gains and losses reported as a component of accumulated other comprehensive loss. The amounts of realized gains and losses reclassified into earnings are based on the specific identification of the securities sold. The realized gains and losses from sales of securities in the periods presented were not significant.

The following table summarizes the contractual maturities of the Company’s investments measured at fair value as of April 30, 2016:

	Less Than 12 Months	12 to 36 Months	Total
	(in thousands)		
U.S. agency securities	$64,190	$2,088	$66,278
Commercial paper	140,586	—	140,586
Corporate bonds	186,236	70,015	256,251
U.S. government bonds	74,539	30,058	104,597
Foreign government bonds	5,914	—	5,914
Money market funds	68,417	—	68,417
Total	$539,882	$102,161	$642,043

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.

In December 2015, the Company invested $5.0 million in a convertible note issued by a privately-held company. The note did not have a readily determinable market value. In April 2016, the convertible note with accrued interest of $0.1 million converted to preferred stock. The investment was re-measured at $6.0 million based on the estimated fair value of the preferred

12

stock at the date of conversion. The resulting gain of $0.9 million was recorded as interest income. The equity investment was accounted for under the cost method of accounting, reported in other long term assets on the Company’s condensed consolidated balance sheet, and no longer deemed a Level 3 investment at April 30, 2016.

The following tables summarize the Company’s financial assets measured at fair value on a recurring basis, by level within the fair value hierarchy as of April 30, 2016 and July 31, 2015:

	April 30, 2016			
	Level 1	Level 2	Level 3	Total
	(in thousands)			
Assets				
Cash equivalents:				
Commercial paper	$—	$97,384	$ —	$97,384
Money market funds	68,417	—	—	68,417
Short-term investments:				
U.S. agency securities	—	64,190	—	64,190
Commercial paper	—	43,202	—	43,202
Corporate bonds	—	186,236	—	186,236
U.S. government bonds	—	74,539	—	74,539
Foreign government bonds	—	5,914	—	5,914
Long-term investments:				
U.S. agency securities	—	2,088	—	2,088
U.S. government bonds	—	30,058	—	30,058
Corporate bonds	—	70,015	—	70,015
Total assets	$68,417	$573,626	$ —	$642,043

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

Table of Contents

3. Acquisition

On March 31, 2016, the Company purchased all of the outstanding equity interests of EagleEye Analytics, Inc. (“EagleEye”), a privately held provider of SaaS-based predictive analytics products specifically designed for property and casualty insurers, for total purchase consideration of $40.2 million, including an amount placed into escrow to cover future potential claims. At the time of the purchase, EagleEye maintained a management incentive program that required certain payments to management upon the completion of a change in control. Pursuant to this program, an additional $1.6 million was placed into a separate escrow account to be paid out 18 months after closing to former EagleEye employees. This additional payment is subject to continued employment with the Company and therefore is excluded from the purchase consideration. The payment will be recognized as compensation expense over the requisite service period of 18 months. The Company believes that the acquisition will enable its customers to apply predictive analytics to make better decisions across the insurance lifecycle. Acquisition-related costs of $1.5 million were recorded in general and administrative expenses in the Company’s condensed consolidated statements of operations for the quarter ended April 30, 2016.

As part of the preliminary purchase price allocation, the Company determined that EagleEye’s separately identifiable intangible assets were developed technology, customer contracts and related relationships, partner relationships and order backlog. The Company measured fair values of the intangible assets by applying the income and relief from royalty approach. This fair value measurement is based on significant inputs that are not observable in the market and thus represents a Level 3 measurement. The valuation models were based on estimates of future operating projections of the acquired business 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 pricing projections of future products, expected customer interest, a discount rate that is representative of the weighted average cost of capital, and royalty and long-term sustainable growth rates based on market analysis. The Company is amortizing the acquired intangible assets over their estimated useful lives.

The allocation of the purchase price is preliminary pending final valuation of acquired deferred tax assets and is therefore subject to potential future measurement period adjustments. Preliminary allocation of the purchase consideration was as follows:

	Total Purchase Price Allocation	Estimated Useful Lives
	(in thousands)	(in years)
Assumed Liabilities, net of acquired assets	$ (550)	
Developed technology	6,700	4
Customer contracts and related relationships	4,500	9
Partner relationships	200	9
Order backlog	1,100	3
Deferred tax assets, net	7,849	
Goodwill	20,380	
Total purchase price	$ 40,179	

The goodwill of $20.4 million arising from the acquisition consists largely of the acquired workforce, the expected company-specific synergies and the opportunity to expand the Company’s customer base. None of the goodwill recognized is expected to be deductible for income tax purposes.

The results of EagleEye’s operations since the date of acquisition have been included in the Company’s results for the quarter and were not material. The pro forma results of operations have not been presented because the effects of the business combination were not material to the Company’s consolidated results of operations.

14

Table of Contents

4. Balance Sheet Components

Property and Equipment, Net

Property and equipment consist of the following:

	April 30, 2016	July 31, 2015
	(in thousands)	
Computer hardware	$18,637	$15,099
Software	4,781	4,867
Furniture and fixtures	3,359	3,065
Leasehold improvements	8,365	8,040
Total property and equipment	35,142	31,071
Less accumulated depreciation	(21,891)	(18,911)
Property and equipment, net	$13,251	$12,160

As of April 30, 2016 and July 31, 2015, no property and equipment was pledged as collateral. Depreciation expense was $1.7 million and $4.5 million for the three and nine months ended April 30, 2016, respectively, and was $1.6 million and $4.5 million for the three and nine months ended April 30, 2015, respectively.

Goodwill and Intangible Assets

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

	Total (in thousands)
Goodwill, July 31, 2015	$ 9,205
Addition - EagleEye acquisition	20,380
Goodwill, April 30, 2016	$ 29,585

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

	April 30, 2016			July 31, 2015		
	(in thousands)					
	Cost	Accumulated amortization	Net book value	Cost	Accumulated amortization	Net book value
Amortized intangible assets:						
Acquired technology	$13,900	$ 4,420	$9,480	$7,200	$ 3,201	$3,999
Customer contracts and related relationships	4,500	42	4,458	—	—	—
Partner relationships	200	2	198	—	—	—
Order backlog	1,100	31	1,069	—	—	—
Total	$19,700	$ 4,495	$15,205	$7,200	$ 3,201	$3,999

15

Amortization expense was $0.6 million and $1.3 million for the three and nine months ended April 30, 2016, and was $0.4 million and $1.1 million for the three and nine months ended April 30, 2015. Estimated aggregate amortization expense for each of the next five fiscal years is as follows:

	Future Amortization (in thousands)
Fiscal year ending July 31,	
2016 (remainder of fiscal year)	$ 1,001
2017	4,004
2018	3,682
2019	2,442
2020	1,639
Thereafter	2,437
Total	$ 15,205

Accrued Employee Compensation

Accrued employee compensation expense consists of the following:

	April 30, 2016	July 31, 2015
	(in thousands)	
Accrued bonuses	$14,290	$19,819
Accrued commission	2,201	5,008
Accrued vacation	8,932	7,980
Accrued payroll taxes and benefits	3,910	4,428
Total	$29,333	$37,235

Accumulated Other Comprehensive Loss

Changes in accumulated other comprehensive loss by component during the nine months ended April 30, 2016 were as follows:

