Guidewire Software, Inc.
Form 10-Q
June 06, 2018
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark one)
x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended April 30, 2018
OR
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to .
Commission file number: 001-35394

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

Delaware (State or other jurisdiction of Incorporation or organization)	36-4468504 (I.R.S. Employer Identification No.)
1001 E. Hillsdale Blvd., Suite 800 Foster City, California (Address of principal executive offices)	94404 (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 x No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§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 x No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definition of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

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

Emerging growth company ¨

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

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

On May 31, 2018, the registrant had 80,263,759 shares of common stock issued and outstanding.

Guidewire Software, Inc.
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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, results of operations, revenues, gross margins, operating expenses, products, projected costs and capital expenditures, research and development programs, sales and marketing initiatives, and competition. In some cases, you can identify these statements by forward-looking words, such as “will,” “may,” “might,” “should,” “could,” “estimate,” “expect,” “suggest,” “believe,” “anticipate,” “intend,” “p
“continue,” the negative or plural of these words and other comparable terminology. Actual events or results may differ materially from those expressed or implied by these statements due to various factors, including but not limited to the matters discussed below, in the section titled “Item 1A. Risk Factors,” and elsewhere in this Quarterly Report on Form 10-Q. Many of the forward-looking statements are located in “Management’s Discussion and Analysis of Financial Condition and Results of Operations.” Examples of forward-looking statements include statements regarding:

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

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

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

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

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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)

	April 30, 2018	July 31, 2017
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$476,101	$263,176
Short-term investments	518,151	310,027
Accounts receivable	101,146	79,433
Prepaid expenses and other current assets	31,229	26,604
Total current assets	1,126,627	679,240
Long-term investments	164,206	114,585
Property and equipment, net	15,929	14,376
Intangible assets, net	103,001	71,315
Deferred tax assets, net	58,597	37,430
Goodwill	342,469	141,851
Other assets	21,704	20,104
TOTAL ASSETS	$1,832,533	$1,078,901
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable	$19,357	$13,416
Accrued employee compensation	43,427	48,882
Deferred revenues, current	113,894	91,243
Other current liabilities	12,016	10,075
Total current liabilities	188,694	163,616
Convertible senior notes, net	302,184	—
Deferred revenues, non-current	20,667	19,892
Other liabilities	1,121	2,112
Total liabilities	512,666	185,620
STOCKHOLDERS' EQUITY:		
Common stock	8	8
Additional paid-in capital	1,276,379	830,014
Accumulated other comprehensive loss	(6,598)	(5,796)
Retained earnings	50,078	69,055
Total stockholders' equity	1,319,867	893,281
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$1,832,533	$1,078,901

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 shares and per share amounts)

	Three Months Ended April 30,		Nine Months Ended April 30,	
	2018	2017	2018	2017
Revenues:				
License and other	$50,359	$ 58,971	$164,673	$161,767
Maintenance	18,749	16,858	56,789	49,972
Services	71,361	47,607	190,966	121,445
Total revenues	140,469	123,436	412,428	333,184
Cost of revenues:				
License and other	9,742	5,208	25,497	10,419
Maintenance	3,828	3,480	10,888	9,884
Services	60,751	42,780	168,599	113,995
Total cost of revenues	74,321	51,468	204,984	134,298
Gross profit:				
License and other	40,617	53,763	139,176	151,348
Maintenance	14,921	13,378	45,901	40,088
Services	10,610	4,827	22,367	7,450
Total gross profit	66,148	71,968	207,444	198,886
Operating expenses:				
Research and development	46,787	34,090	126,155	94,865
Sales and marketing	30,378	28,788	85,949	77,808
General and administrative	18,170	13,429	57,907	40,649
Total operating expenses	95,335	76,307	270,011	213,322
Loss from operations	(29,187)	(4,339)	(62,567)	(14,436)
Interest income	3,762	1,400	7,247	4,286
Interest expense	(2,228)	(6)	(2,239)	(6)
Other income (expense), net	(356)	11	1,040	(335)
Loss before income taxes	(28,009)	(2,934)	(56,519)	(10,491)
Provision for (benefit from) income taxes	20,613	(1,115)	46,572	(4,788)
Net loss	$(48,622)	$ (1,819)	$(103,091)	$(5,703)
Net loss per share:				
Basic	$(0.62)	$ (0.02)	$(1.32)	$(0.08)
Diluted	$(0.62)	$ (0.02)	$(1.32)	$(0.08)
Shares used in computing net loss per share:				
Basic	78,777,484	74,175,603	78,246,146	73,731,132
Diluted	78,777,484	74,175,603	78,246,146	73,731,132

