

Guidewire Software, Inc.
 Form 10-Q
 December 03, 2014
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UNITED STATES
 SECURITIES AND EXCHANGE COMMISSION
 Washington, D.C. 20549

FORM 10-Q

(Mark one)

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

For the quarterly period ended October 31, 2014

OR

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

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

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

Delaware (State or other jurisdiction of Incorporation or organization)	36-4468504 (I.R.S. Employer Identification No.)
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1001 E. Hillsdale Blvd., Suite 800 Foster City, California (Address of principal executive offices)	94404 (Zip Code)
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(650) 357-9100
 (Registrant's telephone number, including area code)

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

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

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

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

Large accelerated filer	<input checked="" type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/>	Smaller reporting company	<input type="checkbox"/>

(do not check if a smaller reporting company)

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

On October 31, 2014, the registrant had 69,588,873 shares of common stock issued and outstanding.

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FORWARD-LOOKING STATEMENTS

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

- growth prospects of the Property & Casualty (“P&C”) insurance industry and our company;
- trends in our future sales, including seasonality;
- opportunities for growth by technology leadership;
- competitive advantages of our platform of software application solutions;
- our market strategy in relation to our competitors;
- competitive attributes of our software application solutions;
- opportunities to further expand our position outside of the United States;
- risk of exposure to product liability;
- our research and development investment and efforts;
- satisfying our future liquidity requirements;
- our gross margins and factors that affect gross margins;
- our provision for tax liabilities and other critical accounting estimates;
- our exposure to market risks; and
- future payments required pursuant to lease agreements and commitments.

Forward-looking statements are not guarantees of future performance and involve risks and uncertainties. The forward-looking statements contained in this Quarterly Report on Form 10-Q are based on information available to us as of the filing date of this Quarterly Report on Form 10-Q and our current expectations about future events, which are inherently subject to change and involve risks and uncertainties. You should not place undue reliance on these forward-looking statements. All subsequent written or oral forward-looking statements attributable to our company or persons acting on our behalf are expressly qualified in their entirety by these cautionary statements.

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

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

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PART I – Financial Information

ITEM 1. Financial Statements (unaudited)
GUIDEWIRE SOFTWARE, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(unaudited, in thousands)

	October 31, 2014	July 31, 2014
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$121,510	\$148,101
Short-term investments	378,725	296,231
Accounts receivable	40,118	49,839
Deferred tax assets, current	11,394	11,431
Prepaid expenses and other current assets	11,581	10,828
Total current assets	563,328	516,430
Long-term investments	130,769	203,449
Property and equipment, net	12,401	12,607
Intangible assets, net	5,079	5,439
Deferred tax assets, noncurrent	9,667	8,681
Goodwill	9,205	9,205
Other assets	1,333	1,416
TOTAL ASSETS	\$731,782	\$757,227
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable	\$7,106	\$7,030
Accrued employee compensation	17,271	34,912
Deferred revenues, current	44,897	48,937
Other current liabilities	4,617	4,507
Total current liabilities	73,891	95,386
Deferred revenues, noncurrent	1,975	6,395
Other liabilities	4,603	4,760
Total liabilities	80,469	106,541
STOCKHOLDERS' EQUITY:		
Common stock	7	7
Additional paid-in capital	633,939	629,076
Accumulated other comprehensive loss	(2,606	) (1,367
Retained earnings	19,973	22,970
Total stockholders' equity	651,313	650,686
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$731,782	\$757,227

See accompanying Notes to Condensed Consolidated Financial Statements.

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

	Three Months Ended October 31,		
	2014	2013	
Revenues:			
License	\$28,820	\$18,870	
Maintenance	12,520	9,639	
Services	38,394	38,020	
Total revenues	79,734	66,529	
Cost of revenues: ⁽¹⁾			
License	1,082	846	
Maintenance	2,242	1,782	
Services	32,447	35,229	
Total cost of revenues	35,771	37,857	
Gross profit: ⁽¹⁾			
License	27,738	18,024	
Maintenance	10,278	7,857	
Services	5,947	2,791	
Total gross profit	43,963	28,672	
Operating expenses: ⁽¹⁾			
Research and development	20,310	17,527	
Sales and marketing	17,529	15,673	
General and administrative	9,762	8,099	
Total operating expenses	47,601	41,299	
Loss from operations	(3,638) (12,627)
Interest income, net	512	158	
Other income (expense), net	(483) 115	
Loss before benefit from income taxes ⁽¹⁾	(3,609) (12,354)
Benefit from income taxes ⁽¹⁾	(612) (5,899)
Net loss ⁽¹⁾	\$(2,997) \$(6,455)
Net loss per share: ⁽¹⁾			
Basic	\$(0.04) \$(0.11)
Diluted	\$(0.04) \$(0.11)
Shares used in computing net loss per share: ⁽¹⁾			
Basic	69,316,700	58,649,353	
Diluted	69,316,700	58,649,353	

(1) See Note 2 "Change in Accounting Policy - Stock-Based Compensation" of Notes to Consolidated Financial Statements for the fiscal year ended July 31, 2014 included in the Company's Annual Report on Form 10-K.