	Foreign Currency Translation Adjustments	Unrealized Gain (Loss) on Available-for-Sale Securities	Total
	(in thousands)		
Balance as of July 31, 2015	$(6,247)	$ (96)	$(6,343)
Other comprehensive gain (loss) before reclassification	339	342	681
Amounts reclassified from accumulated other comprehensive loss to earnings	—	4	4
Tax effect	—	(129)	(129)
Balance as of April 30, 2016	$(5,908)	$ 121	$(5,787)

Table of Contents

5. Net Loss Per Share

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

	Three Months Ended April 30,		Nine Months Ended April 30,	
	2016	2015	2016	2015
	(in thousands, except share and per share amounts)			
Numerator:				
Net loss	$(404)	$ (2,987)	$(1,121)	$ (2,008)
Net loss per share:				
Basic	$(0.01)	$ (0.04)	$(0.02)	$ (0.03)
Diluted	$(0.01)	$ (0.04)	$(0.02)	$ (0.03)
Denominator:				
Weighted average shares used in computing net loss per share:				
Basic	72,297,934	70,348,356	71,769,613	69,844,077
Diluted	72,297,934	70,348,356	71,769,613	69,844,077

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

	Three Months Ended April 30,		Nine Months Ended April 30,	
	2016	2015	2016	2015
Stock options to purchase common stock	1,233,705	2,019,320	1,491,148	2,197,389
Restricted stock units	3,048,276	3,193,444	3,287,777	3,491,327

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, 2015. See the Annual Report on Form 10-K for the fiscal year ended July 31, 2015 for additional information regarding the Company’s contractual obligations.

Leases

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

Lease expense for all worldwide facilities and equipment, which is being recognized on a straight-line basis over terms of the various leases, was $1.5 million and $4.2 million for the three and nine months ended April 30, 2016, respectively, and was $1.3 million and $4.1 million for the three and nine months ended April 30, 2015, respectively.

Letters of Credit

The Company had two outstanding letters of credit required to secure contractual commitments and prepayments as of April 30, 2016 and July 31, 2015, respectively. In addition to the unsecured letter of credit for the building lease, the Company had an unsecured letter of credit agreement related to a customer arrangement for Polish Zloty 10.0 million (approximately $2.6 million as of April 30, 2016) to secure contractual commitments and prepayments. No amounts were outstanding under the Company’s unsecured letters of credit as of April 30, 2016 or July 31, 2015.

Legal Proceedings

17

Table of Contents

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

Indemnification

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

The Company has not had to reimburse any of its customers for losses related to indemnification provisions and no material claims against the Company were outstanding as of April 30, 2016 or July 31, 2015. For several reasons, including the lack of prior indemnification claims and the lack of a monetary liability limit for certain infringement cases under various Software Licenses, the Company cannot estimate the amount of potential future payments, if any, related to indemnification provisions.

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

7.Stockholders' Equity and Stock-Based Compensation

Stock-Based Compensation Expense

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

	Three Months Ended April 30,		Nine Months Ended April 30,	
	2016	2015	2016	2015
	(in thousands)			
Cost of license revenues	$107	$54	$299	$158
Cost of maintenance revenues	388	293	1,107	879
Cost of services revenues	4,450	3,774	13,486	11,165
Research and development	3,889	2,813	11,472	7,618
Sales and marketing	3,602	2,620	10,648	9,049
General and administrative	3,757	2,840	10,873	9,011
Total stock-based compensation expenses	$16,193	$12,394	$47,885	$37,880

As of April 30, 2016, total unamortized stock-based compensation cost, adjusted for estimated forfeitures, was as follows:

	As of April 30, 2016	
	Unrecognized Expense	Weighted Average Expected Recognition Period
	(in thousands)	(in years)
Stock options	$3,219	1.8

Restricted stock units	116,841	2.5
	$120,060	

Table of Contents

RSUs

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

	RSUs Outstanding		
	Number of RSUs Outstanding	Weighted Average Grant Date Fair Value	Aggregate Intrinsic Value (in thousands) (1)
Balance as of July 31, 2015	2,882,674	$ 42.65	$ 170,222
Granted	1,435,557	$ 54.25	
Released	(1,076,740)	$ 40.28	$ 58,765
Canceled	(263,534)	$ 45.83	
Balance as of April 30, 2016	2,977,957	$ 48.82	$ 169,654
Expected to vest as of April 30, 2016	2,774,943	$ 48.60	$ 158,089

(1) Aggregate intrinsic value at each period end represents the total market value of RSUs at the Company's closing stock price of $56.97 and $59.05 on April 30, 2016 and July 31, 2015, respectively. Aggregate intrinsic value for released RSUs represents the total market value of released RSUs at date of release.

Stock Options

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

	Stock Options Outstanding			
	Number of Stock Options Outstanding	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life	Aggregate Intrinsic Value (1)
			(in years)	(in thousands)
Balance as of July 31, 2015	1,822,062	$ 14.29	4.9	$ 81,548
Granted	10,000	$ 54.00		
Exercised	(467,726)	$ 11.59		$ 20,342
Canceled	(20,658)	$ 40.86		
Balance as of April 30, 2016	1,343,678	$ 15.12	4.2	$ 56,229
Vested and expected to vest as of April 30, 2016	1,336,972	$ 14.96	4.2	$ 56,170
Exercisable as of April 30, 2016	1,158,874	$ 10.31	3.6	$ 54,075

(1) Aggregate intrinsic value at each period end represents the difference between the Company's closing stock prices of $56.97 and $59.05 on April 30, 2016 and July 31, 2015, respectively, and the exercise price of outstanding options. Aggregate intrinsic value for exercised options represents the difference between the Company's stock price at date of exercise and the exercise price.

Valuation of Awards

The assumptions used to estimate the grant date fair value of options and the estimated weighted average grant date fair value of options for the nine months ended April 30, 2016 and 2015 are as follows:

	Three Months Ended April 30,		Nine Months Ended April 30,	
	2016	2015	2016	2015
Expected life (in years)	*	6.1	4.9	6.0 - 6.1
Risk-free interest rate	*	1.7%	1.49%	1.7% - 1.9%
Expected volatility	*	39.4%	38.8%	39.4% - 45.1%
Expected dividend yield	*	—%	—%	—%
Weighted average grant date fair value of options	*	$21.52	$19.18	$20.78

* There were no options granted during the three months ended April 30, 2016.

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

Common Stock Reserved for Issuance

As of April 30, 2016 and July 31, 2015, the Company was authorized to issue 500,000,000 shares of common stock with a par value of $0.0001 per share, and 72,522,807 and 71,005,738 shares of common stock were issued and outstanding, respectively. As of April 30, 2016 and July 31, 2015, the Company had reserved shares of common stock for future issuance as follows:

	April 30, 2016	July 31, 2015
Exercise of stock options to purchase common stock	1,343,678	1,822,062
Vesting of restricted stock units	2,977,957	2,882,674
Shares available under stock plans	16,828,527	14,363,906
Total common stock reserved for issuance	21,150,162	19,068,642

8.Income Taxes

The Company recognized income tax benefits of $2.4 million for both the three and nine months ended April 30, 2016, as compared to income tax benefits of $3.0 million and $4.6 million for the three and nine months ended April 30, 2015, respectively. The changes for the three and nine months ended April 30, 2016 were primarily due to changes in profitability, partially offset by increased benefit from discrete tax items, as compared to the same periods a year ago. The effective tax rates of 85.4% and 68.3% for the three and nine months ended April 30, 2016 differ from the statutory U.S. federal income tax rate of 35% mainly due to permanent differences for stock-based compensation, research and development credits, domestic manufacturing deduction, the tax rate differences between the United States and foreign countries, and discrete charges recorded in the current periods.

