

Guidewire Software, Inc.  
 Form 10-Q  
 June 03, 2014  
Table of Contents

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

---

FORM 10-Q

---

(Mark one)

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

For the quarterly period ended April 30, 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	36-4468504
(State or other jurisdiction of Incorporation or organization)	(I.R.S. Employer Identification No.)

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

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

---

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

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definition of "large accelerated filer," "accelerated filer" 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)

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

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

On April 30, 2014, the registrant had 68,557,084 shares of common stock issued and outstanding.

---

Table of Contents

Guidewire Software, Inc.  
Index

<u>Part I – Financial Information</u>	<u>2</u>
Item 1. <u>Financial Statements (unaudited):</u>	<u>3</u>
<u>Condensed Consolidated Balance Sheets as of April 30, 2014 and July 31, 2013</u>	<u>3</u>
<u>Condensed Consolidated Statements of Operations for the Three and Nine Months Ended April 30, 2014 and 2013</u>	<u>4</u>
<u>Condensed Consolidated Statements of Comprehensive Income (Loss) for the Three and Nine Months Ended April 30, 2014 and 2013</u>	<u>5</u>
<u>Condensed Consolidated Statements of Cash Flows for the Nine Months Ended April 30, 2014 and 2013</u>	<u>6</u>
<u>Notes to Condensed Consolidated Financial Statements</u>	<u>7</u>
Item 2. <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>21</u>
Item 3. <u>Quantitative and Qualitative Disclosures about Market Risk</u>	<u>35</u>
Item 4. <u>Controls and Procedures</u>	<u>35</u>
<u>Part II – Other Information</u>	<u>37</u>
Item 1. <u>Legal Proceedings</u>	<u>37</u>
Item 1A. <u>Risk Factors</u>	<u>37</u>
Item 6. <u>Exhibits</u>	<u>53</u>
<u>Signatures</u>	<u>54</u>

Table of Contents

FORWARD-LOOKING STATEMENTS

The “Management's Discussion and Analysis of Financial Condition and Results of Operations” section and other parts of this Quarterly Report on Form 10-Q and certain information incorporated herein by reference contain forward-looking statements within the meaning of the Securities Act of 1933 and the Securities Exchange Act of 1934, which are subject to risks and uncertainties. The forward-looking statements include statements concerning, among other things, our business strategy (including anticipated trends and developments in, and management plans for, our business and the markets in which we operate), financial results, 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.”



Table of Contents

## PART I – Financial Information

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

	April 30, 2014	July 31, 2013
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$159,336	\$79,767
Short-term investments	271,033	76,932
Accounts receivable	58,319	40,885
Deferred tax assets, current	2,917	2,897
Prepaid expenses and other current assets	11,589	9,612
Total current assets	503,194	210,093
Long-term investments	169,780	51,040
Property and equipment, net	12,459	12,914
Intangible assets, net	5,799	6,879
Deferred tax assets, noncurrent	31,786	21,091
Goodwill	9,205	9,048
Other assets	1,485	1,205
<b>TOTAL ASSETS</b>	<b>\$733,708</b>	<b>\$312,270</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Accounts payable	\$6,418	\$6,517
Accrued employee compensation	24,214	26,302
Deferred revenues, current	52,746	37,351
Other current liabilities	5,088	4,614
Total current liabilities	88,466	74,784
Deferred revenues, noncurrent	5,552	3,845
Other liabilities	4,695	5,212
Total liabilities	98,713	83,841
<b>STOCKHOLDERS' EQUITY:</b>		
Common stock	7	6
Additional paid-in capital	657,027	237,769
Accumulated other comprehensive loss	(1,386	) (1,558
Accumulated deficit	(20,653	) (7,788
Total stockholders' equity	634,995	228,429
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b>\$733,708</b>	<b>\$312,270</b>
See accompanying Notes to Condensed Consolidated Financial Statements.		

Table of Contents

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

	Three Months Ended April 30,		Nine Months Ended April 30,		
	2014	2013	2014	2013	
Revenues:					
License	\$31,927	\$22,918	\$86,012	\$74,482	
Maintenance	10,440	9,110	29,969	27,690	
Services	39,668	36,222	116,058	101,567	
Total revenues	82,035	68,250	232,039	203,739	
Cost of revenues:					
License	845	139	3,394	436	
Maintenance	2,238	2,079	6,192	5,430	
Services	34,259	33,774	106,397	89,071	
Total cost of revenues	37,342	35,992	115,983	94,937	
Gross profit:					
License	31,082	22,779	82,618	74,046	
Maintenance	8,202	7,031	23,777	22,260	
Services	5,409	2,448	9,661	12,496	
Total gross profit	44,693	32,258	116,056	108,802	
Operating expenses:					
Research and development	20,634	16,854	58,444	47,503	
Sales and marketing	17,968	11,915	53,871	36,680	
General and administrative	9,489	7,851	27,567	23,962	
Total operating expenses	48,091	36,620	139,882	108,145	
Income (loss) from operations	(3,398	) (4,362	) (23,826	) 657	
Interest income, net	415	137	919	359	
Other income (expense), net	190	(268	) 372	(104	)
Income (loss) before benefit from income taxes	(2,793	) (4,493	) (22,535	) 912	
Benefit from income taxes	(1,435	) (1,823	) (9,670	) (2,366	)
Net income (loss)	\$(1,358	) \$(2,670	) \$(12,865	) \$3,278	
Earnings (loss) per share:					
Basic	\$(0.02	) \$(0.05	) \$(0.20	) \$0.06	
Diluted	\$(0.02	) \$(0.05	) \$(0.20	) \$0.05	
Shares used in computing earnings (loss) per share:					
Basic	68,261,964	57,017,856	64,718,852	55,887,786	
Diluted	68,261,964	57,017,856	64,718,852	61,732,623	
See accompanying Notes to Condensed Consolidated Financial Statements.					

Table of Contents

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

	Three Months Ended April 30,		Nine Months Ended April 30,	
	2014	2013	2014	2013
	(in thousands)			
Net income (loss)	\$ (1,358	) \$ (2,670	) \$ (12,865	) \$ 3,278
Other comprehensive income (loss):				
Foreign currency translation adjustments	546	(214	) 109	(215
Unrealized gains on available-for-sale securities, net of tax of \$10 and \$0; \$42 and \$0	58	38	102	58
Reclassification adjustment for gains realized on available-for-sale securities, included in net income (loss)	(19	) —	(39	) —
Other comprehensive income (loss)	585	(176	) 172	(157
Comprehensive income (loss)	\$ (773	) \$ (2,846	) \$ (12,693	) \$ 3,121
See accompanying Notes to Condensed Consolidated Financial Statements				



Table of Contents

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

	Nine Months Ended April 30,	
	2014	2013
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income (loss)	\$(12,865	) \$3,278
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	4,978	3,182
Stock-based compensation	47,520	28,430
Excess tax benefit from exercise of stock options and vesting of RSUs	(498	) (323
Deferred taxes	(10,712	) (4,779
Other noncash items affecting net income (loss)	2,227	272
Changes in operating assets and liabilities:		
Accounts receivable	(17,820	) (15,949
Prepaid expenses and other assets	(2,187	) 403
Accounts payable	135	700
Accrued employee compensation	(2,279	) (5,049
Other liabilities	382	1,959
Deferred revenues	17,172	(4,012
Net cash provided by operating activities	26,053	8,112
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchases of available-for-sale securities	(521,005	) (170,513
Sales and maturities of available-for-sale securities	206,046	57,256
Purchase of property and equipment	(3,669	) (7,061
Acquisition of business, net of cash acquired	(157	) —
Decrease in restricted cash	—	3,520
Net cash used in investing activities	(318,785	) (116,798
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Proceeds from issuance of common stock upon exercise of stock options	7,354	7,964
Taxes remitted on RSU awards vested	(25,654	) (14,695
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	(408	) —
Excess tax benefit from exercise of stock options and vesting of RSUs	498	323
Net cash provided by (used in) financing activities	371,739	(6,408
Effect of foreign exchange rate changes on cash and cash equivalents	562	(94
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	<b>79,569</b>	<b>(115,188</b>
<b>CASH AND CASH EQUIVALENTS—Beginning of period</b>	<b>79,767</b>	<b>205,718</b>
<b>CASH AND CASH EQUIVALENTS—End of period</b>	<b>\$ 159,336</b>	<b>\$ 90,530</b>
<b>SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:</b>		
Cash paid for income taxes	\$2,036	\$ 1,569
<b>SUPPLEMENTAL DISCLOSURES OF NONCASH INVESTING AND FINANCING ACTIVITIES:</b>		
Accruals for purchase of property and equipment	\$409	\$953
See accompanying Notes to Condensed Consolidated Financial Statements.		



Table of Contents

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

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

Business

Guidewire Software, Inc., a Delaware corporation, was incorporated on September 20, 2001. Guidewire Software, Inc., together with its subsidiaries (the “Company”), provides 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 provides professional services to the extent requested by its customers.

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 audited 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, 2013. There have been no changes in the Company’s significant accounting policies from those that were disclosed in the Company’s audited consolidated financial statements for the fiscal year ended July 31, 2013 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, Investments, and Restricted Cash

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. The Company classifies investments as short-term when they have remaining contractual maturities of less than one year 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. Cash equivalents are comprised of money market funds and short-term investments with an investment rating of either of the following: Moody’s of A3 or higher or Standard & Poor’s of A- or higher. The Company is exposed to credit risk in the event of default by the financial institutions or the issuers of these investments to the extent the amounts recorded on the balance sheet are in excess of amounts that are insured by the Federal Deposit Insurance Corporation (“FDIC”). Restricted cash is held in

certificates of deposit pursuant to lease agreements, and, in prior periods, pursuant to secured letter of credit agreements as well.

7

---

## Table of Contents

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, short-term and long-term investments, and accounts receivable. The Company maintains its cash, cash equivalents and short-term and long-term investments with high quality financial institutions with investment grade ratings.

No customer accounted for 10% or more of the Company's revenues for the three and nine months ended April 30, 2014 or 2013. Two customers accounted for 10% or more of the Company's total accounts receivable as of April 30, 2014. The Company had one customer that accounted for 10% of total accounts receivable as of July 31, 2013.

### 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:

- License fees, related to term (or time-based) software license revenue which includes enterprise cloud-based (i) applications and technology cross-licensing revenue from a strategic partnership and perpetual software license revenues;
- (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 is 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, for all arrangements that do not include services that are essential to the functionality of the software, 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. The Company began using stated maintenance renewal rates in customers' contracts during fiscal year 2008. Prior to that, customers' contracts did not have stated maintenance renewal rates and the Company was unable to establish VSOE of maintenance. 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.

8

---

Table of Contents

If VSOE of fair value for one or more undelivered elements does not exist, the total arrangement fee is not recognized until delivery of those elements occurs or when VSOE of fair value is established.

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.

When implementation services are sold with a license arrangement, the Company evaluates whether those services are essential to the functionality of the software. Prior to fiscal year 2008, implementation services were determined to be essential to the software because the implementation services were generally not available from other third party vendors. By the beginning of fiscal year 2008, third-party vendors were providing implementation services for ClaimCenter and it was concluded that implementation services generally were not essential to the functionality of the ClaimCenter software. By the beginning of fiscal year 2011, third-party vendors were providing implementation services for PolicyCenter and BillingCenter and it was concluded that implementation services generally were no longer essential to the functionality of the PolicyCenter and BillingCenter software. 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 and the extent of progress toward completion can be made, the Company applies the percentage-of-completion method in recognizing the arrangement fee. The 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 billed monthly on a time and material basis. For term licenses with license fees due in equal installments over the term, the license revenues subject to percentage-of-completion recognition includes only those payments that are due and payable within the reporting period. The fees related to the maintenance are recognized over the period the maintenance is provided.