See accompanying Notes to Condensed Consolidated Financial Statements.

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

	Three Months Ended October 31,	
	2014	2013
	(in thousands)	
Net loss ⁽¹⁾	\$ (2,997	) \$ (6,455
Other comprehensive income (loss):		
Foreign currency translation adjustments ⁽¹⁾	(1,269	) 471
Unrealized gains on available-for-sale securities, net of tax of \$8 and \$17	33	34
Reclassification adjustment for gains included in net loss	(3	) (9
Other comprehensive income (loss)	(1,239	) 496
Comprehensive loss	\$ (4,236	) \$ (5,959

(1) See Note 2 "Change in Accounting Policy - Stock-Based Compensation" of Notes to Consolidated Financial Statements for the fiscal year ended July 31, 2014 included in the Company's Annual Report on Form 10-K. See accompanying Notes to Condensed Consolidated Financial Statements

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

	Three Months Ended October 31,	
	2014	2013
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss ⁽¹⁾	\$(2,997	) \$(6,455
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	1,773	1,591
Stock-based compensation ⁽¹⁾	11,988	9,186
Excess tax benefit from exercise of stock options and vesting of RSUs	—	(132
Deferred taxes ⁽¹⁾	(955	) (6,167
Other noncash items affecting net loss	1,414	316
Changes in operating assets and liabilities:		
Accounts receivable	9,493	(6,210
Prepaid expenses and other assets	(814	) 1,335
Accounts payable	87	884
Accrued employee compensation	(17,232	) (9,857
Other liabilities	10	(1,299
Deferred revenues	(8,315	) 2,225
Net cash used in operating activities	(5,548	) (14,583
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of available-for-sale securities	(113,730	) (43,157
Sales and maturities of available-for-sale securities	102,539	31,102
Purchase of property and equipment	(1,249	) (1,206
Acquisition of business, net of cash acquired	—	(95
Net cash used in investing activities	(12,440	) (13,356
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from issuance of common stock upon exercise of stock options	1,445	2,063
Taxes remitted on RSU awards vested	(8,570	) (7,302
Proceeds from issuance of common stock in connection with public offering, net of underwriting discounts and commissions	—	389,949
Costs paid in connection with public offerings	—	(107
Excess tax benefit from exercise of stock options and vesting of RSUs	—	132
Net cash provided by (used in) financing activities	(7,125	) 384,735
Effect of foreign exchange rate changes on cash and cash equivalents	(1,478	) 582
NET CHANGE IN CASH AND CASH EQUIVALENTS	(26,591	) 357,378
CASH AND CASH EQUIVALENTS—Beginning of period	148,101	79,767
CASH AND CASH EQUIVALENTS—End of period	\$121,510	\$437,145
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid for income taxes	\$506	\$673
SUPPLEMENTAL DISCLOSURES OF NONCASH INVESTING AND FINANCING ACTIVITIES:		
Accruals for purchase of property and equipment	\$703	\$180
Unpaid offering costs	\$—	\$299

(1) See Note 2 “Change in Accounting Policy - Stock-Based Compensation” of Notes to Consolidated Financial Statements for the fiscal year ended July 31, 2014 included in the Company’s Annual Report on Form 10-K.

See accompanying Notes to Condensed Consolidated Financial Statements.

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

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

Business

Guidewire Software, Inc., a Delaware corporation, was incorporated on September 20, 2001. Guidewire Software, Inc., together with its subsidiaries (the “Company”), provides Internet-based software platforms for core insurance operations, including underwriting and policy administration, claim management and billing. The Company’s customers include insurance carriers for property and casualty and workers’ compensation insurance. The Company has wholly-owned subsidiaries in Australia, Canada, China, France, Germany, Hong Kong, Ireland, Italy, Japan, Poland and the United Kingdom.