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 April 30,		Nine Months Ended April 30,	
	2018	2017	2018	2017
Net loss	$(48,622)	$(1,819)	$(103,091)	$(5,703)
Other comprehensive income (loss):				
Foreign currency translation adjustments	(1,522)	183	(94)	(654)
Unrealized (losses) gains on available-for-sale securities, net of tax benefit of $124 and $14 for the three months ended April 30, 2018 and 2017, respectively; $291 and $289 for the nine months ended April 30, 2018 and 2017, respectively	(198)	49	(623)	(352)
Reclassification adjustment for realized gains included in net loss	(100)	(60)	(85)	(119)
Other comprehensive income (loss)	(1,820)	172	(802)	(1,125)
Comprehensive loss	$(50,442)	$(1,647)	$(103,893)	$(6,828)

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)

	Nine Months Ended April 30,	
	2018	2017
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	$(103,091)	$(5,703)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	26,117	12,208
Amortization of debt discount and issuance costs	1,568	—
Stock-based compensation	68,494	53,661
Excess tax benefit from stock-based compensation	—	962
Deferred income tax	43,421	(6,779)
Amortization of premium on available-for-sale securities, and other non-cash items	(34)	1,201
Changes in operating assets and liabilities:		
Accounts receivable	(16,809)	(25,745)
Prepaid expenses and other assets	(1,972)	(7,172)
Accounts payable	4,569	546
Accrued employee compensation	(7,237)	(3,589)
Other liabilities	886	(1,085)
Deferred revenues	20,703	33,032
Net cash provided by operating activities	36,615	51,537
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of available-for-sale securities	(535,310)	(343,761)
Sales of available-for-sale securities	276,686	442,830
Purchases of property and equipment	(4,710)	(3,236)
Capitalized software development costs	(1,850)	(374)
Strategic investment	—	(4,677)
Acquisitions of business, net of acquired cash	(130,058)	(187,590)
Net cash used in investing activities	(395,242)	(96,808)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from issuance of convertible senior notes, net of issuance costs	387,239	—
Proceeds from issuance of common stock, net of issuance costs	220,948	—
Purchase of capped calls	(37,200)	—
Proceeds from issuance of common stock upon exercise of stock options	1,055	3,419
Excess tax benefit (shortfall) from exercise of stock options and vesting of restricted stock units	—	(962)
Net cash provided by financing activities	572,042	2,457
Effect of foreign exchange rate changes on cash and cash equivalents	(490)	(602)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	212,925	(43,416)
CASH AND CASH EQUIVALENTS—Beginning of period	263,176	223,582
CASH AND CASH EQUIVALENTS—End of period	$476,101	$180,166
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid for income taxes, net of tax refunds	$3,786	$2,487
SUPPLEMENTAL DISCLOSURES OF NONCASH INVESTING AND FINANCING ACTIVITIES:		
Accruals for purchase of property and equipment	$823	$569

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. The Company’s technology platform supports core insurance operations, including underwriting and policy administration, claim management and billing, enables new insights into data that can improve business decision making and supports digital sales, service and claims experiences for policyholders, agents, and other key stakeholders. The Company’s customers are primarily insurance carriers for property and casualty (“P&C”) insurance.