When VSOE for maintenance has not been established and the arrangement includes implementation services which are deemed essential to the functionality of the software 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. As a result, billed license and maintenance fees and the profit margin on the professional services are generally deferred until the essential services are completed and then recognized over the remaining term of the maintenance period.

If the Company cannot make reliable estimates of total project implementation and it is reasonably assured that no loss will be incurred under such arrangements, the zero profit margin method is applied whereby an amount of revenues equal to the incurred costs of the project is recognized as well as the incurred costs, producing a zero margin until project estimates become reliable. The percentage-of-completion method is applied when project estimates become reliable; 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. Such cumulative effect adjustment for license revenues was nil for the three and nine months ended April 30, 2014, and nil and \$3.2 million for the three and nine months ended April 30, 2013, respectively, and for service revenues was nil for the three and nine months ended April 30, 2014, and nil and \$1.7 million for the three and nine months ended April 30, 2013, respectively.

#### Deferred Revenues

Deferred revenues represent amounts billed to or collected from customers for which the related revenues have not been recognized because 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

9

---



## Table of Contents

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 accounting guidance 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. Compensation cost for RSUs is generally recognized over the time-based vesting period. The options expire 10 years from the grant date. The Company estimates the grant date fair value, and the resulting stock-based compensation expense, of our stock options using the Black-Scholes option-pricing model. The grant date fair value of the stock-based awards is recognized using the accelerated multiple option approach over the requisite service period, which is generally the vesting period of the respective awards.

### Public Offering

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 shareholders in this follow-on offering.

### Recent Accounting Pronouncement

#### Revenue from Contracts with Customers

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("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.

#### Presentation of Unrecognized Tax Benefits

In July 2013, the FASB issued authoritative guidance that requires an entity to present an unrecognized tax benefit ("UTB"), or a portion of a UTB, in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward, except as follows. To the extent that a net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date under the tax law of the applicable jurisdiction to settle any additional income taxes that would result from the disallowance of a tax position or the tax law of the applicable jurisdiction does not require the entity to use, and the entity does not intend to use, the deferred tax asset for such purpose, the UTB should be presented in the financial statements as a liability and should not be combined with deferred tax assets. The guidance is effective prospectively for fiscal years and interim reporting periods within those years, beginning after December 15, 2013. The Company does not expect this guidance to have a material impact on its condensed consolidated financial statements.



Table of Contents

## 2. Fair Value of Financial Instruments

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

	April 30, 2014			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
	(in thousands)			
U.S. agency securities	\$86,042	\$50	\$(9)	) \$86,083
Asset-backed securities	5,173	—	—	) 5,173
Commercial paper	166,318	17	(1)	) 166,334
Corporate bonds	237,430	118	(41)	) 237,507
U.S. government bonds	4,996	2	—	) 4,998
Foreign government bonds	2,770	—	(17)	) 2,753
Money market funds	51,837	—	—	) 51,837
Certificate of deposit	2,700	—	(2)	) 2,698
Municipal debt securities	14,341	14	(2)	) 14,353
Total	\$571,607	\$201	\$(72)	) \$571,736
	July 31, 2013			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
	(in thousands)			
U.S. agency securities	\$37,087	\$21	\$(4)	) \$37,104
Asset-backed securities	4,522	—	(1)	) 4,521
Commercial paper	35,777	11	(1)	) 35,787
Corporate bonds	63,281	23	(14)	) 63,290
Foreign government bonds	776	—	(1)	) 775
Money market funds	33,216	—	—	) 33,216
Municipal debt securities	9,105	4	(14)	) 9,095
Total	\$183,764	\$59	\$(35)	) \$183,788

Table of Contents

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:

	April 30, 2014					
	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	\$11,098	\$(1)	\$—	\$—	\$11,098	\$(1)
Asset-backed securities	999	—	—	—	999	—
U. S. Agency Securities	27,995	(9)	—	—	27,995	(9)
Corporate bonds	74,350	(41)	—	—	74,350	(41)
Foreign government bonds	2,753	(17)	—	—	2,753	(17)
Certificate of deposit	2,698	(2)	—	—	2,698	(2)
Municipal debt securities	5,895	(2)	—	—	5,895	(2)
Total	\$125,788	\$(72)	\$—	\$—	\$125,788	\$(72)

As of April 30, 2014, the Company had 45 investments in an unrealized loss position making up the unrealized losses of \$72 thousand. The unrealized losses on our 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 believes 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, 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 market value in its condensed consolidated balance sheets, with unrealized gains and losses reported as a component of accumulated other comprehensive income. Upon sale, amounts of gains and losses reclassified into earnings are determined based on specific identification of the securities sold.

The following table summarizes the contractual maturities of the Company's available-for-sale securities as of April 30, 2014:

	Expected maturities for the year ending April 30,		
	2015	2016	Total
	(in thousands)		
U.S. agency securities	\$27,105	\$58,978	\$86,083
Asset-backed securities	4,601	572	5,173
Commercial paper	166,334	—	166,334
Corporate bonds	134,731	102,776	237,507
U.S. government bonds	4,998	—	4,998
Foreign government bonds	—	2,753	2,753
Money market funds	51,837	—	51,837
Certificate of deposit	—	2,698	2,698
Municipal debt securities	12,350	2,003	14,353
Total	\$401,956	\$169,780	\$571,736

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;

12

---

Table of Contents

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 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.

We base the fair value of our Level 1 financial instruments, which are in active markets, using quoted market prices for identical instruments.

We obtain the fair value of our 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. Our professional pricing service gathers observable inputs for all of our 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.

We validate the quoted market prices provided by our primary pricing service by comparing their assessment of the fair values of our Level 2 investment portfolio balance against the fair values of our Level 2 investment portfolio balance provided by our investment managers. Our investment managers use similar techniques to our professional pricing service to derive pricing as described above.

We did not have any Level 3 financial assets or liabilities as of April 30, 2014 or July 31, 2013.

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, 2014 and July 31, 2013:

	April 30, 2014			
	Level 1	Level 2	Level 3	Total
	(in thousands)			
Cash equivalents:				
Commercial paper	\$—	\$79,086	\$—	\$79,086
Money market funds	51,837	—	—	51,837
Short-term investments:				
U.S. agency securities	—	27,105	—	27,105
Asset-backed securities	—	4,601	—	4,601
Commercial paper	—	87,248	—	87,248
Corporate bonds	—	134,731	—	134,731
U.S. government bonds	—	4,998	—	4,998
Municipal debt securities	—	12,350	—	12,350
Long-term investments:				
U.S. agency securities	—	58,978	—	58,978
Asset-backed securities	—	572	—	572
Corporate bonds	—	102,776	—	102,776
Foreign Government Bond	—	2,753	—	2,753
Certificate of deposit	—	2,698	—	2,698
Municipal debt securities	—	2,003	—	2,003
Total assets	\$51,837	\$519,899	\$—	\$571,736

Table of Contents

	July 31, 2013			
	Level 1	Level 2	Level 3	Total
	(in thousands)			
Cash equivalents:				
Commercial paper	\$—	\$20,597	\$—	\$20,597
Corporate bonds	—	2,003	—	2,003
Money market funds	33,216	—	—	33,216
Short-term investments:				
U.S. agency securities	—	9,097	—	9,097
Asset-backed securities	—	2,421	—	2,421
Commercial paper	—	15,190	—	15,190
Corporate bonds	—	47,572	—	47,572
Foreign government bonds	—	775	—	775
Municipal debt securities	—	1,877	—	1,877
Long-term investments:				
U.S. agency securities	—	28,007	—	28,007
Asset-backed securities	—	2,100	—	2,100
Corporate bonds	—	13,715	—	13,715
Municipal debt securities	—	7,218	—	7,218
Total assets	\$33,216	\$150,572	\$—	\$183,788

## 3. Balance Sheet Components

Property and equipment consist of the following:

	April 30, 2014	July 31, 2013
	(in thousands)	
Computer hardware	\$10,972	\$8,820
Software	5,447	4,460
Furniture and fixtures	2,676	2,666
Leasehold improvements	6,635	6,536
Total property and equipment	25,730	22,482
Less accumulated depreciation and amortization	(13,271	) (9,568
Property and equipment, net	\$12,459	\$12,914

As of April 30, 2014 and July 31, 2013, no property and equipment was pledged as collateral against borrowings.

Amortization of leasehold improvements is included in depreciation and amortization expense.

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

	Total
	(in thousands)
Goodwill, July 31, 2013	\$9,048
Changes in carrying value	157
Goodwill, April 30, 2014	\$9,205

Table of Contents

Intangible assets consist of the following:

	April 30, 2014 (in thousands)	July 31, 2013
Acquired technology:		
Cost	\$7,200	\$7,200
Accumulated amortization	(1,401	) (321
Net	\$5,799	\$6,879

Amortization expense was \$0.4 million and \$1.1 million for the three and nine month period ended April 30, 2014, respectively, and nil for the three and nine month period ended April 30, 2013. Estimated aggregate amortization expense for each of the next five fiscal years is as follows:

Fiscal year ending July 31,	Future Amortization (in thousands)
2014 (remainder of fiscal year)	\$360
2015	1,440
2016	1,440
2017	1,440
2018	1,119
Total	\$5,799

Accrued employee compensation consists of the following:

	April 30, 2014 (in thousands)	July 31, 2013
Accrued bonuses	\$11,257	\$13,072
Accrued commission	1,045	2,043
Accrued vacation	7,880	7,335
Payroll accruals	4,032	3,852
Total	\$24,214	\$26,302

Changes in accumulated other comprehensive loss by component during the nine month period ended April 30, 2014 were as follows:

	Foreign Currency Items	Unrealized gain (loss) on available-for-sale securities	Total
	(in thousands)		
Balance as of July 31, 2013	\$(1,582	) \$24	\$(1,558
Other comprehensive gain (loss) before reclassification	109	144	253
Amounts reclassified from accumulated other comprehensive gain (loss) to earnings	—	(39	) (39
Tax effect	—	(42	) (42
Balance as of April 30, 2014	\$(1,473	) \$87	\$(1,386



Table of Contents

## 4. Earnings per Share

The following table sets forth the computation of the Company's basic and diluted earnings per share for the three and nine months ended April 30, 2014 and 2013:

	Three Months Ended April 30,		Nine Months Ended April 30,	
	2014	2013	2014	2013
	(in thousands, except share and per share amounts)			
Numerator:				
Net income (loss)	\$(1,358	) \$(2,670	) \$(12,865	) \$3,278
Earnings (loss) per share:				
Basic	\$(0.02	) \$(0.05	) \$(0.20	) \$0.06
Diluted	\$(0.02	) \$(0.05	) \$(0.20	) \$0.05
Denominator:				
Weighted average shares used in computing earnings (loss) per share:				
Basic	68,261,964	57,017,856	64,718,852	55,887,786
Weighted average effect of dilutive stock options	—	—	—	3,659,929
Weighted average effect of dilutive restricted stock units	—	—	—	2,184,908
Diluted	68,261,964	57,017,856	64,718,852	61,732,623

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

	Three Months Ended April 30,		Nine Months Ended April 30,	
	2014	2013	2014	2013
Stock options to purchase common stock	2,543,620	4,411,791	3,038,569	302,144
Restricted stock units	3,911,941	4,391,477	4,322,264	46,971

## 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, 2013. See the Annual Report on Form 10-K for the fiscal year ended July 31, 2013 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.

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 \$4.4 million during the three and nine months ended April 30, 2014, and \$1.4 million and \$3.8 million for the three and nine months ended April 30, 2013.