The Company provides U.S. income taxes on the earnings of foreign subsidiaries, unless the subsidiaries' earnings are considered indefinitely reinvested outside the United States. As of April 30, 2016, U.S. income taxes were not provided for on the cumulative total of $28.8 million undistributed earnings from certain foreign subsidiaries. As of April 30, 2016, the unrecognized deferred tax liability for these earnings was approximately $9.5 million.

During the nine months ended April 30, 2016, the decrease in unrecognized tax benefits from the beginning of the period was $0.7 million. Accordingly, as of April 30, 2016, the Company had unrecognized tax benefits of $3.9 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. All of the Company’s principal operations and decision-making functions are located in the United States.

Table of Contents

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

	Three Months Ended April 30,		Nine Months Ended April 30,	
	2016	2015	2016	2015
	(in thousands)			
United States	$56,750	$51,150	$153,641	$134,026
Canada	10,794	9,725	32,327	28,942
Other Americas	5,824	1,311	12,578	5,924
Total Americas	73,368	62,186	198,546	168,892
United Kingdom	4,206	7,777	25,783	31,790
Other EMEA	10,558	11,008	24,548	31,635
Total EMEA	14,764	18,785	50,331	63,425
Total APAC	10,728	4,469	34,392	22,303
Total revenues	$98,860	$85,440	$283,269	$254,620

No country, other than those presented above, accounted for more than 10% of revenues during the three and nine months ended April 30, 2016 and 2015, respectively.

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

	April 30, 2016	July 31, 2015
	(in thousands)	
Americas	$55,085	$22,746
EMEA	2,601	2,183
APAC	355	435
Total	$58,041	$25,364

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

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

Overview

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

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

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

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

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

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

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

Table of Contents

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

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

In March 2016, we acquired EagleEye Analytics, a provider of SaaS-based predictive analytics products specifically designed for property and casualty insurers. We believe that the acquisition will enable our customers to apply predictive analytics to make better decisions across the insurance lifecycle. The results of EagleEye’s operations since the date of acquisition have been included in our results of operations for the current periods and were not material.

Seasonality

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

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

Key Business Metrics

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

Four-Quarter Recurring Revenues

We measure four-quarter recurring revenues by adding the total term license revenues and total maintenance revenues recognized under GAAP in the preceding four quarters ended in the stated period. This metric excludes perpetual license revenues, revenues from perpetual buyout rights and services revenues. This metric allows us to better understand the trends in our recurring revenues because it typically reduces the variations in any particular quarter caused by seasonality, the effects of the annual invoicing of our term licenses and certain effects of contractual provisions that may accelerate or delay revenue recognition in some cases. This metric applies revenue recognition rules under GAAP and does not substitute individually tailored revenue recognition and measurement methods. Our four-quarter recurring revenues for each of the nine periods presented were:

	Four quarters ended								
	April 30, 2016	January 31, 2016	October 31, 2015	July 31, 2015	April 30, 2015	January 31, 2015	October 31, 2014	July 31, 2014	April 30, 2014
	(in thousands)								
Term license revenues	$194,458	$184,647	$173,232	$169,366	$160,114	$157,542	$150,309	$139,902	$125,485
Maintenance revenues	56,103	53,610	51,516	50,024	48,785	47,041	44,768	41,888	39,836
Total four-quarter recurring revenues	$250,561	$238,257	$224,748	$219,390	$208,899	$204,583	$195,077	$181,790	$165,321

Adjusted EBITDA

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

- Adjusted EBITDA provides investors and other users of our financial information consistency and comparability with our past financial performance, facilitates period-to-period comparisons of operations and facilitates comparisons with other companies, many of which use similar non-GAAP financial measures to supplement their GAAP results; and
- it is useful to exclude non-cash charges, such as depreciation and amortization and stock-based compensation because the amount of such expenses in any specific period may not directly correlate to the underlying performance of our business operations and these expenses can vary significantly between periods.

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

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

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

	Three Months Ended April 30,		Nine Months Ended April 30,	
	2016	2015	2016	2015
	(in thousands)			
Reconciliation of Adjusted EBITDA:				
Net loss	$(404)	$(2,987)	$(1,121)	$(2,008)
Non-GAAP adjustments:				
Benefit from income taxes	(2,358)	(3,000)	(2,413)	(4,619)
Interest income	(2,211)	(636)	(3,665)	(1,643)
Other expense (income), net	(804)	(77)	161	1,267
Depreciation and amortization	2,293	1,929	5,835	5,550
Stock-based compensation	16,193	12,394	47,885	37,880
Adjusted EBITDA	$12,709	$7,623	$46,682	$36,427

Operating Cash Flows

We monitor our cash flows from operating activities, or operating cash flows, as a key measure of our overall business performance, which enables us to analyze our financial performance without the effects of certain non-cash items such as depreciation and amortization and stock-based compensation expenses. Additionally, operating cash flows takes into account the impact of changes in deferred revenues, which reflects the receipt of cash payment for products before they are recognized as revenues. Our operating cash flows are significantly impacted by timing of invoicing and collections of accounts receivable, annual bonus payment, as well as payments of payroll and other taxes. As a result, our operating cash flows fluctuate significantly on a quarterly basis. Cash provided by operations was $50.6 million and $30.7 million for the nine months ended April 30, 2016 and 2015, respectively. For a further discussion of our operating cash flows, see "Liquidity and Capital Resources—Cash Flows from Operating Activities."

Critical Accounting Policies and Estimates

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

24

Table of Contents

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; and
- Business combinations, intangible assets and goodwill impairment

We added the business combinations, intangible assets and goodwill impairment policy in Note 1 to the Condensed Consolidated Financial Statements in the third quarter of fiscal 2016. Additionally, we adopted ASU 2015-17, Balance Sheet Classification of Deferred Taxes in the second quarter of fiscal 2016. Other than these updates, there were no significant changes in our critical accounting policies and estimates during the nine months ended April 30, 2016. Please refer to Management's Discussion and Analysis of Financial Condition and Results of Operations contained in our Annual Report on Form 10-K filed on September 17, 2015 for a more complete discussion of our critical accounting policies and estimates.