Public Offerings

In March 2018, the Company closed a public offering of 2,628,571 shares of its common stock, including the underwriters’ exercise in full of their option to purchase additional shares of common stock from the Company. The public offering price of the shares sold in the offering was $87.50 per share. No shares were sold by the Company’s stockholders in this public offering. Concurrently, the Company offered and sold $400.0 million aggregate principal amount of its 1.250% Convertible Senior Notes due 2025 (the “Convertible Senior Notes”), including the underwriters’ exercise in full of their option to purchase additional Convertible Senior Notes. Net of offering expenses and underwriting discounts (“issuance costs”), the Company received net proceeds of approximately $220.9 million related to the common stock offering and $387.2 million related to the convertible note offering.
Basis of Presentation
The accompanying condensed consolidated financial statements and accompanying notes include the Company and its wholly-owned subsidiaries, and reflect all adjustments (all of which are normal and recurring in nature) that, in the opinion of management, are necessary for a fair presentation of the interim periods presented. All inter-company balances and transactions have been eliminated in consolidation. Certain information and note disclosures normally included in annual financial statements prepared in accordance with generally accepted accounting principles in the United States of America (“U.S. GAAP”) have been condensed or omitted under the rules and regulations of the U.S. Securities and Exchange Commission (“SEC”).
These condensed consolidated financial statements should be read in conjunction with the Company’s financial statements and related notes, together with management’s discussion and analysis of financial condition and results of operations, presented in the Company’s Annual Report on Form 10-K for the fiscal year ended July 31, 2017. There have been no changes in the Company’s significant accounting policies from those that were disclosed in the Company’s consolidated financial statements for the fiscal year ended July 31, 2017 included in the Company’s Annual Report on Form 10-K filed with the SEC on September 19, 2017, except changes to the income taxes and stock-based compensation policies resulting from the adoption of Accounting Standards Update (“ASU”) 2016-09 during the first quarter of fiscal year 2018.
Use of Estimates
The preparation of the accompanying condensed consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions about future events that affect the amounts of assets and liabilities reported, disclosures about contingent assets and liabilities, and reported amounts of revenues and expenses. Significant items subject to such estimates include, but are not limited to, revenue recognition, the useful lives of property and equipment and intangible assets, allowance for doubtful accounts, valuation allowance for deferred tax assets, stock-based compensation, annual bonus attainment, income tax uncertainties, convertible senior notes fair value, valuation of goodwill and intangible assets, and contingencies. These estimates and assumptions are based on

management's best estimates and judgment. Management regularly evaluates its estimates and assumptions using historical experience and other factors; however, actual results could differ from these estimates.

Cash and Cash Equivalents

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

Investments

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

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

Concentration of Credit Risk

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

No customer individually accounted for 10% or more of the Company's revenues for the three and nine months ended April 30, 2018 and nine months ended April 30, 2017. One customer individually accounted for 10% or more of the Company's revenues for the three months ended April 30, 2017. No customer individually accounted for 10% or more of the Company's total accounts receivable as of April 30, 2018. As of July 31, 2017, one customer individually accounted for 11% of the Company's total accounts receivable.

Revenue Recognition

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

Revenues are derived from three sources:

(i) License fees related to term (or time-based) licenses, software license subscriptions and cloud-based subscriptions (collectively referred to as "subscriptions"), and perpetual software licenses;

(ii) Maintenance fees associated with term or perpetual licenses relate to email and phone support, bug fixes and unspecified software updates, and upgrades released when, and if, available during the maintenance term; and

(iii) Services fees from professional services related to the implementation of the Company's software, reimbursable travel and training expenses.

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

- Persuasive evidence of an arrangement exists. Evidence of an arrangement consists of a written contract signed by both the customer and management prior to the end of the period.
- Delivery or performance has occurred. The Company's software is delivered electronically to the customer. Delivery is considered to have occurred when the Company provides the customer access to the software along with login credentials.
- Fees are fixed or determinable. The Company assesses whether a fee is fixed or determinable at the outset of the arrangement, primarily based on the payment terms associated with the transaction. Fees from term licenses are invoiced in advance in annual or quarterly installments over the term of the agreement beginning on the effective date of the license and represent extended payment terms. A significant majority are invoiced annually. As a result, term license fees are not considered to be fixed and determinable until they become due or payment is received. Perpetual license fees are generally due between 30 and 60 days from delivery of software. We offer extended payment terms in limited cases.
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Collectability is probable or reasonably assured. Collectability is assessed on a customer-by-customer basis, based primarily on creditworthiness as determined by credit checks and analysis, as well as customer payment history. Payment terms generally range from 30 to 90 days from invoice date. If it is determined prior to revenue recognition