## Letters of Credit

In addition to the unsecured letter of credit noted above, the Company had an unsecured letter of credit agreement related to a customer arrangement for Polish Zloty 10.0 million (approximately \$3.3 million as of April 30, 2014) to secure contractual commitments and prepayments. No amounts were outstanding under the Company's unsecured letters of credit as of April 30, 2014 or July 31, 2013. The Company had no outstanding secured letters of credit as of

April 30, 2014 or July 31, 2013.

16

---

## Table of Contents

### Legal Proceedings

In December 2007, Accenture Global Services GmbH and Accenture LLP (collectively, "Accenture"), a competitor, filed a lawsuit against the Company in the U.S. District Court for the District of Delaware (the "Delaware Court") (Accenture Global Services GmbH and Accenture LLP v. Guidewire Software, Inc., Case No 07-826-SLR). Accenture alleged infringement of U.S. Patent No. 7,013,284 (the "'284 patent"), among others, by the Company's products; trade-secret misappropriation; and tortious interference with business relations. In October 2011, the Company agreed with Accenture to resolve all outstanding litigation concerning the parties' respective insurance claims management software. As part of the settlement, the parties agreed to a royalty free cross license of all then-current patents and patent applications. In connection with the settlement, the Company has paid \$10.0 million to Accenture with a potential additional payment based on the final outcome of Accenture's appeal regarding the validity of its '284 patent.

In May 2011, the Delaware Court granted the Company's motion for summary judgment, finding that Accenture's '284 patent was invalid. In September 2013, the United States Court of Appeals for the Federal Circuit (the "Appeals Court") affirmed the decision of the District Court and held the '284 patent invalid. In December 2013, Accenture's request for a rehearing of the Appeals Court's affirmation by the full Federal Circuit sitting en banc was denied. In January 2014, Accenture requested United States Supreme Court review; the Company is opposing the request. If Accenture is allowed to appeal and is ultimately successful, then the Company has agreed to pay Accenture an additional \$20.0 million. Otherwise, no further payments would be due in connection with the settlement. The Company will continue to vigorously defend the favorable decision of the District Court and the affirmation of the Appeals Court, by opposing any requests for further review, as well as defending any such appeal if allowed. In addition to the matters described above, from time to time, the Company is involved in various other legal proceedings and receives claims, arising from the normal course of business activities. The Company has accrued for estimated losses in the accompanying condensed consolidated financial statements for matters with respect to which it 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 April 30, 2014 and July 31, 2013. 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.

### 6. Stockholders' Equity and Stock-based Compensation

#### Stock-based Compensation Expense

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



Table of Contents

	Three Months Ended April 30,		Nine Months Ended April 30,	
	2014	2013	2014	2013 <sup>(1)</sup>
Stock-based compensation expenses:	(in thousands)			
Cost of license and other	\$41	\$—	\$245	\$—
Cost of maintenance revenues	309	313	932	914
Cost of services revenues	3,927	3,150	13,869	9,205
Research and development	3,075	2,056	10,147	6,544
Sales and marketing	3,440	676	12,153	4,269
General and administrative	3,121	2,077	10,174	7,498
Total stock-based compensation expenses	\$13,913	\$8,272	\$47,520	\$28,430

(1) Expenses shown include \$1.0 million of expense recognized in 2013 related to the modification of RSUs upon accelerated vesting terms for the retirement of one of the Company's executives.

As of April 30, 2014, total unrecognized compensation cost, adjusted for estimated forfeitures, was as follows:

	As of April 30, 2014	
	Unrecognized Expense	Average Expected Recognition Period
	(in thousands)	(in years)
Restricted stock units	\$64,759	1.2
Stock options	4,464	1.1
	\$69,223	

## 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
Balance as of July 31, 2013	4,027,601	\$19.27
Granted	1,543,578	44.47
Released	(1,491,302)	) 18.04
Cancelled	(245,458)	) 29.83
Balance as of April 30, 2014	3,834,419	\$29.21

The fair value of RSUs released during the three and nine month periods ended April 30, 2014 was \$28.0 million and \$71.6 million, respectively, and \$14.9 million and \$40.4 million for the three and nine month periods ended April 30, 2013, respectively.

Table of Contents

## 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 <sup>(1)</sup>  (in thousands)
	Number of Stock Options Outstanding	Weighted Average Exercise Price		
Balance as of July 31, 2013	3,763,228	\$6.74	5.7	\$139,315
Granted	215,930	47.10		
Exercised	(1,383,388)	) 5.31		
Cancelled	(8,561)	) 21.75		
Balance as of April 30, 2014	2,587,209	\$10.82	5.7	\$71,667
Vested and expected to vest as of April 30, 2014	2,543,086	\$10.44	5.7	\$71,281
Exercisable as of April 30, 2014	1,972,111	\$5.60	4.9	\$63,699

Aggregate intrinsic value represents the difference between the Company's closing stock price of \$37.76 and <sup>(1)</sup> \$43.76 on April 30, 2014 and July 31, 2013, respectively, and the exercise price of outstanding, in-the-money options.

The options exercisable as of April 30, 2014 include options that are exercisable prior to vesting. The total intrinsic value of options exercised was approximately \$9.9 million and \$58.8 million for the three and nine months ended April 30, 2014, respectively, and \$23.3 million and \$76.4 million for the three and nine months ended April 30, 2013, respectively.

## Valuation of Awards

The per share fair value of each stock option was determined on the date of grant using the Black-Scholes option-pricing model and the following weighted average assumptions:

	Three Months Ended April 30,		Nine Months Ended April 30,	
	2014	2013	2014	2013
Expected life (in years)	5.3	6.1	5.0 - 6.1	5.1 - 6.1
Risk-free interest rate	1.7%	1.2%	1.5% - 2.0%	0.6% - 1.2%
Expected volatility	42.3%	46.9%	41.3% - 46.2%	45.1% - 48.7%
Expected dividend yield	—%	—%	—%	—%

## Common Stock Reserved for Issuance

As of April 30, 2014 and July 31, 2013, the Company was authorized to issue 500,000,000 shares of common stock with a par value of \$0.0001 per share. As of April 30, 2014 and July 31, 2013, the Company had reserved shares of common stock for issuance as follows:

	April 30, 2014	July 31, 2013
Exercise of stock options to purchase common stock	2,587,209	3,763,228
Vesting of restricted stock units	3,834,419	4,027,601
Issuances of shares available under stock plans	11,591,985	9,194,058
Total common stock reserved for issuance	18,013,613	16,984,887

## 7. Income Taxes

Table of Contents

The benefit from income taxes for the three and nine month periods ended April 30, 2014 was \$1.4 million and \$9.7 million, respectively. The benefit for income taxes for the three and nine month periods ended April 30, 2013 was \$1.8 million and \$2.4 million, respectively. The decrease in tax benefit recognized in the three month period is primarily due to an increase in profitability in the current period. The increase in tax benefit recognized in the nine month period is primarily due to a decrease in profitability in the nine month period. The effective tax rate of 51.4% and 42.9% for the three and nine month periods ended April 30, 2014 differs from the statutory U.S. federal income tax rate of 35% mainly due to the benefit for the permanent differences for stock-based compensation, the impact of state income taxes, the tax rate differences between the United States and foreign countries, and research tax credits. 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, 2014, U.S. income taxes were not provided for on the cumulative total of \$14.8 million undistributed earnings from certain foreign subsidiaries. As of April 30, 2014, the unrecognized deferred tax liability for these earnings was approximately \$1.5 million. During the nine month period ended April 30, 2014, the change in unrecognized tax benefits from the beginning of the period was \$1.4 million. Accordingly, as of April 30, 2014, the Company had unrecognized tax benefits of \$4.1 million that, if recognized, would affect the Company's effective tax rate.

## 8. 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.

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,	
	2014	2013	2014	2013
	(in thousands)			
United States	\$48,640	\$37,751	\$126,573	\$109,961
Canada	9,084	10,620	30,039	31,685
Other Americas	1,391	1,358	6,630	6,573
Total Americas	59,115	49,729	163,242	148,219
United Kingdom	7,662	5,035	28,316	17,114
Other EMEA	9,624	6,894	25,649	19,839
Total EMEA	17,286	11,929	53,965	36,953
Total APAC	5,634	6,592	14,832	18,567
Total revenues	\$82,035	\$68,250	\$232,039	\$203,739

No country, other than those presented above, accounted for more than 10% of revenues during the three and nine months ended April 30, 2014 and 2013.

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

	April 30, 2014	July 31, 2013
	(in thousands)	
North America	\$26,183	\$27,280
Europe	1,038	1,276
Asia Pacific	242	285
Total	\$27,463	\$28,841





Table of Contents

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

The following discussion and analysis should be read in conjunction with our condensed consolidated financial statements and the notes thereto included elsewhere in this document and the Risk Factors included in Item 1A of Part II of this Quarterly Report on Form 10-Q. All information presented herein is based on our fiscal calendar. Unless otherwise stated, references in this report to particular years or quarters refer to our fiscal years ended in July and the associated quarters of those fiscal years. We 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 core system software to the global property and casualty ("P&C") insurance and reinsurance industry. Our solutions serve as the transactional systems-of-record for, and enable the key functions of, a P&C insurance carrier's business: underwriting and policy administration, claims management and billing. Since our inception, our mission has been to empower P&C insurance carriers to transform and improve their businesses by replacing their legacy core systems with our software platform.

We derive our revenues from licensing our software applications, providing maintenance support and providing professional services to the extent requested by our customers. 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 an average term of approximately five years and are renewed on an annual or multi-year basis. In certain cases, when required by a customer, we license our software on a perpetual license 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. 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 and quarterly in certain cases, 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.

To extend our technology leadership position in our market, we intend to continue to focus on product innovation through research and development and aggressively pursue new customers and up-sell additional products within our existing customer base. This will require us to make continued investment in our research and development and sales and marketing functions to capitalize on opportunities for growth. We expect research and development, sales and marketing and general and administrative expenses to continue to increase in absolute dollars for the foreseeable future to support this strategy. Research and development and sales and marketing expenses are also expected to increase as a percentage of revenues in future periods as we focus on expanding our technological leadership.

We face a number of risks in the execution of our strategy, including reliance on sales to a relatively small number of large customers, variances in the mix amongst our components of revenues, which could result in lower gross margin from services revenues as compared to license and maintenance revenues, and the overall impact of weakening economic conditions on the insurance industry. We believe that our focus on continued product innovation and customer wins and renewals will support the expansion of our license sales and reduce the impact from weakened economic conditions.

We sell our core system software primarily through our direct sales force. Our sales cycle for new customers is typically 12 to 24 months. Product implementations, the primary driver of our services revenues, typically last 6 to 24 months and may take longer.

Opportunities, Challenges, & Risks

Since August 2010, our license revenues from new orders and subsequent annual and, in some cases, quarterly payments have generally been recognized when payment is due from our customers. Historically, and to a lesser extent during fiscal years 2013, 2012 and 2011, our license revenues from existing orders have been recognized under three methods: under the residual method when payment is due and payable from our customers, under the percentage-of-completion method as we complete customer implementations of our software, or under the zero-gross-margin method as we complete customer implementations of our software. During the three months ended April 30, 2014 and 2013, our license revenues accounted for 39% and 34% of our total revenues, respectively, and our

recurring term license revenues accounted for 88% and 78% of our total license revenues, respectively. During the nine months ended April 30, 2014 and 2013, our license revenues accounted for 37% and 36% of our total revenues, respectively, and our recurring term license revenues accounted for 94% and 91% of our total license revenues, respectively.

Table of Contents

Our maintenance revenues are generally recognized annually over the committed maintenance term. Our maintenance fees are typically priced as a fixed percentage of the associated license fees and generate lower gross margins than our license revenues. Our maintenance revenues accounted for 13% and 13% of our total revenues during the three months ended April 30, 2014 and 2013, respectively, and 13% and 14% of our total revenues during the nine months ended April 30, 2014 and 2013, respectively.