Results of Operations

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

	Three Months Ended April 30,		Nine Months Ended April 30,	
	2016	2015	2016	2015
	(in thousands)			
Revenues:				
License	$45,796	$33,302	$131,512	$105,777
Maintenance	14,676	12,183	42,945	36,866
Services	38,388	39,955	108,812	111,977
Total revenues	98,860	85,440	283,269	254,620
Cost of revenues:				
License	2,137	1,184	4,878	3,411
Maintenance	3,034	2,299	8,145	6,812
Services	33,836	34,421	96,055	97,532
Total cost of revenues	39,007	37,904	109,078	107,755
Gross profit:				
License	43,659	32,118	126,634	102,366
Maintenance	11,642	9,884	34,800	30,054
Services	4,552	5,534	12,757	14,445
Total gross profit	59,853	47,536	174,191	146,865
Operating expenses:				
Research and development	29,273	24,575	80,354	67,167
Sales and marketing	22,908	18,801	64,860	56,506
General and administrative	13,449	10,860	36,015	30,195
Total operating expenses	65,630	54,236	181,229	153,868
Loss from operations	(5,777)	(6,700)	(7,038)	(7,003)
Interest income	2,211	636	3,665	1,643
Other income (expense), net	804	77	(161)	(1,267)
Loss before income taxes	(2,762)	(5,987)	(3,534)	(6,627)

Benefit from income taxes	(2,358)	(3,000)	(2,413)	(4,619)
Net loss	$(404)	$(2,987)	$(1,121)	$(2,008)

25

Table of Contents

	Three Months Ended April 30, 2016	2015	Nine Months Ended April 30, 2016	2015
	(percentage of total revenues)			
Revenues:				
License	46 %	39 %	46 %	42 %
Maintenance	15 %	14 %	15 %	14 %
Services	39 %	47 %	39 %	44 %
Total revenues	100 %	100 %	100 %	100 %
Cost of revenues:				
License	2 %	1 %	2 %	1 %
Maintenance	3 %	3 %	3 %	3 %
Services	34 %	40 %	34 %	38 %
Total cost of revenues	39 %	44 %	39 %	42 %
Gross profit:				
License	44 %	38 %	44 %	41 %
Maintenance	12 %	11 %	12 %	11 %
Services	5 %	7 %	5 %	6 %
Total gross profit	61 %	56 %	61 %	58 %
Operating expenses:				
Research and development	30 %	29 %	28 %	27 %
Sales and marketing	23 %	22 %	23 %	22 %
General and administrative	14 %	13 %	13 %	12 %
Total operating expenses	67 %	64 %	64 %	61 %
Loss from operations	(6)%	(8)%	(3)%	(3)%
Interest income	2 %	1 %	2 %	1 %
Other income (expense), net	1 %	— %	— %	(1)%
Loss before income taxes	(3)%	(7)%	(1)%	(3)%
Benefit from income taxes	(3)%	(4)%	(1)%	(2)%
Net loss	— %	(3)%	— %	(1)%

Revenues

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

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

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

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

	Three Months Ended April 30,					
	2016		2015			
	Amount	% of total revenues	Amount	% of total revenues	Change ($)	(%)
	(in thousands, except percentages)					
Revenues:						
License	$45,796	46 %	$33,302	39 %	$12,494	38 %
Maintenance	14,676	15 %	12,183	14 %	2,493	20 %
Services	38,388	39 %	39,955	47 %	(1,567)	(4)%
Total revenues	$98,860	100 %	$85,440	100 %	$13,420	16 %

	Nine Months Ended April 30,					
	2016		2015			
	Amount	% of total revenues	Amount	% of total revenues	Change ($)	(%)
	(in thousands, except percentages)					
Revenues:						
License	$131,512	46 %	$105,777	42 %	$25,735	24 %
Maintenance	42,945	15 %	36,866	14 %	6,079	16 %
Services	108,812	39 %	111,977	44 %	(3,165)	(3)%
Total revenues	$283,269	100 %	$254,620	100 %	$28,649	11 %

License Revenues

License revenues increased by $12.5 million and $25.7 million during the three and nine months ended April 30, 2016, respectively, as compared to the same periods a year ago. The increases in license revenues were primarily driven by increased adoption of InsuranceSuite and sales of newer products to both new and existing customers. Our license revenues are comprised of term license revenue and perpetual license revenue. Term license remains our predominant licensing model.

	Three Months Ended April 30,					
	2016		2015			
	Amount	% of license revenues	Amount	% of license revenues	Change ($)	(%)
	(in thousands, except percentages)					
License revenues:						
Term	$40,598	89 %	$30,785	92 %	$9,813	32 %
Perpetual	5,198	11 %	2,517	8 %	2,681	107 %
Total license revenues	$45,796	100 %	$33,302	100 %	$12,494	38 %

	Nine Months Ended April 30,				
	2016		2015		
		% of license		% of license	Change

	Amount	revenues	Amount	revenues	($)	(%)
	(in thousands, except percentages)					
License revenues:						
Term	$125,903	96 %	$100,809	95 %	$25,094	25 %
Perpetual	5,609	4 %	4,968	5 %	641	13 %
Total license revenues	$131,512	100 %	$105,777	100 %	$25,735	24 %

Term license revenues increased by $9.8 million during the three months ended April 30, 2016, as compared to the same quarter a year ago. The increase was the result of $6.9 million of revenues recognized for current quarter orders from new and existing customers, and a $2.9 million net increase in revenues recognized primarily due to timing of invoicing and corresponding due dates.

Table of Contents

Term license revenues increased by $25.1 million during the nine months ended April 30, 2016, as compared to the same period a year ago. The increase was the result of $19.1 million of orders from new customers, expanded orders from existing customers in the current period, and a net increase of $6.0 million in revenues recognized primarily due to timing of invoicing and corresponding due dates.

Perpetual license revenues increased by $2.7 million and $0.6 million during the three and nine months ended April 30, 2016, respectively, as compared to the same periods a year ago. Increases in perpetual license revenues were primarily due to new perpetual orders executed in the current periods and the timing of invoicing and corresponding due dates. This was partially offset by fewer perpetual buyouts in the current periods.

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

Maintenance Revenues

Maintenance revenues increased by $2.5 million and $6.1 million during the three and nine months ended April 30, 2016, respectively, as compared to the same periods a year ago. The increases reflect our growing customer base and increased license revenues.

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

Services Revenues

Services revenues during the three and nine months ended April 30, 2016 decreased by $1.6 million and $3.2 million, respectively, as compared to the same periods a year ago. The decreases in services revenues were primarily due to the completion of a few large service projects at the beginning of the current fiscal year and our continued engagement with our system integrator partners. These effects were partially offset by services performed on new projects to new and existing customers.

We expect our services revenues to decrease as a percentage of total revenues in the current fiscal year as we continue to expand our network of third-party system integrators with whom our customers can contract for services related to our products.

Deferred Revenues

	As of April 30, 2016	July 31, 2015	Change	
	Amount	Amount	($)	(%)
	(in thousands, except percentages)			
Deferred revenues:				
Deferred license revenues	$26,246	$13,558	$12,688	94%

Deferred maintenance revenues	33,763	32,365	1,398	4 %
Deferred services revenues	8,283	6,643	1,640	25%
Total deferred revenues	$68,292	$52,566	$15,726	30%

The $12.7 million increase in deferred license revenues compared to the prior fiscal year end was primarily driven by a $10.7 million net increase in billings related to existing customer contracts that are being deferred due to invoice timing and corresponding due dates and, to a lesser extent, deferred subscription revenue acquired through the EagleEye acquisition. License billings related to new contracts executed during the nine months ended April 30, 2016 contributed an additional increase of $2.0 million which will be recognized as contractual obligations are met or on a ratable basis over the contractual period.

The $1.4 million increase in deferred maintenance revenues compared to the prior fiscal year end was primarily driven by billings in excess of revenues recognized from new and existing orders during the nine months ended April 30, 2016.

28

The $1.6 million increase in deferred services revenues compared to the prior fiscal year end was primarily driven by $4.0 million of services billings deferred due to certain contractual terms, partially offset by $2.4 million from prior fiscal year billings which were recognized upon fulfillment of certain contractual obligations.

