

Guidewire Software, Inc.
 Form 10-Q
 December 02, 2015
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UNITED STATES
 SECURITIES AND EXCHANGE COMMISSION
 Washington, D.C. 20549

FORM 10-Q

(Mark one)

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

For the quarterly period ended October 31, 2015

OR

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

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

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

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

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

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

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

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

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

(do not check if a smaller reporting company)

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

On October 31, 2015, the registrant had 71,491,693 shares of common stock issued and outstanding.

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FORWARD-LOOKING STATEMENTS

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

- growth prospects of the Property & Casualty (“P&C”) insurance industry and our company;
- trends in our future sales, including seasonality;
- opportunities for growth by technology leadership;
- competitive advantages of our platform of software application solutions;
- our market strategy in relation to our competitors;
- competitive attributes of our software application solutions;
- opportunities to further expand our position outside of the United States;
- our research and development investment and efforts;
- 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;
- our ability to satisfy future liquidity requirements.

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

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

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

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PART I – Financial Information

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

	October 31, 2015	July 31, 2015
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$192,731	\$212,362
Short-term investments	343,800	359,273
Accounts receivable	54,303	62,062
Deferred tax assets, current	13,832	13,845
Prepaid expenses and other current assets	14,416	14,102
Total current assets	619,082	661,644
Long-term investments	127,118	106,117
Property and equipment, net	13,418	12,160
Intangible assets, net	3,639	3,999
Deferred tax assets, noncurrent	12,795	5,896
Goodwill	9,205	9,205
Other assets	1,675	926
TOTAL ASSETS	\$786,932	\$799,947
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable	\$5,943	\$8,816
Accrued employee compensation	17,318	37,235
Deferred revenues, current	46,973	50,766
Other current liabilities	6,477	7,592
Total current liabilities	76,711	104,409
Deferred revenues, noncurrent	2,658	1,800
Other liabilities	3,951	4,350
Total liabilities	83,320	110,559
STOCKHOLDERS' EQUITY:		
Common stock	7	7
Additional paid-in capital	679,080	662,869
Accumulated other comprehensive loss	(6,700	) (6,343
Retained earnings	31,225	32,855
Total stockholders' equity	703,612	689,388
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$786,932	\$799,947

See accompanying Notes to Condensed Consolidated Financial Statements.

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

	Three Months Ended October 31,		
	2015	2014	
Revenues:			
License	\$32,340	\$28,820	
Maintenance	14,013	12,520	
Services	35,927	38,394	
Total revenues	82,280	79,734	
Cost of revenues:			
License	1,164	1,082	
Maintenance	2,475	2,242	
Services	31,531	32,447	
Total cost of revenues	35,170	35,771	
Gross profit:			
License	31,176	27,738	
Maintenance	11,538	10,278	
Services	4,396	5,947	
Total gross profit	47,110	43,963	
Operating expenses:			
Research and development	25,672	20,310	
Sales and marketing	19,291	17,529	
General and administrative	11,110	9,762	
Total operating expenses	56,073	47,601	
Loss from operations	(8,963) (3,638)
Interest income	696	512	
Other income (expense), net	217	(483)
Loss before income taxes	(8,050) (3,609)
Benefit from income taxes	(6,420) (612)
Net loss	\$(1,630) \$(2,997)
Net loss per share:			
Basic	\$(0.02) \$(0.04)
Diluted	\$(0.02) \$(0.04)
Shares used in computing net loss per share:			
Basic	71,242,897	69,316,700	
Diluted	71,242,897	69,316,700	

See accompanying Notes to Condensed Consolidated Financial Statements.

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

	Three Months Ended October 31,		
	2015	2014	
	(in thousands)		
Net loss	\$ (1,630	) \$ (2,997)
Other comprehensive loss:			
Foreign currency translation adjustments	(287	) (1,269)
Unrealized gains (losses) on available-for-sale securities, net of tax of \$4 and \$8	(50	) 33	
Reclassification adjustment for realized gains included in net loss	(20	) (3)
Other comprehensive loss	(357	) (1,239)
Comprehensive loss	\$ (1,987	) \$ (4,236)

See accompanying Notes to Condensed Consolidated Financial Statements

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

	Three Months Ended October 31,	
	2015	2014
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	\$(1,630	) \$(2,997
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	1,791	1,773
Stock-based compensation	15,147	11,988
Excess tax benefit from exercise of stock options and vesting of restricted stock units	(475) —
Deferred tax assets	(6,905	) (955
Amortization of premium on available-for-sale securities	877	1,414
Loss on disposals of property and equipment	18	—
Changes in operating assets and liabilities:		
Accounts receivable	7,638	9,493
Prepaid expenses and other assets	(1,071	) (814
Accounts payable	(2,542	) 87
Accrued employee compensation	(19,840	) (17,232
Other liabilities	(1,039	) 10
Deferred revenues	(2,859	) (8,315
Net cash used in operating activities	(10,890	) (5,548
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of available-for-sale securities	(195,336	) (113,730
Sales of available-for-sale securities	188,867	102,539
Purchase of property and equipment	(3,016	) (1,249
Net cash used in investing activities	(9,485	) (12,440
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from issuance of common stock upon exercise of stock options	1,463	1,445
Taxes remitted on RSU awards vested	(874	) (8,570
Excess tax benefit from exercise of stock options and vesting of restricted stock units	475	—
Net cash provided by (used in) financing activities	1,064	(7,125
Effect of foreign exchange rate changes on cash and cash equivalents	(320	) (1,478
NET CHANGE IN CASH AND CASH EQUIVALENTS	(19,631	) (26,591
CASH AND CASH EQUIVALENTS—Beginning of period	212,362	148,101
CASH AND CASH EQUIVALENTS—End of period	\$ 192,731	\$ 121,510
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid for income taxes	\$394	\$506
SUPPLEMENTAL DISCLOSURES OF NONCASH INVESTING AND FINANCING ACTIVITIES:		
Accruals for purchase of property and equipment	\$177	\$703

See accompanying Notes to Condensed Consolidated Financial Statements.