We generally charge services fees on a time and materials basis and revenues are typically recognized upon delivery of our services. In certain offerings sold as fixed fee arrangements, we recognize 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. We derive our services revenues primarily from implementation services performed for our customers, revenues related to reimbursable travel expenses and training fees. Our services revenues generate lower gross margins than our license and maintenance revenues and accounted for 48% and 53% of our total revenues during the three months ended April 30, 2014 and 2013, respectively. Our services revenues accounted for 50% and 50% of our total revenues during the nine months ended April 30, 2014 and 2013, respectively.

We enter into multi-year renewable contracts to license our software. Regardless of contract length, we typically invoice our customers for annual or quarterly amounts at the beginning of the corresponding period. 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. Further, we expect to recognize our current deferred services revenue into income but do not expect significant deferrals of services revenue in future periods. Deferred license and service revenues related to projects under contract accounting as of April 30, 2014 were \$1.3 million and \$1.9 million, respectively, while deferred license and service revenues related to projects under contract accounting as of July 31, 2013 were \$2.2 million and \$2.0 million, respectively. Such deferral is in accordance with our Revenue Recognition policy as described in Note 1 to the condensed consolidated financial statements.

We have historically experienced seasonal variations in our revenues as a result of increased customer orders in our second and fourth fiscal quarters and subsequent annual fees. 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 fees are invoiced and recognized as revenues during those quarters at contract inception or in the subsequent quarter when the annual license payment is due and in subsequent years upon the anniversary of the contract date. We generally expect these seasonal trends to continue in the future, which may cause quarterly fluctuations in our results of operations and certain financial metrics.

Our quarterly growth in license revenues 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 specified terms for product upgrades or functionality, which may require us to delay revenue recognition until the period in which the upgrade or functionality is delivered; and
  - we may enter into license agreements with other contractual terms that may affect the timing of revenue recognition.
- Our revenue seasonality may fluctuate versus comparable prior periods or prior quarters within the same fiscal year based upon when new orders are executed in the quarter and the payment terms of each order. Additionally, our revenue may fluctuate if our customers make an early payment or change payment terms during or after the end of the contract term for up-sell of additional products or renewals. Our ability to renew existing contracts for multiple year terms versus annual automatic renewals may 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 rare circumstances, our customers desire the ability to purchase our products on a perpetual license basis, resulting in an acceleration of license 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.

Table of Contents

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.

We generated revenues of \$82.0 million and \$68.3 million in the three months ended April 30, 2014 and 2013, respectively and revenues of \$232.0 million and \$203.7 million in the nine months ended April 30, 2014 and 2013, respectively. We generate the majority of our revenues in the United States and Canada. Our revenues from outside the United States and Canada as a percentage of total revenues were 30% and 29% in the three months ended April 30, 2014 and 2013, respectively, and 33% and 30% in the nine months ended April 30, 2014 and 2013, respectively. We generated a net loss of \$1.4 million and \$2.7 million in the three months ended April 30, 2014 and 2013, respectively, and a net loss of \$12.9 million and net income of \$3.3 million in the nine months ended April 30, 2014 and 2013, respectively. No customer accounted for 10% or more of our revenues for the three and nine months ended April 30, 2014 or 2013. Our ten largest customers accounted for 38% and 39% of our total revenues for the three months ended April 30, 2014 and 2013, respectively, and 37% and 34% of our total revenues for the nine month periods ended April 30, 2014 and 2013, respectively. We count as customers distinct buying entities, which may include multiple national or regional subsidiaries of large, global P&C insurance carriers.

**Key Business Metrics**

We use certain key metrics to evaluate and manage our business, including rolling four-quarter recurring revenues from term licenses and 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 operating cash flow and non-GAAP measures such as Adjusted EBITDA.

**Four-Quarter Recurring Revenues**

We measure four-quarter recurring revenues by adding the total term license revenues and maintenance revenues recognized in the preceding four quarters ended in the stated period and excluding 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, the effects of differences in timing of payments, and certain effects of contractual provisions that may accelerate or delay revenue recognition in some cases. Our four-quarter recurring revenues for each of the eight periods presented were:

	Four quarters ended							
	4/30/2014	1/31/2014	10/31/2013	7/31/2013	4/30/2013	1/31/2013	10/31/2012	7/31/2012
	(in thousands)							
Term license revenues	\$125,485	\$115,144	\$110,640	\$112,863	\$95,303	\$92,792	\$83,114	\$74,869
Maintenance revenues	39,836	38,510	37,830	37,561	35,548	34,207	31,802	29,538
Total four-quarter recurring revenues	\$165,321	\$153,654	\$148,470	\$150,424	\$130,851	\$126,999	\$114,916	\$104,407

**Adjusted EBITDA**

We believe Adjusted EBITDA, a non-GAAP measure, is useful, in addition to other financial measures presented in accordance with GAAP, 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, stock-based compensation and one-time cash or non-cash charges 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.

23

---

Table of Contents

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 regarding 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.

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

	Three Months Ended April 30,		Nine Months Ended April 30,	
	2014	2013	2014	2013
	(in thousands)			
Reconciliation of Adjusted EBITDA:				
Net income (loss)	\$ (1,358	) \$ (2,670	) \$ (12,865	) \$ 3,278
Non-GAAP adjustments:				
Benefit from income taxes	(1,435	) (1,823	) (9,670	) (2,366
Other expense (income), net	(190	) 268	(372	) 104
Interest income, net	(415	) (137	) (919	) (359
Depreciation and amortization	1,770	1,137	4,978	3,182
Total stock-based compensation	13,913	8,272	47,520	28,430
Adjusted EBITDA	\$ 12,285	\$ 5,047	\$ 28,672	\$ 32,269

## 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 changes in deferred revenues, timing of bonus payments and collections of accounts receivable. As a result, our operating cash flows fluctuate significantly on a quarterly basis. Cash provided by operations was \$26.1 million and \$8.1 million for the nine months ended April 30, 2014 and 2013, respectively. For a further discussion of our operating cash flows, see “Liquidity and Capital Resources—Cash Flows from Operating Activities.”

## Results of Operations

The following tables set forth our results of operations for the periods presented (in thousands, except per share data, and as a percentage of our total revenues) for those periods. The data have 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 27, 2013.

Table of Contents

	Three Months Ended April 30,		Nine Months Ended April 30,		
	2014	2013	2014	2013	
	(in thousands)				
Revenues:					
License	\$31,927	\$22,918	\$86,012	\$74,482	
Maintenance	10,440	9,110	29,969	27,690	
Services	39,668	36,222	116,058	101,567	
Total revenues	82,035	68,250	232,039	203,739	
Cost of revenues:					
License	845	139	3,394	436	
Maintenance	2,238	2,079	6,192	5,430	
Services	34,259	33,774	106,397	89,071	
Total cost of revenues	37,342	35,992	115,983	94,937	
Gross profit:					
License	31,082	22,779	82,618	74,046	
Maintenance	8,202	7,031	23,777	22,260	
Services	5,409	2,448	9,661	12,496	
Total gross profit	44,693	32,258	116,056	108,802	
Operating expenses:					
Research and development	20,634	16,854	58,444	47,503	
Sales and marketing	17,968	11,915	53,871	36,680	
General and administrative	9,489	7,851	27,567	23,962	
Total operating expenses	48,091	36,620	139,882	108,145	
Income (loss) from operations	(3,398)	) (4,362)	) (23,826)	) 657	
Interest income, net	415	137	919	359	
Other income (expense), net	190	(268)	) 372	(104)	)
Income (loss) before benefit from income taxes	(2,793)	) (4,493)	) (22,535)	) 912	
Benefit from income taxes	(1,435)	) (1,823)	) (9,670)	) (2,366)	)
Net income (loss)	\$(1,358)	) \$(2,670)	) \$(12,865)	) \$3,278	
	Three Months Ended April 30,		Nine Months Ended April 30,		
	2014	2013	2014	2013	
Revenues:					
License	39	% 34	% 37	% 36	%
Maintenance	13	% 13	% 13	% 14	%
Services	48	% 53	% 50	% 50	%
Total revenues	100	% 100	% 100	% 100	%
Total cost of revenues	46	% 52	% 50	% 47	%
Total gross profit	54	% 48	% 50	% 53	%
Operating expenses:					
Research and development	25	% 25	% 25	% 23	%
Sales and marketing	22	% 17	% 23	% 18	%
General and administrative	12	% 12	% 12	% 12	%
Total operating expenses	59	% 54	% 60	% 53	%
Income (loss) from operations	(5)	)% (6)	)% (10)	)% —	%
Interest income, net	1	% —	% —	% 1	%
Other income (expense), net	—	% (1)	)% —	% —	%
Income (loss) before benefit from income taxes	(4)	)% (7)	)% (10)	)% 1	%
Benefit from income taxes	(2)	)% (3)	)% (4)	)% (1)	)%
Net income (loss)	(2)	)% (4)	)% (6)	)% 2	%





Table of Contents

Comparison of the Three and Nine Months Ended April 30, 2014 and 2013

## Revenues

Please 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,		2013		Change (\$)	(% )		
	2014	% of total	Amount	% of total				
	Amount	revenues	Amount	revenues				
(in thousands, except percentages)								
Revenues:								
License	\$31,927	39	% \$22,918	34	% \$9,009	39	%	
Maintenance	10,440	13	% 9,110	13	% 1,330	15	%	
Services	39,668	48	% 36,222	53	% 3,446	10	%	
Total revenues	\$82,035	100	% \$68,250	100	% \$13,785	20	%	
	Nine Months Ended April 30,		2013		Change (\$)	(% )		
	2014	% of total	Amount	% of total				
	Amount	revenues	Amount	revenues				
(in thousands, except percentages)								
Revenues:								
License	\$86,012	37	% \$74,482	36	% \$11,530	15	%	
Maintenance	29,969	13	% 27,690	14	% 2,279	8	%	
Services	116,058	50	% 101,567	50	% 14,491	14	%	
Total revenues	\$232,039	100	% \$203,739	100	% \$28,300	14	%	

## License Revenues

License revenues for the three and nine month periods were primarily driven by ClaimCenter, continued adoption of our PolicyCenter software, adoption of our BillingCenter and an increase in customer purchases of our product suite, and expansion of our international reach.

	Three Months Ended April 30,		2013		Change (\$)	(% )		
	2014	% of license	Amount	% of license				
	Amount	revenues	Amount	revenues				
(in thousands, except percentages)								
License revenues:								
Term	\$28,213	88	% \$17,877	78	% \$10,336	58	%	
Perpetual	3,714	12	% 5,041	22	% (1,327)	(26)	%	
Total license revenues	\$31,927	100	% \$22,918	100	% \$9,009	39	%	

Table of Contents

	Nine Months Ended April 30, 2014		2013		Change (\$)	Change (%)	
	Amount (in thousands, except percentages)	% of license revenues	Amount	% of license revenues			
License revenues:							
Term	\$80,598	94	% \$67,981	91	% \$12,617	19	%
Perpetual	5,414	6	% 6,501	9	% (1,087	) (17	)%
Total license revenues	\$86,012	100	% \$74,482	100	% \$11,530	15	%

The \$10.3 million increase in term license revenues during the three month period ended April 30, 2014, was primarily driven by \$2.8 million of revenues recognized from new orders or expanded orders from existing customers, \$7.1 million of revenues recognized due to timing of invoicing and corresponding due dates, early payments made by our customers or other contractual terms that affected license revenue recognition from customer contracts.