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

Cost of Revenues and Gross Profit

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

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

	Three Months Ended April 30,			
	2016	2015	Change	
	Amount	Amount	($)	(%)
	(in thousands, except percentages)			
Cost of revenues:				
License	$2,137	$1,184	$953	80 %
Maintenance	3,034	2,299	735	32 %
Services	33,836	34,421	(585)	(2)%
Total cost of revenues	$39,007	$37,904	$1,103	3 %
Includes stock-based awards of:				
Cost of license revenues	$107	$54	$53	
Cost of maintenance revenues	388	293	95	
Cost of services revenues	4,450	3,774	676	
Total	$4,945	$4,121	$824	

	Nine Months Ended April 30,			
	2016	2015	Change	
	Amount	Amount	($)	(%)
	(in thousands, except percentages)			
Cost of revenues:				
License	$4,878	$3,411	$1,467	43 %
Maintenance	8,145	6,812	1,333	20 %
Services	96,055	97,532	(1,477)	(2)%
Total cost of revenues	$109,078	$107,755	$1,323	1 %
Includes stock-based compensation of:				
Cost of license revenues	$299	$158	$141	
Cost of maintenance revenues	1,107	879	228	
Cost of services revenues	13,486	11,165	2,321	

Total	$14,892	$12,202	$2,690

The $1.1 million increase in cost of revenues during the three months ended April 30, 2016 was primarily driven by a $1.0 million increase in cost of license revenues and a $0.7 million increase in cost of maintenance revenues, partially offset by a $0.6 million decrease in service revenues. The $1.0 million increase in cost of license revenues was primarily attributable to increased royalty expense, intangible asset amortization, and to a lesser extent the aggregate effect of increased headcount and related expenses. The $0.7 million increase in cost of maintenance revenues was primarily attributable to the aggregate effect of increased headcount and related expenses including stock-based compensation expense. The $0.6 million decrease in cost of services revenues was primarily attributable to a $1.8 million decrease in third-party consultant costs as certain large

Table of Contents

implementation projects near completion and our continued partnership with system integrator partners to assist in the implementation of our products. This decrease in cost of services revenues was partially offset by a $1.2 million increase in headcount and related expenses which included $0.7 million of stock-based compensation expense. Our professional service and technical support headcount was 602 at April 30, 2016 compared to 548 at April 30, 2015. The increase in headcount was required to support newer products and our growing customer base.

The $1.3 million increase in cost of revenues during the nine months ended April 30, 2016 was primarily driven by a $1.5 million increase in cost of license revenues and a $1.3 million increase in cost of maintenance revenues, partially offset by a $1.5 million decrease in cost of service revenues. The $1.5 million increase in cost of license revenues was primarily attributable to the aggregate effect of increased headcount and related expenses, and to a lesser extent increased royalty and intangible asset amortization expense. The $1.3 million increase in cost of maintenance revenues was primarily attributable to the aggregate effect of increased headcount and related expenses including stock-based compensation expense. The $1.5 million decrease in cost of services revenues was primarily attributable to a $5.9 million decrease in third-party consultant costs as certain large implementation projects near completion and our continued partnership with system integrator partners to assist in the implementation of our products. This decrease in cost of services revenues was partially offset by a $4.4 million increase in headcount and related expenses which included $2.3 million of stock-based compensation expense.

	Three Months Ended April 30,					
	2016		2015		Change	
	Amount	Margin %	Amount	Margin %	($)	(%)
	(in thousands, except percentages)					
Gross profit:						
License	$43,659	95 %	$32,118	96 %	$11,541	36 %
Maintenance	11,642	79 %	9,884	81 %	1,758	18 %
Services	4,552	12 %	5,534	14 %	(982)	(18)%
Total gross profit	$59,853	61 %	$47,536	56 %	$12,317	26 %

	Nine Months Ended April 30,					
	2016		2015		Change	
	Amount	Margin %	Amount	Margin %	($)	(%)
	(in thousands, except percentages)					
Gross profit:						
License	$126,634	96 %	$102,366	97 %	$24,268	24 %
Maintenance	34,800	81 %	30,054	82 %	4,746	16 %
Services	12,757	12 %	14,445	13 %	(1,688)	(12)%
Total gross profit	$174,191	61 %	$146,865	58 %	$27,326	19 %

Gross profit margin was 61% for both the three and nine months ended April 30, 2016, as compared with 56% and 58% for the three and nine months ended April 30, 2015, respectively. The improvements were due to increases in license and maintenance revenues as a percentage of total revenues. License and maintenance revenues yield a higher gross margin than our professional services.

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

Operating Expenses

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

Table of Contents

	Three Months Ended April 30,								
	2016			2015					
	Amount	% of total revenues		Amount	% of total revenues		Change ($)	(%)	
	(in thousands, except percentages)								
Operating expenses:									
Research and development	$29,273	30	%	$24,575	29	%	$4,698	19	%
Sales and marketing	22,908	23	%	18,801	22	%	4,107	22	%
General and administrative	13,449	14	%	10,860	13	%	2,589	24	%
Total operating expenses	$65,630	67	%	$54,236	64	%	$11,394	21	%
Includes stock-based compensation of:									
Research and development	$3,889			$2,813			$1,076		
Sales and marketing	3,602			2,620			982		
General and administrative	3,757			2,840			917		
Total	$11,248			$8,273			$2,975		

	Nine Months Ended April 30,								
	2016			2015					
	Amount	% of total revenues		Amount	% of total revenues		Change ($)	(%)	
	(in thousands, except percentages)								
Operating expenses:									
Research and development	$80,354	28	%	$67,167	27	%	$13,187	20	%
Sales and marketing	64,860	23	%	56,506	22	%	8,354	15	%
General and administrative	36,015	13	%	30,195	12	%	5,820	19	%
Total operating expenses	$181,229	64	%	$153,868	61	%	$27,361	18	%
Includes stock-based compensation of:									
Research and development	$11,472			$7,618			$3,854		
Sales and marketing	10,648			9,049			1,599		
General and administrative	10,873			9,011			1,862		
Total	$32,993			$25,678			$7,315		

Research and Development

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

The $4.7 million increase in research and development expenses during the three months ended April 30, 2016 was primarily related to the aggregate effect from increased headcount and related expenses and included increases in compensation and related headcount costs of $3.8 million, increased stock-based compensation costs of $1.1 million, partially offset by a decrease in expenses for professional services. Our research and development headcount was 448 at April 30, 2016 compared with 383 at April 30, 2015. The increase in headcount reflects our continued investment in data management and analytics, and digital engagement, in addition to employees from the acquisition of EagleEye which was completed on March 31, 2016.

The $13.2 million increase in research and development expenses during the nine months ended April 30, 2016 was primarily related to the aggregate effect from increased headcount and related expenses and included increases in compensation and related headcount costs of $9.7 million, increased stock-based compensation costs of $3.9 million, partially offset by a decrease in expenses for professional services.

Table of Contents

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

Sales and Marketing

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

The $4.1 million increase in sales and marketing expenses during the three months ended April 30, 2016 was primarily related to the aggregate effect from increased headcount and related expenses and increased selling expenses which were primarily related to increased expenses for sales commissions. The increase included increased expenses from compensation and related headcount costs of $1.7 million, increased costs for stock-based compensation of $1.0 million and increased selling expenses of $1.8 million resulting from an increase in our customer orders. These increases were partially offset by a decrease in expenses for professional services. Our sales and marketing headcount was 256 at April 30, 2016 compared with 230 at April 30, 2015. The increase in headcount was required to support the growth in our revenue base.