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

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

Business

Guidewire Software, Inc., a Delaware corporation, was incorporated on September 20, 2001. Guidewire Software, Inc., together with its subsidiaries (the “Company”), provides a technology platform which consists of three key elements: core transaction processing, data management and analytics, and digital engagement. It supports core insurance operations, including underwriting and policy administration, claim management and billing. The Company’s customers include insurance carriers for property and casualty insurance.

Basis of Presentation

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

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

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 and Cash Equivalents

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

Investments

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

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

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Concentration of Credit Risk

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

No customer accounted for 10% or more of the Company’s revenues for the three months ended October 31, 2015 or 2014. Two customers individually accounted for 10% or more of the Company’s total accounts receivable as of October 31, 2015 and no customer accounted for 10% or more of the Company’s total accounts receivable as of July 31, 2015.

Revenue Recognition

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

Revenues are derived from three sources:

- (i) License fees, related to term (or time-based) licenses, perpetual software licenses, and other;
- (ii) Maintenance fees, related to email and phone support, bug fixes and unspecified software updates and upgrades released when, and if, available during the maintenance term; and
- (iii) Services fees, related to professional services related to implementation of our software, reimbursable travel and training.

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

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

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

Fees are fixed or determinable. The Company assesses whether a fee is fixed or determinable at the outset of the arrangement, primarily based on the payment terms associated with the transaction. Term and perpetual license fees are not considered to be fixed or determinable until they become due. Fees from term licenses are generally invoiced in annual, or in certain cases quarterly, installments over the term of the agreement beginning on the effective date of the license. Perpetual license fees are generally due between 30 and 60 days from delivery of software, however in certain cases extended payment terms may be offered.

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

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

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

If the undelivered elements are all service elements and VSOE of fair value does not exist for one or more service element, the total arrangement fee is recognized ratably over the longest service period starting at software delivery,

assuming all the related services have been made available to the customer.

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

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

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

Income Taxes

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

The effective tax rate in a given financial statement period may also be materially impacted by changes in the mix and level of income or losses, changes in the expected outcome of audits, or changes in the deferred tax valuation allowance.

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

Stock-Based Compensation

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

Recent Accounting Pronouncement

Balance Sheet Classification of Deferred Taxes

In November 2015, the FASB issued ASU 2015-17, Income Taxes (Subtopic 740-10) which provides guidance for balance sheet classification of deferred taxes. This ASU requires that deferred tax assets and liabilities be classified as non-current on the balance sheet. The current requirement that deferred tax liabilities and assets of a tax-paying component of an entity be offset and presented as a single amount is not affected by the amendments in this ASU.

ASU 2015-17 is effective for financial statements issued for annual periods beginning after December 15, 2016, and interim periods within those annual periods with earlier application permitted as of the beginning of an interim or annual reporting period. The amendments in this Update may be applied either prospectively to all deferred tax liabilities and assets or retrospectively to all periods presented. We have not yet selected a transition method and continue to evaluate the impact that this guidance will have on our consolidated financial statements.

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Cloud Computing Arrangements that Include a Software Element

In April 2015, the FASB issued ASU 2015-05, Intangibles-Goodwill and Other-Internal-Use Software (Subtopic 350-40): Customer's Accounting for Fees Paid in a Cloud Computing Arrangement (ASU 2015-05). ASU 2015-05 provides guidance to customers about whether a cloud computing arrangement includes software. If a cloud computing arrangement includes a software license, the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract. The new guidance does not change the accounting for service contracts. ASU 2015-05 is effective for the Company in the first quarter of fiscal 2017 with early adoption permitted using either of two methods: (i) prospective to all arrangements entered into or materially modified after the effective date and represent a change in accounting principle; or (ii) retrospectively. The Company has evaluated the impact of the adoption of ASU 2015-05 and concluded that the adoption will not have a material impact on its consolidated financial statements.

Revenue from Contracts with Customers

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606), which provides guidance for revenue recognition. This ASU affects any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of non-financial assets. This ASU will supersede the revenue recognition requirements in Topic 605, Revenue Recognition, and most industry-specific guidance. This ASU also supersedes some cost guidance included in Subtopic 605-35, Revenue Recognition-Construction-Type and Production-Type Contracts. In July 2015, the FASB deferred the effective date to annual reporting periods and interim periods within fiscal years beginning after December 15, 2017. Early adoption is permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period. The standard will be effective for the Company beginning August 1, 2018 and permits the use of either the retrospective or cumulative effect transition method. We have not yet selected a transition method and continue to evaluate the impact that this guidance will have on our consolidated financial statements.

2. Fair Value of Financial Instruments

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

October 31, 2015

Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
(in thousands)			

U.S. agency securities