The Company offers a suite of applications to enable core property and casualty (“P&C”) insurance operations comprised of the following products: PolicyCenter, ClaimCenter and BillingCenter. The Company also provides maintenance support and professional services to the extent requested by its customers.

Public Offerings

On October 28, 2013, the Company closed its follow-on public offering of 8,306,291 shares of its common stock, including the underwriters’ partial exercise of their over-allotment option from the Company. The public offering price of the shares sold in the offering was \$48.75 per share. The Company received aggregate proceeds of approximately \$389.9 million from the follow-on offering, net of underwriters’ discounts and commissions applicable to the sale of shares by the Company, but before deduction of offering costs of approximately \$0.4 million payable by the Company. No shares were sold by the Company’s stockholders in this follow-on public offering.

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, 2014. 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, 2014 included in the Company’s Annual Report on Form 10-K.

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 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, Cash Equivalents and Investments

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. The Company classifies investments as short-term when they have remaining contractual maturities of less than one year from the balance sheet date,

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and as long-term when the investments have remaining contractual maturities of more than one year from the balance sheet date. The Company's investment policy is consistent with the definition of available-for-sale securities. From time to time, the Company may sell certain securities but the objectives are generally not to generate profits on short-term differences in price.

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 and cash equivalents 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 accounted for 10% or more of the Company's revenues for the three months ended October 31, 2014 or 2013. One customer accounted for 10% or more of the Company's total accounts receivable as of October 31, 2014 and July 31, 2014.

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 taxes 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. Arrangements where a significant portion of the fee is due beyond 90 days from delivery are not considered to be fixed or determinable. Revenues from such arrangements are recognized as payments become due, assuming all other revenue recognition criteria have been met. Fees from term licenses are generally due in annual or, in certain cases, quarterly, installments over the term of the agreement beginning on the effective date of the license. Accordingly, fees from term licenses are not considered to be fixed or determinable until they become due.

• 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. The Company generally enters into term licenses ranging from 3 to 7 years. 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.

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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.

If reliable estimates of total project costs cannot be made or VSOE for maintenance has not been established and it is reasonably assured that no loss will be incurred under the arrangement, revenues are recognized pursuant to the zero gross margin method. Under this method, revenues recognized are limited to the costs incurred for the implementation services. When the zero gross margin method is applied for lack of reliable project estimates and subsequently project estimates become reliable, the Company switches to the percentage-of-completion method; resulting in a cumulative effect adjustment for deferred license revenues to the extent of progress toward completion, and the related deferred professional service margin is recognized in full as revenues. There were no such cumulative effect adjustments for revenues for the three months ended October 31, 2014 and 2013.

Deferred Revenues

Deferred revenues represent license, maintenance and professional services amounts, which are billed to or collected from customers for which the related revenues have not been recognized. The revenues are deferred when one or more of the revenue recognition criteria have not been met. The current portion of deferred revenues represents the amount that is expected to be recognized as revenues within one year from the balance sheet date. The Company generally invoices fees for licenses and maintenance to its customers in annual or, in certain cases, quarterly installments payable in advance. Accordingly, 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. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. 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. The Company records a valuation allowance to reduce deferred tax assets to an amount of which realization is more likely than not.

Accounting guidance related to accounting for uncertainties in income taxes provides that a tax benefit from an uncertain tax position may be recognized when it is more likely than not that the position will be sustained upon examination, including resolutions of any related appeals or litigation processes, based on the technical merits of the position. This interpretation also provides guidance on measurement, derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition.

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 RSUs are subject to time-based vesting, which generally occurs over a period of 4 years. The 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 determines the grant date fair value of its RSUs based on the closing market price of the Company’s common stock on the date of grant. The Company recognizes the fair value of stock-

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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.

In the fourth quarter of fiscal 2014, the Company changed its policy for recognizing stock-based compensation expense from the accelerated attribution method of accounting to the straight-line method of accounting for certain share-based compensation awards. Comparative financial statements for prior periods have been adjusted to apply the straight-line method retrospectively. See Note 2 “Change in Accounting Policy - Stock-based Compensation” of Notes to Consolidated Financial Statements for the fiscal year ended July 31, 2014 included in the Company’s Annual Report on Form 10-K filed with the SEC on September 17, 2014.

Recent Accounting Pronouncement

Stock-Based Compensation

In June 2014, the FASB issued ASU No. 2014-12, Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period (Topic 718). This ASU provides authoritative guidance for share-based payments with a performance condition that could be achieved after the requisite service period is achieved. The standard will be effective for the Company beginning August 1, 2016. The Company currently does not have such share-based arrangements and does not expect the adoption of this standard will have material impact on its condensed 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 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. The standard will be effective for the Company beginning August 1, 2017. The Company is currently evaluating the impact of the adoption of this accounting standard update on its condensed consolidated financial statements.