The \$12.6 million increase in term license revenues during the nine month period ended April 30, 2014, was primarily driven by \$12.9 million of revenues recognized from new orders or expanded orders from existing customers offset by a net \$0.3 million of revenues due to timing of invoicing and corresponding due dates, early payments made by our customers or other contractual terms that affected license revenue recognition from customer contracts.

The \$1.3 million decrease in perpetual license revenues during the three month period ended April 30, 2014, was primarily driven by new customers' increasingly signing term license agreements. This decrease was net of a \$1.0 million increase in revenues for one customer who exercised a perpetual buyout option in the current period.

The \$1.1 million decrease in perpetual license revenues during the nine month period ended April 30, 2014, was primarily driven by new customers' increasingly signing term license agreements. This decrease was net of a \$1.0 million increase in revenues for one customer who exercised a perpetual buyout option in the current period.

**Maintenance Revenues**

The \$1.3 million increase in maintenance revenues during the three month period ended April 30, 2014, was primarily driven by new and existing orders.

The \$2.3 million increase in maintenance revenues during the nine month period ended April 30, 2014, was primarily driven by new and existing orders.

**Services Revenues**

The \$3.4 million increase in services revenues during three month period ended April 30, 2014, was primarily driven by an additional \$2.9 million of revenues related to implementation of our software. Also, an additional \$0.5 million in revenues were recognized related to training and reimbursable travel costs.

The \$14.5 million increase in services revenues during the nine month period ended April 30, 2014, was primarily driven by an additional \$13.1 million of revenues related to implementation of our software and \$1.4 million of revenues related to training and reimbursable travel costs. This increase is net of \$1.9 million of services billings that were deferred due to certain contractual terms and \$0.9 million of services revenues were deferred due to specified terms for future product functionality during the nine months ended April 30, 2014.



Table of Contents

## Deferred Revenues

	As of April 30, 2014 Amount (in thousands, except percentages)	July 31, 2013 Amount	Change (\$)	(%)	
Deferred revenues:					
Deferred license revenues	\$24,907	\$14,435	\$10,472	73	%
Deferred maintenance revenues	25,157	22,017	3,140	14	%
Deferred services revenues	8,234	4,744	3,490	74	%
Total deferred revenues	\$58,298	\$41,196	\$17,102	42	%

The \$10.5 million increase in deferred license revenues compared to the prior year end was primarily driven by \$4.7 million of deferred license billings for new deals during nine months ended April 30, 2014, and remaining deferred revenues related to billings on existing orders as of April 30, 2014.

The \$3.1 million increase in deferred maintenance revenues compared to the prior year end was primarily driven by revenues deferred from new and existing orders during the nine months ended April 30, 2014. This increase reflects the seasonal nature of the billing of maintenance revenues.

The \$3.5 million increase in deferred services revenues compared to the prior year end was primarily driven by \$1.9 million of services billings deferred due to certain contractual terms and \$0.9 million of services revenues deferred due to specified terms for future product functionality during the nine months ended April 30, 2014.

Included in our deferred license revenues as of April 30, 2014, is \$4.0 million of deferred revenue for one customer that is subject to refund in the event of nonperformance of certain project implementation milestones.

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

	Three Months Ended April 30, 2014 Amount (in thousands, except percentages)	2013 Amount	Change (\$)	(%)	
Cost of revenues:					
License	\$845	\$139	\$706	508	%
Maintenance	2,238	2,079	159	8	%
Services	34,259	33,774	485	1	%
Total cost of revenues	\$37,342	\$35,992	\$1,350	4	%

## Includes stock-based compensation of:

Cost of license revenues:	\$41	\$—	\$41		
Cost of maintenance revenues:	309	313	(4)	)	
Cost of services revenues:	3,927	3,150	777		
Total	\$4,277	\$3,463	\$814		

Table of Contents

	Nine Months Ended April 30,		Change (\$)	Change (%)	
	2014 Amount (in thousands, except percentages)	2013 Amount			
Cost of revenues:					
License	\$3,394	\$436	\$2,958	678	%
Maintenance	6,192	5,430	762	14	%
Services	106,397	89,071	17,326	19	%
Total cost of revenues	\$115,983	\$94,937	\$21,046	22	%

Includes stock-based compensation of:

Cost of license revenues:	245	—	\$245		
Cost of maintenance revenues:	932	914	18		
Cost of services revenues:	13,869	9,205	4,664		
Total	\$15,046	\$10,119	\$4,927		

The \$1.4 million increase in cost of revenues during the three month period was primarily driven by an increase of \$1.1 million in personnel-related expenses as a result of 9 additional employees hired during the last twelve months primarily to provide implementation services to our customers, a \$0.8 million increase in stock-based compensation, and a \$0.4 million increase in royalties and amortization of acquired intangible assets, which was offset by a \$0.9 million decrease in third-party consultant costs and billable expenses.

The \$21.0 million increase in cost of revenues during the nine month period was primarily driven by an increase of \$8.0 million in personnel-related expenses as a result of 9 additional employees hired during the last twelve months primarily to provide implementation services to our customers, a \$4.9 million increase in stock-based compensation, a \$4.1 million increase in third-party consultant costs and billable expenses, a \$2.0 million increase in royalties and amortization of acquired intangible assets, a \$1.2 million increase in operating expenses, and a \$0.8 million increase in non-billable travel and professional services.

We expect our cost of revenues in future periods to trend in-line with implementation services provided to our customers.

	Three Months Ended April 30,		2013 Amount	Margin %	Change (\$)	Change (%)	
	2014 Amount	Margin %					
(in thousands, except percentages)							
Gross profit:							
License	\$31,082	97 %	\$22,779	99 %	\$8,303	36 %	%
Maintenance	8,202	79 %	7,031	77 %	1,171	17 %	%
Services	5,409	14 %	2,448	7 %	2,961	121 %	%
Total gross profit	\$44,693	55 %	\$32,258	48 %	\$12,435	39 %	%

	Nine Months Ended April 30,		2013 Amount	Margin %	Change (\$)	Change (%)	
	2014 Amount	Margin %					
(in thousands, except percentages)							
Gross profit:							
License	\$82,618	96 %	\$74,046	99 %	\$8,572	12 %	%
Maintenance	23,777	79 %	22,260	80 %	1,517	7 %	%
Services	9,661	8 %	12,496	12 %	(2,835)	(23) %	%
Total gross profit	\$116,056	50 %	\$108,802	53 %	\$7,254	7 %	%



Table of Contents

The \$12.4 million increase in gross profit during the three month period was primarily due to increases in services and license revenues that were partially offset by increases in corresponding costs of revenues. License margins decreased to 97% in the three month period ended April 30, 2014, from 99% in the three month period ended April 30, 2013, due to amortization of acquired intangibles and royalties owed on third-party licensed technology. Service margin increased to 14% when compared to the three month period ended April 30, 2013, primarily due to increased services revenues, while cost of revenues for services remain flat. Gross margin increased to 55% from 48% for the three month periods ended April 30, 2014 and 2013, respectively, primarily due to the increase in maintenance and service margin, as well as a greater percentage of revenues from services.

The \$7.3 million increase in gross profit during the nine month period was primarily due to increases in license and services revenues that were partially offset by increases in corresponding costs of revenues. Service margin decreased to 8% in the nine month period ended April 30, 2014, from 12% in the nine month period ended April 30, 2013, primarily due to an increase in cost related to 9 additional employees hired during the last twelve months to support expected growth, as well as increases in stock-based compensation and third-party consultant costs. License margins decreased to 96% in the nine month period ended April 30, 2014, from 99% in the nine month period ended April 30, 2013, due to amortization of acquired intangibles and royalties owed on our acquired technology. Gross margin decreased to 50% from 53% for the nine month periods ended April 30, 2014 and 2013, respectively, primarily due to a higher proportion of revenues being attributed to services, which have lower margins than license and maintenance revenues, as well as a decrease in services and license margins.

## Operating Expenses

	Three Months Ended April 30,		2013	% of total revenues	Change (\$)	2013	% of total revenues	Change (%)
	2014	Amount						
	(in thousands, except percentages)							
Operating expenses:								
Research and development	\$20,634	25	% \$16,854	25	% \$3,780	22	%	
Sales and marketing	17,968	22	% 11,915	17	% 6,053	51	%	
General and administrative	9,489	12	% 7,851	12	% 1,638	21	%	
Total operating expenses	\$48,091	59	% \$36,620	54	% \$11,471	31	%	
Includes stock-based compensation of:								
Research and development	\$3,075		\$2,056		\$1,019			
Sales and marketing	3,440		676		2,764			
General and administrative	3,121		2,077		1,044			
Total	\$9,636		\$4,809		\$4,827			



Table of Contents

	Nine Months Ended April 30, 2014		2013		Change (\$)	Change (%)		
	Amount (in thousands, except percentages)	% of total revenues	Amount	% of total revenues				
Operating expenses:								
Research and development	\$58,444	25	% \$47,503	23	% \$10,941	23	%	
Sales and marketing	53,871	23	% 36,680	18	% 17,191	47	%	
General and administrative	27,567	12	% 23,962	12	% 3,605	15	%	
Total operating expenses	\$139,882	60	% \$108,145	53	% \$31,737	29	%	
Includes stock-based compensation of:								
Research and development	\$10,147		\$6,544		\$3,603			
Sales and marketing	12,153		4,269		7,884			
General and administrative	10,174		7,498		2,676			
Total	\$32,474		\$18,311		\$14,163			

The \$11.5 million increase in operating expenses during the three month period was primarily driven by a \$5.0 million increase in personnel-related expenses as a result of 101 additional employees during the last twelve months, a \$4.8 million increase in stock-based compensation, a \$1.2 million increase in travel and marketing expenses, and \$0.5 million increase in other operational expenses.

The \$31.7 million increase in operating expenses during the nine month period was primarily driven by a \$14.6 million increase in personnel-related expenses as a result of 101 additional employees during the last twelve months, a \$14.2 million increase in stock-based compensation, a \$1.5 million increase in travel and marketing expenses, and \$1.4 million increase in other operational expenses.

We expect all of our operating expense line items to increase in absolute dollars in future periods to support our future growth strategy.

### Research and Development

The \$3.8 million increase in research and development expenses during the three month period was primarily due to an increase of \$1.7 million in personnel-related expenses as a result of 34 additional employees during the last twelve months to support our continued development of new products and services and product improvements, a \$1.1 million increase in other operational expenses, and a \$1.0 million increase in stock-based compensation.

The \$10.9 million increase in research and development expenses during the nine month period was primarily due to an increase of \$5.5 million in personnel-related expenses as a result of 34 additional employees during the last twelve months to support our continued development of new products and services and product improvements, a \$3.6 million increase in stock-based compensation, a \$1.3 million increase in other operational expenses, and a \$0.5 million increase in travel and marketing expenses.

### Sales and Marketing

The \$6.1 million increase in sales and marketing expenses during the three month period was primarily due to a \$2.8 million increase in stock-based compensation, an increase of \$2.0 million in personnel-related expenses as a

result of 46 additional employees during the last twelve months to support our sales growth and marketing new products and services, a \$0.8 million increase in employee travel costs and marketing programs, and a \$0.5 million increase in other operational expenses.

The \$17.2 million increase in sales and marketing expenses during the nine month period was primarily due to a \$7.9 million increase in stock-based compensation, an increase of \$6.0 million in personnel-related expenses as a result of 46

31

---

Table of Contents

additional employees during the last twelve months to support our sales growth and marketing new products and services, a \$1.9 million increase in employee travel costs and marketing programs, and a \$1.4 million increase in other operational expenses.

## General and Administrative

The \$1.6 million increase in general and administrative expenses during the three month period was primarily due to a \$1.2 million increase in personnel-related expenses as a result of 21 additional employees during the last twelve months to support investment in our infrastructure and general administrative functions, and a \$1.0 million increase in stock-based compensation, offset by a decrease of \$0.6 million in other operational expenses.