The $8.4 million increase in sales and marketing expenses during the nine months ended April 30, 2016 was primarily related to the aggregate effect from increased headcount and related expenses, and increased selling expenses which were primarily related to increased expenses for sales commissions. The increase included increased expenses from compensation and related headcount costs of $4.1 million, increased stock-based compensation expense of $1.6 million, and increased selling expenses of $2.8 million resulting from increased customer orders.

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

General and Administrative

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

The $2.6 million increase in general and administrative expenses during the three months ended April 30, 2016 was primarily due to increased expenses for headcount and related costs which included increased cost for stock-based compensation. Our general and administrative headcount was 161 at April 30, 2016 compared with 138 at April 30, 2015. The increase in headcount was required to support the growth of our business.

The $5.8 million increase in general and administrative expenses during the nine months ended April 30, 2016 was primarily due to the increased headcount and related costs including stock-based compensation, and to a lesser extent increased professional services related to the acquisition of EagleEye.

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

Other Income (Expense)

	Three Months Ended April 30,			
	2016	2015	Change	
	Amount	Amount	($)	(%)
	(in thousands, except percentages)			
Interest income	$2,211	$636	$1,575	248 %
Other income (expense), net	$804	$77	$727	944 %

	Nine Months Ended April 30,			
	2016	2015	Change	
	Amount	Amount	($)	(%)
	(in thousands, except percentages)			
Interest income	$3,665	$1,643	$2,022	123 %
Other income (expense), net	$(161)	$(1,267)	$1,106	(87)%

Interest Income

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

Interest income in the three and nine months ended April 30, 2016 included $1.0 million in imputed interest income realized upon conversion in the third fiscal quarter of 2016 of our strategic investment from convertible debt to preferred equity. Excluding this amount, interest income increased by $0.6 million and $1.0 million during the three and nine months ended April 30, 2016, respectively, due to higher yields on our cash equivalents and investments.

Other Income (Expense), Net

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

Other income (expense), net increased by $0.7 million and $1.1 million for the three and nine months ended April 30, 2016, respectively, primarily due to a decline in the U.S. dollar relative to Australia and Canadian dollar, Euro, British Pound and Japanese Yen during the three and nine months ended April 30, 2016, as compared with a stronger U.S. dollar during the same periods a year ago.

Benefit from Income Taxes

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

	Three Months Ended April 30,		
	2016	2015	Change

	Amount	Amount	($)	(%)
	(in thousands, except percentages)			
Benefit from income taxes	(2,358)	(3,000)	$642	*

	Nine Months Ended April 30,			
	2016	2015	Change	
	Amount	Amount	($)	(%)
	(in thousands, except percentages)			
Benefit from income taxes	$(2,413)	$(4,619)	$2,206	*

33

Table of Contents

* Not meaningful

We recognized income tax benefits of $2.4 million for both the three and nine months ended April 30, 2016, as compared to income tax benefits of $3.0 million and $4.6 million for the three and nine months ended April 30, 2015, respectively. The changes for the three and nine months ended April 30, 2016 was primarily due to changes in profitability, partially offset by increased benefit from discrete tax items, as compared to the same periods a year ago. Our effective tax rates of 85.4% and 68.3% for the three and nine months ended April 30, 2016, respectively, differ from the statutory U.S. federal income tax rate of 35% mainly due to permanent differences for stock-based compensation, research and development credits, domestic manufacturing deduction, the tax rate differences between the United States and foreign countries, and discrete charges recorded in the current periods.

Liquidity and Capital Resources

As of April 30, 2016 and July 31, 2015, we had $680.8 million and $677.8 million of cash, cash equivalents and investments, respectively, and working capital of $546.3 million and $557.2 million, respectively. As of April 30, 2016, approximately $24.8 million of our cash and cash equivalents were domiciled in foreign tax jurisdictions. While we have no plans to repatriate these funds to the United States in the short term, if we choose to do so, we would be required to accrue and pay additional taxes on any portion of the repatriation where no United States income tax had been previously provided.

On March 31, 2016, we acquired EagleEye Analytics, a provider of SaaS-based predictive analytics products designed for property and casualty insurers for $40.2 million. Net of $0.7 million cash acquired, we utilized $39.5 million of our cash to complete the acquisition.

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

Cash Flows

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

	Nine Months Ended April 30,	
	2016	2015
	(in thousands)	
Net cash provided by operating activities	$50,641	$30,664
Net cash provided by (used in) investing activities	$(62,950)	$3,848
Net cash provided by (used in) financing activities	$4,499	$(21,607)

Cash Flows from Operating Activities

Net cash provided by operating activities increased by $20.0 million for the nine months ended April 30, 2016 when compared to the nine months ended April 30, 2015. We used $8.5 million less cash for working capital activity as compared to the same period a year ago, primarily due to higher cash collections from customers and changes in deferred revenues as compared to the same period a year ago. This is partially offset by higher vendor payments in the current period. The increase in operating cash inflow was also attributable to an $11.4 million increase in profitability after excluding the impact of non-cash charges and income such as deferred taxes, stock-based compensation, depreciation and amortization expense, and other non-cash items.

Cash Flows from Investing Activities

Net cash used in investing activities increased by $66.8 million for the nine months ended April 30, 2016, as compared to the same period a year ago, primarily due to $39.5 million used for the acquisition of EagleEye and a net increase of $22.1 million in purchases of marketable securities net of sales proceeds. In addition, in the quarter ended January 31, 2016, we purchased a $5 million non-marketable convertible debt security that converted to equity in the quarter ended April 30, 2016.

Cash Flows from Financing Activities

Net cash provided by financing activities was $4.5 million for the nine months ended April 30, 2016, as compared to $21.6 million net cash used during the same period a year ago. The increase of $26.1 million in net cash provided by financing activities was primarily a result of the transition from the net share settlement to the sell-to-cover tax withholding method which began in the fourth quarter of fiscal year 2015 for a significant majority of the employee population and was completed in the quarter ended January 31, 2016.

Contractual Obligations

Our primary contractual obligations are from operating leases for office space and letters of credit related to those leases. See Note 6 to the Condensed Consolidated Financial Statements for a discussion of our lease commitments and letters of credit.

Other than the lease commitments and letters of credit discussed in Note 6 to the Condensed Consolidated Financial Statements, we do not have commercial commitments under lines of credit, standby repurchase obligations or other such debt arrangements. We do not have any material non-cancellable purchase commitments as of April 30, 2016.

Off-Balance Sheet Arrangements

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

ITEM 3. Quantitative and Qualitative Disclosures about Market Risk

Interest Rate Sensitivity

Our exposure to market risk for changes in interest rates relates primarily to our cash, cash equivalents and investments as of April 30, 2016 and July 31, 2015. Our cash, cash equivalents and investments as of April 30, 2016 and July 31, 2015 were $680.8 million and $677.8 million, respectively, consisted primarily of cash, corporate bonds, U. S. agency debt securities, commercial paper, money market funds and municipal debt securities. Our primary exposure to market risk is interest income sensitivity, which is affected by changes in the general level of the interest rates in the United States. However, because of the short-term nature of our interest-bearing securities, a ten percent change in market interest rates would not be expected to have a material impact on our consolidated financial condition or results of operations.