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2. Fair Value of Financial Instruments

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

	October 31, 2014			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
	(in thousands)			
U.S. agency securities	\$93,646	\$48	\$(2)	) \$93,692
Asset-backed securities	13	—	—	) 13
Commercial paper	117,155	14	(2)	) 117,167
Corporate bonds	315,937	76	(159)	) 315,854
U.S. government bonds	16,978	2	—	) 16,980
Foreign government bonds	2,740	6	—	) 2,746
Money market funds	36,689	—	—	) 36,689
Certificates of deposit	6,705	2	(1)	) 6,706
Municipal debt securities	9,740	5	—	) 9,745
Total	\$599,603	\$153	\$(164)	) \$599,592
	July 31, 2014			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
	(in thousands)			
U.S. agency securities	\$94,048	\$30	\$(21)	) \$94,057
Asset-backed securities	1,363	—	(2)	) 1,361
Commercial paper	132,442	14	(4)	) 132,452
Corporate bonds	297,731	104	(182)	) 297,653
U.S. government bonds	17,991	3	(3)	) 17,991
Foreign government bonds	2,755	—	(1)	) 2,754
Certificates of deposit	6,709	—	(1)	) 6,708
Money market funds	53,959	—	—) 53,959
Municipal debt securities	12,985	13	(1)) 12,997
Total	\$619,983	\$164	\$(215)) \$619,932

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

	October 31, 2014		12 Months or Greater		Total	Gross Unrealized Losses
	Less Than 12 Months		Gross			
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses		
	(in thousands)					
Commercial paper	\$26,491	\$(2)	\$—	\$—	\$26,491	\$(2)
Asset-backed securities	13	—	—	—	13	—
U. S. Agency Securities	9,848	(2)	—	—	9,848	(2)
Corporate bonds	193,470	(159)	—	—	193,470	(159)
Certificate of deposit	2,699	(1)	—	—	2,699	(1)
Municipal debt securities	1,000	—	—	—	1,000	—
Total	\$233,521	\$(164)	\$—	\$—	\$233,521	\$(164)

As of October 31, 2014, the Company had 89 investments in an unrealized loss position. The unrealized losses on its available-for-sale securities were primarily a result of unfavorable changes in interest rates subsequent to the initial purchase of these securities. The Company does not intend to sell, nor believe it will need to sell, these securities before recovering the associated unrealized losses. The Company does not consider any portion of the unrealized losses at October 31, 2014 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 immaterial.

The following table summarizes the contractual maturities of the Company's available-for-sale securities as of October 31, 2014:

	Expected maturities for the quarter ending October 31,		
	2015	2016	Total
	(in thousands)		
U.S. agency securities	\$31,085	\$62,607	\$93,692
Asset-backed securities	13	—	13
Commercial paper	117,167	—	117,167
Corporate bonds	257,421	58,433	315,854
U.S. government bonds	9,997	6,983	16,980
Foreign government bonds	—	2,746	2,746
Money market funds	36,689	—	36,689
Certificates of deposit	6,706	—	6,706
Municipal debt securities	9,745	—	9,745
Total	\$468,823	\$130,769	\$599,592

Fair value is defined as the exchange price that would be received for an asset or an exit price paid to transfer a liability in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Valuation techniques used to measure fair value must maximize the use of observable inputs and minimize the use of unobservable inputs. 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 I 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

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

The categorization of a financial instrument within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement. The carrying value of the Company's accounts receivable, accounts payable and accrued liabilities approximates their fair value due to the short-term nature of these instruments.

The Company bases the fair value of its Level 1 financial instruments, which are in active markets, using quoted market prices for identical instruments.

The Company obtains the fair value of its Level 2 financial instruments, which are not in active markets, from a third-party professional pricing service using quoted market prices for identical or comparable instruments, rather than direct observations of quoted prices in active markets. The Company's professional pricing service gathers observable inputs for all of its fixed income securities from a variety of industry data providers (e.g. large custodial institutions) and other third-party sources. Once the observable inputs are gathered, all data points are considered and an average price is determined.

The Company validates the quoted market prices provided by its primary pricing service by comparing their assessment of the fair values of its Level 2 investment portfolio balance against the fair values of its Level 2 investment portfolio balance provided by its investment managers. Its investment managers use similar techniques to its professional pricing service to derive pricing as described above.