The \$3.6 million increase in general and administrative expenses during the nine month period was primarily due to a \$3.1 million increase in personnel-related expenses as a result of 21 additional employees during the last twelve months to support investment in our infrastructure and general administrative functions, and a \$2.7 million increase in stock-based compensation, offset by a decrease of \$0.9 million in professional services costs, including legal and consultant expenses, and a decrease of \$1.3 million in other operational expenses.

## Other Income (Expense)

	Three Months Ended April 30,		Change (\$)	(% )
	2014 Amount	2013 Amount		
	(in thousands, except percentages)			
Interest income, net	\$415	\$137	\$278	*
Other income (expense), net	190	(268)	) 458	*
Total	\$605	\$(131)	) \$736	*

\* Not meaningful

	Nine Months Ended April 30,		Change (\$)	(% )
	2014 Amount	2013 Amount		
	(in thousands, except percentages)			
Interest income, net	\$919	\$359	\$560	*
Other income (expense), net	372	(104)	) 476	*
Total	\$1,291	\$255	\$1,036	*

\* Not meaningful

## Interest Income, Net

Interest income increased \$0.3 million and \$0.6 million during the three and nine month periods ended April 30, 2014, primarily due to higher interest income on our cash, cash equivalents, and investments due to higher balances.

## Other Income (Expense), Net

Other income remained insignificant for the three and nine month periods ended April 30, 2014, when compared to the three and nine month periods ended April 30, 2013.

## Provision for (Benefit from) Income Taxes

We recognized an income tax benefit of \$1.4 million and \$9.7 million for the three and nine month periods ended April 30, 2014, respectively, and an income tax benefit of \$1.8 million and \$2.4 million for the three and nine month periods ended April 30, 2013, respectively. The decrease in tax benefit recognized in the three month period is primarily due to an

Table of Contents

increase in profitability in the current period. The increase in tax benefit recognized in the nine month period is primarily due to a decrease in profitability in the nine month period. Our effective income tax rate of 51.4% and 42.9% for the three and nine month periods ended April 30, 2014, respectively, increased compared to the three and nine month periods ended April 30, 2013 of 40.6% and (259.4)%, respectively, due to a tax benefit on a projected worldwide pretax loss for the three and nine month periods ended April 30, 2014, as compared to the tax benefit on a projected worldwide pretax income for the three and nine month periods ended April 30, 2013, the benefit from permanent differences related to stock-based compensation, the impact of state income taxes, and the tax rate differences between the United States and foreign countries, and tax credits.

Liquidity and Capital Resources

On October 28, 2013, we received proceeds of approximately \$389.9 million from our follow-on offering of common stock, net of underwriters' discounts and commissions, but before deduction of offering costs of approximately \$0.4 million payable by the Company.

Cash flows provided by operating activities were \$26.1 million and \$8.1 million during the nine months ended April 30, 2014 and 2013, respectively. We had capital expenditures of \$3.7 million and \$7.1 million for the nine months ended April 30, 2014 and 2013, respectively. Our capital expenditures consisted of purchases of property and equipment, primarily consisting of computer hardware, software and leasehold improvements. Additionally, cash paid for employee withholding taxes on RSU awards vested was \$25.7 million and \$14.7 million during the nine months ended April 30, 2014 and 2013, respectively. As of April 30, 2014 and July 31, 2013, we had \$600.1 million and \$207.7 million of cash, cash equivalents and investments, respectively, and working capital of \$414.7 million and \$135.3 million, respectively.

Our cash flows from operations are significantly impacted by timing of revenues, bonus payments and collections of accounts receivable, as well as by changes in deferred 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. As such, 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 long-term capital requirements will depend on many factors, including our rate of revenues 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 may also seek to invest in, or acquire complementary businesses, applications or technologies for which we may need to raise additional funds through public or private equity or debt financing. Additional funds may not be available on terms favorable to us or at all.

As of April 30, 2014, approximately \$14.1 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.

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, 2014	2013	
	(in thousands)		
Net cash provided by operating activities	\$26,053	\$8,112	
Net cash used in investing activities	(318,785	) (116,798	)
Net cash provided by (used in) financing activities	371,739	(6,408	)
Cash Flows from Operating Activities			

Cash flows provided by operating activities increased \$17.9 million for the nine month period ended April 30, 2014 when compared to the comparable period ended April 30, 2013, primarily due to current year revenue deferrals where the prior year included significant release from deferrals upon attainment of revenue recognition criteria and a \$19.1 million increase in

33

---

## Table of Contents

stock-based compensation due to increases in stock prices and number of awards granted. These increases were partially offset by a decrease in net income of \$16.1 million and an increase in deferred tax assets which was \$5.9 million greater than the increase in the comparable period of the prior year primarily due to the increase in stock-based compensation. Additionally, accounts receivable increased \$1.9 million more in the current period than in the comparable period of the prior year due primarily to an increase in billings.

### Cash Flows from Investing Activities

Our investing activities consist primarily of investment of excess cash and cash equivalents into short-term and long-term investments, as well as capital expenditures to purchase property and equipment and changes in our restricted cash.

Cash used in investing activities increased \$202.0 million for the nine month period ended April 30, 2014 when compared to the comparable period ended April 30, 2013, primarily due to the investment of excess cash into available-for-sale securities from our stock issuance in October 2013, as seen in increased net purchases of available-for-sale securities. The prior year included the release of restricted cash related to secured lines of credit. This decrease was partially offset by a \$3.4 million decrease in capital expenditures compared to the comparable period of the prior year, as the prior year included payments for our corporate headquarters move.

### Cash Flows from Financing Activities

Cash flows from financing activities increased by \$378.1 million for the nine month period ended April 30, 2014 when compared to the comparable period ended April 30, 2013. During the three months ended October 31, 2013, we received \$389.9 million in net proceeds from our follow-on offering of common stock, after deducting underwriters' discounts and commissions. These proceeds were offset by a \$10.9 million increase in taxes remitted related to the vesting of RSUs held by employees. Additionally, proceeds from stock options exercises decreased by \$0.6 million as we have granted more RSUs than stock options in recent years to employees.

### Application of 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 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 consolidated financial statements and because of the possibility that future events affecting them may differ markedly from management's current judgments. While there are a number of accounting policies, methods and estimates affecting our consolidated financial statements, areas that are particularly significant include:

Revenue recognition policies;  
Stock-based compensation; and  
Income taxes.

There were no significant changes in our critical accounting policies and estimates during the nine months ended April 30, 2014. 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 27, 2013 for a more complete discussion of our critical accounting policies and estimates.

### Contractual Obligations

Our primary contractual obligations are from operating leases for office space and letters of credit related to those leases. See Note 5 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 5 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, 2014.

### 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.

34

---



## Table of Contents

### Anticipated Cash Flows

We expect to incur significant operating costs, particularly related to services delivery costs, sales and marketing, and research and development for the foreseeable future in order to execute our business plan. We anticipate that such operating costs, as well as planned capital expenditures will constitute a material use of our cash resources. As a result, our net cash flows will depend heavily on the level of future sales, changes in deferred revenues and our ability to manage infrastructure costs.

### 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 short-term and long-term investments as of April 30, 2014 and July 31, 2013. Our cash, cash equivalents and short-term and long-term investments as of April 30, 2014 were \$600.1 million and consisted primarily of cash, money market funds, commercial paper, agency debt securities, corporate bonds, U.S. government bonds and municipal debt securities with maturities of up to two years from the date of purchase. 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 10% 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 exchange rates for the Canadian dollar, Australian dollar, EU Euro, British pound, and Japanese yen. The volatility of exchange rates depends on many factors that we cannot forecast with reliable accuracy. We believe our operating activities act as a natural hedge for a substantial portion of our foreign currency exposure because we typically collect revenues and incur costs in the currency in the location in which we provide our application. Although we have experienced and will continue to experience fluctuations in our net income as a result of transaction gains (losses) related to transactions denominated in currencies other than the U.S. dollar, we believe that a 10% change in foreign exchange rates would not have a material impact on our results of operations. To date, we have entered into one foreign currency hedging contract, but may consider entering into more such contracts in the future. As our international operations grow, we will continue to reassess our approach to manage our risk relating to fluctuations in currency rates.

#### 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

35

---

Table of Contents

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.

36

---

Table of Contents

PART II – OTHER INFORMATION

ITEM 1. Legal Proceedings

In December 2007, Accenture Global Services GmbH and Accenture LLP (collectively, “Accenture”), a competitor, filed a lawsuit against the Company in the U.S. District Court for the District of Delaware (the “Delaware Court”) (Accenture Global Services GmbH and Accenture LLP v. Guidewire Software, Inc., Case No 07-826-SLR). Accenture alleged infringement of U.S. Patent No. 7,013,284 (the “ ’284 patent”), among others, by the Company's products; trade-secret misappropriation; and tortious interference with business relations. In October 2011, the Company agreed with Accenture to resolve all outstanding litigation concerning the parties' respective insurance claims management software. As part of the settlement, the parties agreed to a royalty free cross license of all then-current patents and patent applications. In connection with the settlement, the Company has paid \$10.0 million to Accenture with a potential additional payment based on the final outcome of Accenture’s appeal regarding the validity of its '284 patent.

In May 2011, the Delaware Court granted the Company's motion for summary judgment, finding that Accenture's '284 patent was invalid. In September 2013, the United States Court of Appeals for the Federal Circuit (the "Appeals Court") affirmed the decision of the District Court and held the '284 patent invalid. In December 2013, Accenture's request for a rehearing of the Appeals Court’s affirmation by the full Federal Circuit sitting en banc was denied. In January 2014, Accenture requested United States Supreme Court review; the Company is opposing the request. If Accenture is allowed to appeal and is ultimately successful, then the Company has agreed to pay Accenture an additional \$20.0 million. Otherwise, no further payments would be due in connection with the settlement. The Company will continue to vigorously defend the favorable decision of the District Court and the affirmation of the Appeals Court, by opposing any requests for further review, as well as defending any such appeal if allowed. In addition to the matters described above, from time-to-time, we are involved in various other legal proceedings arising from the normal course of business activities.

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:

- structure of our licensing contracts, including fluctuations in perpetual licenses from period to period;
- 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, at comparable prices;
- our ability to renew existing contracts for multiple year terms versus annual automatic renewals;

- our ability to attract new customers, particularly larger customers, in both domestic and international markets;
- 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;
- commissions expense related to large transactions;
- bonus expense based on the bonus attainment rate;

## Table of Contents

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, particularly in light of recent adverse global economic conditions;  
our ability to control costs, including our operating expenses;  
any significant change in our facilities-related costs;  
the timing and cost of hiring personnel and of large expenses such as those for trade shows and third-party professional services;  
the timing and amount of an additional litigation settlement payment, if any;  
stock-based compensation expenses and related payroll taxes, which vary along with changes to our stock price;  
general domestic and international economic conditions, in the insurance industry in particular;  
fluctuations in foreign currency exchange rates;  
future accounting pronouncements or changes in our accounting policies; and  
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.

In addition, our revenue may fluctuate if our customers make an early payment of their annual fees. 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. Any failure to adjust spending quickly enough to compensate for a revenues shortfall could magnify the adverse impact of such revenues shortfall on our results of operations. Failure to achieve our quarterly forecasts or to meet or exceed the expectations of research analysts or investors will cause our stock price to 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 specified terms for product upgrades or functionality, which may require us to delay revenue recognition for the initial period; 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 fees. 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.

Table of Contents

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 majority of our revenues. In fiscal years 2013, 2012 and 2011, our ten largest customers accounted for 33%, 35% and 41% 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, 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.