Foreign Currency Exchange Risk

Our results of operations and cash flows are subject to fluctuations due to changes in foreign currency exchange rates, particularly changes in the Canadian dollar, Australian dollar, Euro, British Pound, Japanese Yen and Brazilian Real. The volatility of exchange rates depends on many factors that we cannot forecast with reliable accuracy. Although we believe our operating activities act as a natural hedge for a substantial portion of our foreign currency exposure because we typically collect revenues and incur costs in the currency in the location in which we provide our application, our contracts with our customers are long term in nature so it is difficult to predict if our operating activities will provide a natural hedge in the future. Additionally, changes in foreign currency exchange rates can affect our financial results due to transaction gains or losses related to revaluing certain current asset and current liability balances that are denominated in currencies other than the functional currency of the entities in which they are recorded. For example, for the three months ended April 30, 2016, we recorded a foreign currency gain of $0.8 million as other income in our statement of operations due to favorable currency exchange rate movement during the fiscal quarter. However, for the nine months ended April 30, 2015, we experienced 9 to 18 percent unfavorable fluctuations in exchange rates in Euro, British Pound, Australia, Canadian dollar and Japanese Yen and as a result, recorded a foreign currency loss of $1.3 million as other expense in our statement of operations for the nine months ended April

30, 2015. We will continue to experience fluctuations in foreign currency exchange rates, and if a ten percent change in foreign exchange rates occurs in the future, a similar impact would result. As our international operations grow, we will continue to reassess our approach to manage our risk relating to fluctuations in currency rates.

Table of Contents

Fair Value of Financial Instruments

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

ITEM 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

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

Changes in Internal Control over Financial Reporting

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

Inherent Limitations of Internal Controls

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

Table of Contents

PART II – OTHER INFORMATION

ITEM 1. Legal Proceedings

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

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

ITEM 1A. Risk Factors

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

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

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

Factors that may affect our results of operations include:

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

- fluctuations in foreign currency exchange rates;
- unanticipated trade sanctions and other restrictions that may impede our ability to sell internationally;

- general domestic and international economic conditions, in the insurance industry in particular; and
- future accounting pronouncements or changes in accounting rules or our accounting policies.

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

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

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

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

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

- for the initial year of a multi-year term license, we generally recognize revenues when payment is due and payment may not be due until a subsequent fiscal quarter;
- we may enter into license agreements with future product delivery requirements or specified terms for product upgrades or functionality, which may require us to delay revenue recognition for the initial period;
- our term licenses may include payment terms that are modest at the outset and increase over time; and
- we may enter into license agreements with other contractual terms that may affect the timing of revenue recognition.

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

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

In addition, because we price our products based on the amount of DWP that will be managed by our solutions, license revenues from each customer may fluctuate up or down based upon insurance policies sold by the customer in the preceding year. If we enter into a new territory, our revenue recognition pattern may change, depending on the contractual terms and local laws and regulations. Seasonal and other variations related to our revenue recognition may cause significant fluctuations in our results of operations and cash flows, may make it challenging for an investor to predict our performance on a quarterly basis and may prevent us from achieving our quarterly or annual forecasts or meeting or exceeding the expectations of research analysts or investors, which may cause our stock price to decline.

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

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

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

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

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

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

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

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

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

Our business strategy includes the potential acquisitions of the shares or assets of companies with complementary software, technologies or businesses or alliances with such companies. For example, in March 2016, we acquired EagleEye Analytics, a provider of SaaS-based predictive analytics products designed for property and casualty insurers. Acquisitions and alliances may result in unforeseen operating difficulties and expenditures and may not result in the benefits anticipated by such corporate activity. In particular, we may fail to: assimilate or integrate the businesses, technologies, services, products, personnel or operations of the acquired companies; retain key personnel necessary to favorably execute the combined companies business plan; retain existing customers or sell acquired products to new customers. Acquisitions and alliances may also disrupt our ongoing business, divert our resources and require significant management attention that would otherwise be available for ongoing development of our current business. We also may be required to use a substantial amount of our cash or issue debt or equity securities to complete an acquisition or realize the potential of an alliance, which could deplete our cash reserves and/or dilute our existing stockholders. Following an acquisition or the establishment of an alliance offering new products, we may be required to defer the recognition of revenues that we receive from the sale of products that we acquired or that result from the alliance, or from the sale of a bundle of products that includes such new products, if we have not established vendor-specific objective evidence ("VSOE") for the undelivered elements in the arrangement. In addition, our ability to maintain favorable pricing of new products may be challenging if we bundle such products with sales of existing products. A delay in the recognition of revenues from sales of acquired or alliance products, or reduced pricing due to bundled sales, may cause fluctuations in our quarterly financial results, may adversely affect our operating margins and may reduce the benefits of such acquisitions or alliances.

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

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

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

We expect the intensity of competition to remain high in the future as existing companies obtain new capital, consolidate with other vendors or develop stronger capabilities or as new companies enter our markets. Such intense competition could result in increased pricing pressure, reduced profit margins, increased sales and marketing expenses, and failure to increase, or the loss of, market share, any of which could harm our business, results of operations, financial condition or future prospects. Our larger competitors may be able to devote greater resources to the development, promotion and sale of their products than we can devote to ours, which could allow them to respond more quickly than we can to new technologies and changes in customer needs leading to wider market acceptance. We may not be able to compete effectively and competitive pressures may prevent us from acquiring and maintaining the customer base necessary for us to increase our revenues and profitability.

Our current and potential competitors may also establish cooperative relationships among themselves or with third parties that may further enhance their resources. Current or potential competitors may be acquired by other vendors or third parties

Table of Contents

with greater available resources. As a result of such acquisitions, our current or potential competitors might be more able than we to adapt more quickly to new technologies and customer needs, devote greater resources to the promotion or sale of their products and services, initiate or withstand substantial price competition, or take advantage of other opportunities to more readily or develop and expand their product and service offerings more quickly. Additionally, they may hold larger portfolios of patents and other intellectual property rights as a result of such acquisitions. If we are unable to compete effectively for a share of our market, our business, results of operations and financial condition could be materially and adversely affected.

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

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

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

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

In the European Community, Directive 95/46/EC (the "Directive") has required European Union member states to implement data protection laws to meet the strict privacy requirements of the Directive. Among other requirements, the Directive regulates transfers of personally identifiable data that is subject to the Directive ("Personal Data") to third countries, such as the United States, that have not been found to provide adequate protection to such Personal Data. We have in the past relied upon adherence to the U.S. Department of Commerce's Safe Harbor Privacy Principles and compliance with the U.S.-EU and U.S.-Swiss Safe Harbor Frameworks as agreed to and set forth by the U.S. Department of Commerce, and the European Union and Switzerland, which established a means for legitimating the transfer of Personal Data collected by US companies doing business s in the European Economic Area (or "EEA"), to the U.S. As a result of the October 6, 2015 European Union Court of Justice, or ECJ, opinion in Case C-362/14 (Schrems v. Data Protection Commissioner) regarding the adequacy of the U.S.-EU Safe Harbor Framework, the U.S. - EU Safe Harbor Framework is no longer deemed to be a valid method of compliance with requirements set forth in the Directive (and member states' implementations thereof) regarding the transfer of Personal Data outside of the EEA.