The Company did not have any Level 3 financial assets or liabilities as of October 31, 2014 or July 31, 2014.

The following tables summarize the Company's financial assets measured at fair value on a recurring basis, by level within the fair value hierarchy as of October 31, 2014 and July 31, 2014:

	October 31, 2014			
	Level 1	Level 2	Level 3	Total
	(in thousands)			
Assets				
Cash and cash equivalents:				
Commercial paper	\$—	\$53,409	\$—	\$53,409
Money market funds	36,689	—	—	36,689
Short-term investments:				
U.S. agency securities	—	31,085	—	31,085
Asset-backed securities	—	13	—	13
Commercial paper	—	63,758	—	63,758
Corporate bonds	—	257,421	—	257,421
U.S. government bonds	—	9,997	—	9,997
Municipal debt securities	—	9,745	—	9,745
Certificates of deposit	—	6,706	—	6,706
Long-term investments:				
U.S. agency securities	—	62,607	—	62,607
U.S. government bonds	—	6,983	—	6,983
Corporate bonds	—	58,433	—	58,433
Foreign government bonds	—	2,746	—	2,746
Total assets	\$36,689	\$562,903	\$—	\$599,592

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	July 31, 2014			
	Level 1	Level 2	Level 3	Total
	(in thousands)			
Assets				
Cash and cash equivalents:				
Commercial paper	\$—	\$66,293	\$—	\$66,293
Money market funds	53,959	—	—	53,959
Short-term investments:				
U.S. agency securities	—	29,062	—	29,062
Asset-backed securities	—	1,361	—	1,361
Commercial paper	—	66,159	—	66,159
U. S. government bonds	—	9,995	—	9,995
Corporate bonds	—	172,648	—	172,648
Certificate of deposit	—	4,009	—	4,009
Municipal debt securities	—	12,997	—	12,997
Long-term investments:				
U.S. agency securities	—	64,995	—	64,995
Certificate of deposit	—	2,699	—	2,699
Corporate bonds	—	125,005	—	125,005
U.S. government bonds	—	7,996	—	7,996
Foreign government bonds	—	2,754	—	2,754
Total assets	\$53,959	\$565,973	\$—	\$619,932

3. Balance Sheet Components

Property and Equipment, Net

Property and equipment consist of the following:

	October 31, 2014	July 31, 2014
	(in thousands)	
Computer hardware	\$12,018	\$11,882
Software	4,666	4,605
Furniture and fixtures	2,928	2,732
Leasehold improvements	7,621	7,069
Total property and equipment	27,233	26,288
Less accumulated depreciation	(14,832)	(13,681)
Property and equipment, net	\$12,401	\$12,607

As of October 31, 2014 and July 31, 2014, no property and equipment was pledged as collateral against borrowings. Depreciation expense was \$1.4 million and \$1.2 million during the three months ended October 31, 2014 and 2013, respectively.

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Goodwill and Intangible Assets

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

	Total (in thousands)
Goodwill, July 31, 2014	\$9,205
Changes in carrying value	—
Goodwill, October 31, 2014	\$9,205

Intangible assets consist of the following:

	October 31, 2014 (in thousands)	July 31, 2014
Acquired technology:		
Cost	\$7,200	\$7,200
Accumulated amortization	(2,121	) (1,761
Intangible assets, net	\$5,079	\$5,439

Amortization expense was \$0.4 million for the three months ended October 31, 2014 and 2013. Estimated aggregate amortization expense for each of the next four fiscal years is as follows:

	Future Amortization (in thousands)
Fiscal year ending July 31, 2015 (remainder of fiscal year)	1,080
2016	1,440
2017	1,440
2018	1,119
Total	\$5,079

Accrued Employee Compensation

Accrued employee compensation consists of the following:

	October 31, 2014 (in thousands)	July 31, 2014
Accrued bonuses	\$4,314	\$19,213
Accrued commission	977	3,593
Accrued vacation	7,975	8,100
Accrued salaries, payroll taxes and benefits	4,005	4,006
Total	\$17,271	\$34,912

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Accumulated Other Comprehensive Loss

Changes in accumulated other comprehensive loss by component during the three months ended October 31, 2014 were as follows:

	Foreign Currency Items	Unrealized gain (loss) on available-for-sale securities	Total
	(in thousands)		
Balance as of July 31, 2014	\$(1,310	) \$(57	) \$(1,367)
Other comprehensive gain (loss) before reclassification	(1,269	) 41	(1,228)
Amounts reclassified from accumulated other comprehensive loss to earnings	—	(3	) (3)
Tax effect	—	(8	) (8)
Balance as of October 31, 2014	\$(2,579	) \$(27	) \$(2,606)