Our services revenues produce lower gross margins than our license or maintenance revenues, and an increase in services revenues as a percentage of total revenues could adversely affect our overall gross margins and profitability. Our services revenues were 46%, 45% and 45% of total revenues for each of fiscal years 2013, 2012 and 2011, respectively. Our services revenues produce lower gross margins than our license revenues. The gross margin of our services revenues was 12%, 19% and 18% for fiscal years 2013, 2012 and 2011, respectively, while the gross margin for license revenues was 99%, 99% and 98% for the respective periods. An increase in the percentage of total revenues represented by services revenues could reduce our overall gross margins.

The volume and profitability of our services offerings depend in large part upon:

- price charged to our customers;
- the utilization rate of our services personnel;
- the complexity of our customers' information technology environments;
- our ability to accurately forecast the time and resources required for each implementation project;
- the resources directed by our customers to their implementation projects;
- our ability to hire, train and retain qualified services personnel;
- unexpected difficulty in projects which may require additional efforts on our part without commensurate compensation;
- our ability to manage fixed fee arrangements;
- the extent to which system integrators provide services directly to customers; and
- our ability to adequately predict customer demand and scale our professional services staff accordingly.

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

Table of Contents

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.

Any intellectual property infringement or misappropriation claim or assertion against us, our customers or partners, and those from whom we license technology and intellectual property could have a material adverse effect on our business, financial condition, reputation and competitive position regardless of the validity or outcome. 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. Royalty or licensing agreements, if required or desirable, may be unavailable on terms acceptable to us, or at all, and may require significant royalty payments and other expenditures. Any of these events could seriously harm our business, results of operations and financial condition. In addition, any lawsuits regarding intellectual property rights, regardless of their success, could be expensive to resolve and divert the time and attention of our management and technical personnel. We may incur additional future expenses in connection with the settlement of our litigation with Accenture.

In December 2007, we were sued by Accenture, a competitor, in the U.S. District Court for the District of Delaware (the "Delaware Court") over our alleged infringement of certain of their intellectual property rights and related state law claims. Over time, both parties asserted additional claims against each other. In October 2011, we agreed with Accenture to resolve all outstanding litigation. In connection with the settlement, we paid \$10.0 million to Accenture with a potential additional payment based on the final outcome of Accenture's pending appeal of the Delaware Court's ruling of invalidity on one of Accenture's patents. In September 2013, the United States Court of Appeals for the Federal Circuit (the "Federal Circuit") ruled in our favor, affirming the judgment of the Delaware Court and finding Accenture's patent invalid. Accenture has requested United States Supreme Court review, and, if Accenture is allowed to appeal and is ultimately successful, then we have agreed to pay Accenture an additional \$20.0 million. Otherwise, no further payments would be due in connection with the settlement. Our patent litigation with Accenture and the terms of the settlement are further described in "Legal Proceedings" in Item 1 of Part II of this Quarterly Report on Form 10-Q.

We may expand through acquisitions of 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.

In May 2013, we acquired Millbrook, Inc., a complementary business, and in September 2013, we announced a strategic alliance with Mitchell, Inc., a business which also services the P&C industry. In the future, our business strategy may include additional acquisitions of complementary software, technologies or businesses or alliances with businesses offering the same. Acquisitions and alliances may result in unforeseen operating difficulties and expenditures. In particular, we may encounter difficulties in assimilating or integrating the businesses, technologies, services, products, personnel or operations of the acquired companies, especially if the key personnel of the acquired company choose not to work for us, and we may have difficulty retaining the existing customers or signing new customers of any acquired business. 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 equity securities to complete an acquisition or realize the potential of an alliance, which could deplete our cash reserves and 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. A delay in the recognition of revenues from sales of acquired or alliance products, or bundles that include the same, may cause fluctuations in our quarterly financial results and may adversely affect our operating margins.

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, the anticipated benefits

Table of Contents

of any acquisition, including our revenues or return on investment assumptions, may not be realized or we may be exposed to unknown liabilities as a result of such acquisition.

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. Our implementation cycle is lengthy, variable and requires the investment of significant time and expense by our customers. 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. 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. We also encounter competition from small independent firms that compete on the basis of price, custom developments or unique product features or functions and from vendors of software products that may be customized to address the needs of P&C insurance carriers.

We expect the intensity of competition to remain high in the future as new companies enter our markets and existing competitors develop stronger capabilities. 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 and financial condition. Our competitors may be able to devote greater resources to the development, promotion and sale of their products than we can to ours, which could allow them to respond more quickly than we can to new technologies and changes in customer needs and achieve 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 third parties with greater available resources, such as Accenture's acquisition of Duck Creek Technologies, Inc. in July 2011. As a result of such acquisitions, our current or potential competitors might be able 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, take advantage of other opportunities more readily or develop and expand their product and service offerings more quickly than we do. 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.

Certain of our software products may be deployed through cloud-based implementations, and if such implementations are compromised by data security breaches or other disruptions, our reputation could be harmed, and we could lose customers or be subject to significant liabilities.

Although our software products typically are deployed on our customers' premises, some of our products are deployed in cloud-based environments we maintain and some of our products may be deployed in our customers' cloud-based environments, in which our products and associated services are made available using an Internet-based infrastructure. In cloud deployments, our infrastructure and the infrastructure of third-party service providers used by both ourselves and our customers may be vulnerable to hacking incidents, other security breaches, computer viruses, telecommunications failures, power loss, other system failures and similar disruptions.

Any of these occurrences, whether intentional or accidental, could lead to interruptions, delays or cessation of operation of our servers or the servers of third-party service providers' used by our customers, and to the unauthorized use or access of our software and proprietary information and sensitive or confidential data stored or transmitted by our products. The inability of service providers used by our customers, or our own inability, to provide continuous access to hosted services, and to secure hosted services and associated customer information from unauthorized use, access or disclosure, could cause us reputational harm, loss of customers and could expose us to significant liability, all of which could harm our business, financial condition and results of operations.

If our products 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.

Our products are used by our customers to manage and store proprietary information and sensitive or confidential data relating to their businesses. Although we maintain security features in our products, our security measures may not detect or prevent hacker interceptions, break-ins, security breaches, the introduction of viruses or malicious code, and other disruptions

Table of Contents

that may jeopardize the security of information stored in and transmitted by our products. A party that is able to circumvent our security measures in our products could misappropriate our or our customers' proprietary or confidential information, cause interruption in operations, damage or misuse of computer systems, and misuse any information misappropriated.

If any compromise of the security of our products were to occur, we may lose customers and our reputation, business, financial condition and results of operations could be harmed. In addition, if there is any perception that we cannot protect our customers' proprietary and confidential information, we may lose the ability to retain existing customers and attract new customers and our revenues could decline.

Weakened global economic conditions may adversely affect the P&C insurance industry, including the rate of information technology spending, which could cause our customers to defer or forego purchases of our products or services.

Our business depends on the overall demand for information technology from, and on the economic health of, our current and prospective customers. In addition, the purchase of our products is discretionary and involves a significant commitment of capital and other resources. The United States and world economies currently face a number of economic challenges, including threatened sovereign defaults, credit downgrades, restricted credit for businesses and consumers and potentially falling demand for a variety of products and services. Our customers may suffer from reduced operating budgets, which could cause them to defer or forego purchases of our products or services.

Challenging global economic conditions, or a reduction in information technology spending even if economic conditions improve, could adversely impact our business, results of operations and financial condition in a number of ways, including longer sales cycles, lower prices for our products and services, material default rates among our customers, reduced sales of our products and services and lower or no growth.

Our sales cycle is lengthy and variable, depends upon many factors outside our control, and could cause us to expend significant time and resources prior to earning associated 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. Moreover, a purchase decision by a potential customer typically requires the approval of several senior decision makers, including the board of directors of our customers. Our sales cycle for new customers is typically one to two years and can extend even longer in some cases. We spend substantial time, effort and money in our sales efforts without any assurance that our efforts will produce any sales. 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 lengthy and variable sales cycle may also 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 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 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 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 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. Although we have established relationships with some of the leading system integrators, our products and services compete directly against the products and services of other leading system integrators, including Accenture. We are unable to control the resources that our system integrator partners commit to implementing our products or the quality of such implementation. If they do not commit sufficient resources to these activities, our business and results of operations could fail to grow in line with our projections.

Table of Contents

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 are large P&C insurance carriers with significant bargaining power in negotiations with us. In fiscal years 2013, 2012 and 2011, our top 10 customers accounted for 33%, 35% and 41% of our revenues, respectively. 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 offset any reductions in our average selling prices or increases in our average costs with increased sales volumes and reduced costs, our results of operations could be harmed.

Our limited operating history and the evolving nature of the industry in which we operate may make it difficult to evaluate our business.

We were incorporated in 2001, and since that time have been developing products to meet the evolving demands of customers in the markets in which we operate. We sold the initial versions of ClaimCenter in 2003, PolicyCenter in 2004 and BillingCenter in 2006. This limited operating history makes financial forecasting and evaluation of our business difficult. Furthermore, because we depend in part on the market's acceptance of our products, it is difficult to evaluate trends that may affect our business. We have limited historical financial data, and we operate in an evolving industry, and, as such, any predictions about our future revenues and expenses may not be as accurate as they would be if we had a longer operating history or operated in a more predictable industry.

We have a history of significant net losses and may not be profitable in future periods.

Although we have been profitable the past four fiscal years, we have incurred significant losses in prior years, including a net loss of \$11.0 million in fiscal year 2009 and a net loss of \$16.9 million in fiscal year 2008. We expect that our expenses will increase in future periods as we implement initiatives designed to grow our business, including, among other things, improvement of our current products, development and marketing of new services and products, stock-based compensation expense, international expansion, investment in our infrastructure, and increased general and administrative functions. If our revenues do not sufficiently increase to offset these expected increases in operating expenses, we will incur significant losses and will not be profitable. We may choose to increase expenses in future periods to further invest in future growth, which may cause us to become unprofitable in certain periods. Our growth in revenues in recent periods should not be considered indicative of our future performance. Any failure to continue profitability may harm our business, results of operations and financial condition.

Because we derive substantially all of our revenues and cash flows from our ClaimCenter, PolicyCenter, BillingCenter and InsuranceSuite 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 substantially all of our revenues and cash flows from our ClaimCenter, PolicyCenter, BillingCenter and InsuranceSuite products and related services. We expect to continue to derive a substantial portion of our revenues from these products and related services. 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 beyond our control, including the timing of development and release of new products by us and our competitors, technological change, and 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 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, which is typically one to three years. 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

43

---

## Table of Contents

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.

Our implementation cycle is lengthy and variable, depends upon factors outside our control, and could cause us to expend significant time and resources prior to earning associated revenues.

The implementation and testing of our products by our customers 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. Depending upon the nature and complexity of our customers' systems and the time and resources that our customers are willing to devote to implementation of our products, the implementation and testing of our products may take significantly longer than 24 months. Historically, under the zero gross margin method, until the implementation project was completed, we recognized revenues in connection with implementing our products up to the corresponding costs of revenues and operating expenses. The lengthy and variable implementation cycle may also have a negative impact on the timing of our revenues, causing our revenues and results of operations to vary significantly from period to period.

Our product development cycles are lengthy, and we may incur significant expenses before we generate revenues, if any, from new products.

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 expense and time to our development cycles. Moreover, development projects can be technically challenging and expensive. 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 expend a significant amount of resources on research and development and our efforts do not lead to the successful introduction or improvement of products that are competitive in the marketplace, this could materially and adversely affect our business and results of operations. Additionally, anticipated customer demand for a product we are developing could decrease or not materialize after the development cycle has commenced. Such lower customer demand may cause us to fall short of our sales targets, and we may nonetheless be unable to avoid substantial costs associated with the product's development. If we are unable to complete product development cycles successfully and in a timely fashion and generate revenues from such future products, the growth of our business may be harmed.