Recently, it was announced that negotiators from the EU and US reached political agreement on a successor to the Safe Harbor framework that will be referred to as the EU-US Privacy Shield. However, it is likely to be months before all of the details regarding the Privacy Shield program are finalized and a procedure is introduced to allow interested companies to participate in the program. While the details regarding the Privacy Shield program continue to be finalized, we will continue to face uncertainty to the limited extent we may transfer any Personal Data and as to whether our efforts to comply with our obligations under European privacy laws will be sufficient. If we are investigated by a European data protection authority, we could face fines and other penalties. Any such investigation or charges by European data protection authorities could have a negative effect on our existing business and on our ability to attract and retain new customers.

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

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

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

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

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

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

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

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

The increased pace of consolidation in the P&C insurance industry may result in reduced overall spending on our products. Acquisitions of customers can delay or cancel sales cycles and because we cannot predict the timing or duration of such acquisitions, our results of operations could be materially impacted by the change in the industry.

Table of Contents

Factors outside of our control including but not limited to natural catastrophes and terrorism may adversely impact the P&C insurance industry, preventing us from expanding or maintaining our existing customer base and increasing our revenues.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

If we fail to develop new products or enhancements to our existing products, our business could be adversely affected, especially if our competitors are able to introduce products with enhanced functionality. It is critical to our success for us to anticipate changes in technology, industry standards and customer requirements and to successfully introduce new, enhanced and competitive products to meet our customers' and prospective customers' needs on a timely basis. We have invested and intend to increase investments in research and development to meet these challenges. Revenues may not be sufficient to support the future product development that is required for us to remain competitive. If we fail to develop products in a timely manner that are competitive in technology and price or develop products that fail to meet customer demands, our market share will decline and our business and results of operations could be harmed.

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

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

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

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

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

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

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

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

We attempt to protect our intellectual property, technology, and confidential information by generally requiring our employees and consultants to enter into confidentiality and assignment of inventions agreements and third parties to enter into nondisclosure agreements, all of which offer only limited protection. These agreements may not effectively prevent unauthorized use or disclosure of our confidential information, intellectual property or technology and may not provide an adequate remedy in the event of unauthorized use or disclosure of our confidential information, intellectual property or technology. Despite our efforts to protect our confidential information, intellectual property, and technology, unauthorized third parties may gain access to our confidential proprietary information, develop and market products or services similar to ours, or use trademarks similar to ours, any of which could materially harm our business and results of operations. In addition, others may independently discover our trade secrets and confidential information, and in such cases, we could not assert any trade secret rights against such parties. Existing U.S. federal, state and international intellectual property laws offer only limited protection. The laws of some foreign countries do not protect our intellectual property rights to as great an extent as the laws of the United States, and many foreign countries do not enforce these laws as diligently as governmental agencies and private parties in the United States. Moreover, policing our intellectual property rights is difficult, costly and may not always be effective.

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

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

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

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

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

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

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

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

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

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

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

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

Our ability to sell our products is highly dependent on the quality of our professional services and technical support services and the support of our system integration providers, and the failure of us or our system integration providers to offer high-quality professional services or technical support services could damage our reputation and adversely affect our ability to sell our products and services to new customers and renew our licenses to existing customers.

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

adverse effect on our business, results of operations, financial condition and growth prospects.
If we are unable to retain our personnel and hire and integrate additional skilled personnel, we may be unable to achieve our goals and our business will suffer.
Our future success depends upon our ability to continue to attract, train, integrate and retain highly skilled employees, particularly our management team, sales and marketing personnel, professional services personnel and software engineers. Our

47

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

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

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

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

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

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

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

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

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

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

- increased exposure to fluctuations in currency exchange rates;
- the burdens and costs of complying with a wide variety of foreign laws and legal standards;
- compliance with the U.S. Foreign Corrupt Practices Act of 1977, as amended (“FCPA”), the U.K. Bribery Act and other anti-corruption regulations, particularly in emerging market countries;
- compliance by international staff with accounting practices generally accepted in the United States, including adherence to our accounting policies and internal controls;
- import and export license requirements, tariffs, taxes and other trade barriers;
- increased financial accounting and reporting burdens and complexities;
- weaker protection of intellectual property rights in some countries;
- multiple and possibly overlapping tax regimes;
- government sanctions that may interfere with our ability to sell into particular countries, such as Russia; and
- political, social and economic instability abroad, terrorist attacks and security concerns in general.

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

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

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

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

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

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

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

The FASB issued new accounting guidance on revenue recognition that becomes effective for us beginning August 1, 2018. The standard permits the use of either the retrospective or cumulative effect transition method. We have not yet selected a transition method. While we continue to evaluate the impact this guidance will have on our financial condition and results of operations, any change in how we recognize revenues can have a significant impact on our quarterly or annual financial results from operations. In order to reduce the risk of financial statement volatility, we will likely need to revise how we license and deliver our software to customers. If we are unsuccessful in adapting our business to the requirements of the new revenue standard, then we may experience greater volatility in our quarterly and annual results, which may cause our stock price to decline. In addition to greater volatility, the application of this new standard may result in the exclusion of licensing revenues from contracts in effect prior to the adoption date, which, despite no change in associated cash flows, could have a material adverse effect on our recognized revenues and net income.

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

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

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

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

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

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

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

business, financial condition and results of operations.
We may not be able to obtain capital when desired on favorable terms, if at all, or without dilution to our stockholders.
We may need additional financing to execute on our current or future business strategies, including to develop new or enhance existing products and services, acquire businesses and technologies, or otherwise to respond to competitive pressures.
If we raise additional funds through the issuance of equity or convertible debt securities, the percentage ownership of our stockholders could be significantly diluted, and these newly-issued securities may have rights, preferences or privileges senior

Table of Contents

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

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

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

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

The market price of our common stock could be subject to wide fluctuations in response to, among other things, the risk factors described in this report, and other factors beyond our control, such as fluctuations in the valuation of companies perceived by investors to be comparable to us and research analyst coverage about our business. Furthermore, the stock markets have experienced price and volume fluctuations that have affected and continue to affect the market prices of equity securities of many companies. These fluctuations often have been unrelated or disproportionate to the operating performance of those companies. These broad market and industry fluctuations, as well as general economic, political and market conditions, such as recessions, interest rate changes or international currency fluctuations, have and may continue to affect the market price of our common stock.

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

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

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

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

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

- providing for a classified board of directors with staggered three-year terms, which could delay the ability of stockholders to change the membership of a majority of our board of directors;
- not providing for cumulative voting in the election of directors, which limits the ability of minority stockholders to elect director candidates;
- authorizing our board of directors to issue, without stockholder approval, preferred stock rights senior to those of common stock, which could be used to significantly dilute the ownership of a hostile acquirer;
- prohibiting stockholder action by written consent, which forces stockholder action to be taken at an annual or special meeting of our stockholders;
-

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

Table of Contents

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

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

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

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

ITEM 6. Exhibits

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

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

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

Table of Contents

SIGNATURES

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

Date:	June 1, 2016	GUIDEWIRE SOFTWARE, INC.
		By: /s/ Richard Hart
		Richard Hart
		Chief Financial Officer
		(Principal Financial and Accounting Officer)

53