4. Net Loss Per Share

The following table sets forth the computation of the Company's basic and diluted net loss per share for the three months ended October 31, 2014 and 2013:

	Three Months Ended October 31, 2014		2013	
	(in thousands, except share and per share amounts)			
Numerator:				
Net loss	\$(2,997	)	\$(6,455)
Net loss per share:				
Basic	\$(0.04	)	\$(0.11)
Diluted	\$(0.04	)	\$(0.11)
Denominator:				
Weighted average shares used in computing net loss per share:				
Basic	69,316,700		58,649,353	
Weighted average effect of dilutive stock options	—		—	
Weighted average effect of dilutive restricted stock units	—		—	
Diluted	69,316,700		58,649,353	

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

	Three Months Ended October 31,	
	2014	2013
Stock options to purchase common stock	2,386,474	3,602,105
Restricted stock units	3,763,160	4,671,772

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5. 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, 2014. See the Annual Report on Form 10-K for the fiscal year ended July 31, 2014 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 August 1, 2014, the Company amended its operating lease agreement to reduce the unsecured letter of credit to \$0.8 million.

Lease expense for all worldwide facilities and equipment, which is being recognized on a straight-line basis over terms of the various leases, was \$1.6 million and \$1.4 million for the three months ended October 31, 2014 and 2013, respectively.

Letters of Credit

The Company had two outstanding letters of credit required to secure contractual commitments and prepayments as of October 31, 2014 and July 31, 2014, 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 \$3.0 million as of October 31, 2014) to secure contractual commitments and prepayments. No amounts were outstanding under the Company's unsecured letters of credit as of October 31, 2014 or July 31, 2014.

Legal Proceedings

From time to time, the Company is involved in various legal proceedings and receives claims, arising from the normal course of business activities. The Company 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 are outstanding as of October 31, 2014 and July 31, 2014. For several reasons, including the lack of prior indemnification claims and the lack of a monetary liability limit for certain infringement cases under various Software Licenses, the Company cannot estimate the amount of potential future payments, if any, related to indemnification provisions.

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

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6. Stockholders' Equity and Stock-Based Compensation

Stock-Based Compensation Expense

Stock-based compensation expense related to all employee and non-employee stock-based awards is as follows:

	Three Months Ended October 31,	
	2014	2013
	(in thousands)	
Stock-based compensation expenses:		
Cost of license	\$49	\$45
Cost of maintenance revenues	277	160
Cost of services revenues	3,513	2,714
Research and development	2,143	1,995
Sales and marketing	2,987	2,059
General and administrative	3,019	2,213
Total stock-based compensation expenses	\$11,988	\$9,186

As of October 31, 2014, total unrecognized compensation cost, adjusted for estimated forfeitures, was as follows:

	As of October 31, 2014	
	Unrecognized Expense	Average Expected
	(in thousands)	Recognition Period
		(in years)
Restricted stock units	\$112,718	2.6
Stock options	6,735	2.2
	\$119,453	

RSUs

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

	RSUs Outstanding	Weighted
	Number of RSUs	Average Grant
	Outstanding	Date Fair Value
Balance as of July 31, 2014	3,384,221	\$30.70
Granted	1,096,112	45.27
Released	(519,154)	) 21.84
Canceled	(129,085)	) 32.70
Balance as of October 31, 2014	3,832,094	\$36.00

The weighted average per share grant date fair value of RSUs granted during the three months ended October 31, 2014 and 2013 was \$45.27 and \$43.74, respectively. The fair value of RSUs released during the three months ended October 31, 2014 and 2013 was \$23.8 million and \$20.6 million, respectively.

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Stock Options

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

	Stock Options Outstanding		Weighted Average Remaining Contractual Life (in years)	Aggregate Intrinsic Value ⁽¹⁾ (in thousands)
	Number of Stock Options Outstanding	Weighted Average Exercise Price		
Balance as of July 31, 2014	2,400,253	\$11.24	5.5	\$71,640
Granted	103,643	45.27		
Exercised	(173,842)	8.32		
Canceled	(40,803)	24.18		
Balance as of October 31, 2014	2,289,251	\$12.77	5.3	\$85,102
Vested and expected to vest as of October 31, 2014	2,261,137	\$12.40	5.3	\$84,889
Exercisable as of October 31, 2014	1,887,279	\$6.78		