Failure to meet customer expectations on the implementation of our products could result in negative publicity and reduced sales, both of which would significantly harm our business, results of operations, financial condition and growth prospects.

We provide our customers with upfront estimates regarding the duration, budget and costs associated with the implementation of our products. Failing to meet these upfront estimates and 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, which could adversely affect our ability to attract new customers and sell additional products and services to existing customers. Such failure could result from our product capabilities or service engagements by us, our system integrator partners or our customers' IT employees. 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.

If we are unable to maintain vendor specific objective evidence of fair value for any undelivered element of a software order from a customer, offer certain contractual provisions to our customers, such as delivery of specified

functionality, or combine multiple arrangements signed in different periods, our revenues relating to the entire software order will be deferred and recognized over future periods, reducing the revenues we recognize on a significant portion of such order in a particular quarter.

In the course of our selling efforts, we typically enter into sales arrangements pursuant to which we license our software applications and provide maintenance support and professional services. We refer to each individual product or service as an “element” of the overall sales arrangement. These arrangements typically require us to deliver particular elements in a future period. We apply software revenue recognition rules and allocate the total revenues among elements based on the objective and

## Table of Contents

reliable evidence of fair value, or VSOE of fair value of each element. As we discuss further in Note 1 of Notes to Condensed Consolidated Financial Statements, if we are unable to determine the VSOE of fair value of any undelivered elements, offer certain contractual provisions to our customers, such as delivery of specified functionality, or combine multiple arrangements signed in different periods, then we may be required under U.S. generally accepted accounting principles ("U.S. GAAP") to defer additional revenues to future periods. If we are required to defer additional revenues to future periods for a significant portion of our sales, our revenues for that quarter could fall below our expectations or those of securities analysts and investors, resulting in a decline in our stock price.

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 any of our 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 exact effect of the protection of 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. We have registered the trademarks Guidewire, Guidewire PolicyCenter, Guidewire ClaimCenter and Guidewire BillingCenter in the United States and Canada. We also own a U.S. trademark registration, an International Registration (with protection extended to Australia and the European Community) and a Canada trademark for the Gosu trademark. Additionally, we own an Australia trademark registration, a Hong Kong trademark registration, and a Japan trademark registration for the Guidewire trademark. We have also registered the trademark Guidewire Software in the European Community. Finally, we own international registrations, designating China, the European Community and Russia, for the Guidewire trademark, all of which are pending. 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. In addition, 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.

Table of Contents

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.

Further, although we believe that there are currently adequate replacements for the third-party technology and intellectual property we presently use and distribute, the loss of our right to use any of this technology and intellectual property could result in delays in producing or delivering affected products until equivalent technology or intellectual property is identified, licensed or otherwise procured, and integrated. Our business would be disrupted if any technology and intellectual property we license from others or functional equivalents of this software were either no longer available to us or no longer offered to us on commercially reasonable terms. In either case, we would be required either to attempt to redesign our products to function with technology and intellectual property available from other parties or to develop these components ourselves, which would result in increased costs and could result in delays in product sales and the release of new product offerings. Alternatively, we might be forced to limit the features available in affected products. Any of these results could harm our business and impact our results of operations. Catastrophes 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, catastrophe losses that adversely impact their businesses. Catastrophes can be caused by various events, including, amongst others, hurricanes, tsunamis, floods, windstorms, earthquakes, hail, tornados, 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 disasters and catastrophes are inherently unpredictable, and it is difficult to predict the timing of such events or estimate the amount of loss they will generate. In the event a future catastrophe adversely impacts our current or potential customers, we may be prevented from maintaining and expanding our customer base and from increasing our revenues because such events may cause customers to postpone purchases of new products and professional service engagements or discontinue projects. There may be consolidation in the P&C insurance industry, which could reduce the use of our products and services and adversely affect our revenues.

Mergers or consolidations among our customers could reduce the number of our customers and potential customers. This could adversely affect our revenues even if these events do not reduce the aggregate number of customers or the activities of the consolidated entities. If our customers merge with or are acquired by other entities that are not our customers, or that use fewer of our products and services, they may discontinue or reduce their use of our products and services. Any of these developments could materially and adversely affect our results of operations and cash flows. 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

Table of Contents

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.

Real or perceived errors or failures in our products, or unsatisfactory performance of our products or services could adversely affect our reputation and the market acceptance of our products, and cause us to lose customers or 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.

Product errors will affect the performance of our products and could delay the development or release of new products or new versions of products, adversely affect our reputation and our customers' willingness to buy products from us, and adversely affect market acceptance or perception of our products. In addition, because our software is used to manage functions that are critical to our customers, the licensing and support of our products may involve the risk of product liability claims. We also may face liability for breaches of our product warranties, product failures or damages caused by faulty installation of our products. Provisions in our contracts relating to warranty disclaimers and liability limitations may be unenforceable or otherwise ineffective.

Any errors or delays in releasing new products or new versions of products or allegations of unsatisfactory performance of our products or services could cause us to lose revenues or market share, increase our service costs, cause us to incur substantial costs in redesigning the products, cause us to lose significant customers, harm our reputation, subject us to liability for breach of warranty claims or damages and divert our resources from other tasks, any one of which could materially and adversely affect our business, results of operations and financial condition.

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 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.

Incorrect or improper use of our products or our failure to properly train customers on how to implement or 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. Additionally, our customers or third-party partners may incorrectly implement or use our products. 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.

47

---

## Table of Contents

Similarly, our products are sometimes installed or maintained by customers or third parties with smaller or less qualified IT departments, potentially resulting in sub-optimal installation and, consequently, performance that is less than the level anticipated by the customer. 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 implementation or 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 implementation and 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 implementation and 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 partners, and the failure of us or our partners 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, which is key to the growth of our revenues and profitability. As we rely more on system integrators to provide deployment and on-going support, 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 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. However, we cannot assure that this process can be maintained. 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. We plan to continue our investment in product development in future periods. 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. However, we cannot assure that revenues will be sufficient to support the future product development that is required for us to be competitive. Although we may be able to release new products in addition to enhancements to existing products, we cannot assure that our new or upgraded products will be accepted by the market, will not be delayed or canceled, will not contain errors or "bugs" that could affect the performance of the products or cause damage to users' data, or will not be rendered obsolete by the introduction of new products or technological developments by others. If we fail to develop products that are competitive in technology and price and fail to meet customer needs, our market share will decline and our business and results of operations could be harmed.

We may be subject to significant liability claims if our core system software fails and the limitation of liability provided in our license agreements may not protect us, which may adversely impact our financial condition. The license and support of our core system 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 have a material and adverse impact on our results of operations and financial condition.

## Table of Contents

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

We face intense competition for qualified individuals from numerous software and other technology companies. In addition, 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 have a limited number of sales people. The loss of some of these sales people in a short period of time could have a negative impact on our sales efforts. Further, qualified individuals are in high demand. 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. We may be unable to attract and retain suitably qualified individuals who are capable of meeting our growing technical, operational and managerial requirements, on a timely basis or at all, and we may be required to pay increased compensation in order to do so. 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 have a material adverse effect on our ability to generate sales or successfully develop new products, customer and consulting services and enhancements of existing products. 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.

Our ability to effectively use equity compensation to help attract and retain qualified personnel may be limited by our stockholders, and equity compensation arrangements may negatively impact our results of operations.

We intend to continue to issue stock options and restricted stock units as key components of our overall compensation and employee attraction and retention efforts. We may face pressure from stockholders, who must approve extraordinary increases in our equity compensation pool, to limit the use of equity-based compensation so as to minimize its dilutive effect on stockholders. In addition, we are required under GAAP to recognize compensation expense in our results of operations for employee share-based equity compensation under our equity grants, which may negatively impact our results of operations and may increase the pressure to limit equity-based compensation. These factors may make it more difficult or unlikely for us to continue granting attractive equity-based compensation packages to our employees, which could adversely impact our ability to attract and retain key employees. If we lose any senior executive or other key employee, our business and results of operations could be materially and adversely affected.

Failure to manage our rapid growth effectively could harm our business.

We have recently experienced rapid growth, and expect to continue to experience growth, in our number of employees and in our international operations that has placed, and will continue to place, a significant strain on our operational and financial resources and our personnel. To manage our anticipated future growth 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. We also must attract, train and retain a significant number of additional qualified sales and marketing personnel, professional services personnel, software engineers, technical personnel and management personnel. Our failure to manage our growth effectively could have a material adverse effect on our business, results of operations and financial condition.

Our growth could require significant capital expenditures and may divert financial resources from other projects, such as the development of new services or product enhancements. For example, since it may take as long as six months to hire and train a new member of our professional services staff, we make decisions regarding the size of our professional services staff based upon our expectations with respect to customer demand for our products and services. If these expectations are incorrect, and we increase the size of our professional services 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 growth, 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. We also

Table of Contents

intend to continue to expand into additional international markets which, if not technologically or commercially successful, could harm our financial condition and prospects.

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 2013, 2012 and 2011, 28%, 30% and 34% 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 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;
- 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; 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.

If our estimates or judgments relating to our critical accounting policies are based on assumptions that change or prove to be incorrect, our results of operations could fall below expectations of securities analysts and investors, resulting in a decline in our stock price.

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 condensed consolidated financial statements. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, as provided in “Management’s Discussion and Analysis of Financial Condition and Results of Operations” in Item 2 of Part I of this Quarterly Report on Form 10-Q and Note 1 of Notes to Condensed Consolidated Financial Statements, 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. Because our customer contracts are highly negotiated, they often include unique terms and conditions that require judgment with respect to revenue recognition. Our results of operations may be adversely affected if our assumptions change or if actual circumstances differ from those in our assumptions, which could cause our results of operations to fall below the expectations of securities analysts and investors, resulting in a decline in our stock price.

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. During fiscal year 2013, we were required to comply with Section 404 of the Sarbanes-Oxley Act and 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.

Table of Contents

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:

- hire additional personnel;
- develop new or enhance existing products and services;
- enhance our operating infrastructure;
- acquire businesses or technologies; or
- otherwise 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 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.

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, we may need to restate our financial results and the price of our common stock may 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, which became applicable to us beginning with the filing of our Annual Report on Form 10-K for the fiscal year ended July 31, 2013. 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.

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

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. Acts of terrorism could cause disruptions in our or our customers' business or the economy as a whole. 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.

## Table of Contents

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.

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, may negatively 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.

If research analysts do not publish research about our business or if they issue unfavorable commentary or downgrade our common stock, our stock price and trading volume could decline.

The trading market for our common stock depends in part on the research and reports that research analysts publish about us and our business. If we do not maintain adequate research coverage, or if one or more analysts who covers us downgrades our stock or publishes inaccurate or unfavorable research about our business, the price of our common stock could decline. If one or more of the research analysts ceases coverage of our company or fails to publish reports on us regularly, demand for our common stock could decrease, which could cause our stock price or trading volume to decline.

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

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

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

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

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

The affirmative vote of the holders of at least 66 2/3% of our shares of capital stock entitled to vote is generally necessary to amend or repeal the above provisions that are contained in our amended and restated certificate of

incorporation. Also, absent approval of our board of directors, our amended and restated bylaws may only be amended or repealed by the affirmative vote of the holders of at least 50% of our shares of capital stock entitled to vote.

Table of Contents

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.

\*\*Users of this data are advised that, pursuant to Rule 406T of Regulation S-T, these interactive data files are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of

1933 or Section 18 of the Securities Exchange Act of 1934 and otherwise are not subject to liability under these sections.

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 2, 2014

GUIDEWIRE SOFTWARE, INC.

By: /s/ Karen Blasing  
Karen Blasing  
Chief Financial Officer  
(Principal Financial and Accounting Officer)

54