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that collection of an arrangement fee is not probable, revenues are deferred until collection becomes probable or reasonably assured, or cash is collected, assuming all other revenue recognition criteria are satisfied.
VSOE of fair value does not exist for the Company's software licenses; therefore, the Company allocates revenues to software licenses using the residual method. Under the residual method, the amount recognized for license fees is the difference between the total fixed and determinable fees and the VSOE of fair value for the undelivered elements under the arrangement.
The VSOE of fair value for elements of an arrangement is based upon the normal pricing and discounting practices for those elements when sold separately. VSOE of fair value for maintenance is established using the stated maintenance renewal rate in the customer's contract. For term licenses with duration of one year or less, no VSOE of fair value for maintenance exists. VSOE of fair value for services is established if a substantial majority of historical stand-alone selling prices for a service fall within a reasonably narrow price range.
If the undelivered elements are all service elements and VSOE of fair value does not exist for one or more service element, the total arrangement fee is recognized ratably over the longest service period starting at software delivery, assuming all the related services have been made available to the customer.
The Company's subscriptions are recognized ratably over the term of the arrangement typically upon provisioning the products.
As noted above, the Company generally invoices fees for licenses and maintenance to its customers in annual or, in certain cases, quarterly installments payable in advance. Deferred revenues represent amounts, which are billed to or collected from creditworthy customers for which one or more of the revenue recognition criteria have not been met. The deferred revenues balance does not represent the total contract value of annual or multi-year, non-cancellable arrangements.

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

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

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

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

Income Taxes

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

The effective tax rate in any given financial statement period may differ materially from the statutory rate. These differences may be caused by changes in tax regulations and resulting changes in the deferred tax valuation allowance, changes in the mix and level of income or losses, changes in the expected outcome of tax audits, as well as permanent differences for stock-based compensation, including excess tax benefits, research and development credits, the tax rate differences between the United States and foreign countries, foreign withholding taxes, certain non-deductible expenses including executive compensation, and acquisition-related expenses.

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

Stock-Based Compensation

The Company accounts for stock-based compensation using the fair value method, which requires the Company to measure the stock-based compensation based on the grant-date fair value of the awards and recognize the compensation expense over the requisite service period. The Company recognizes compensation expense net of actual forfeitures. To date, the Company has granted stock options, restricted stock awards (“RSAs”), time-based restricted stock units (“RSUs”), performance-based restricted stock units (“PSUs”), and restricted stock units that may be earned subject to the Company’s total shareholder return ranking relative to the software companies in the S&P Software and Services Select Industry Index (“S&P Index”) for a specified performance period or specified performance periods, service periods, and in select cases, subject to certain performance conditions (“TSR PSUs”). RSAs, RSUs, PSUs, and TSR PSUs are collectively referred to as “Stock Awards”.

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

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

Business Combinations

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

Software Development Costs

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

Impairment of Long-Lived Assets, Intangible Assets and Goodwill

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The Company evaluates its long-lived assets, consisting of property and equipment and intangible assets, for indicators of possible impairment when events or changes in circumstances indicate that the carrying amount of certain assets may not be recoverable. Impairment exists if the carrying amounts of such assets exceed the estimates of future net undiscounted cash flows expected to be generated by such assets. Should impairment exist, the impairment loss would be measured based on the excess carrying value of the assets over the estimated fair value of the assets. The Company has not written down any of its long-lived assets as a result of impairment during the periods presented. The Company tests goodwill for impairment annually, during the fourth quarter of each fiscal year and in the interim whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. The Company evaluates qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test. In performing the qualitative assessment, the Company considers events and circumstances, including but not limited to, macroeconomic conditions, industry and market considerations, cost factors, overall financial performance, changes in management or key personnel, changes in strategy, changes in customers, changes in the composition or carrying amount of a reporting unit’s net assets, and changes in the price of the Company’s common stock. If, after assessing the totality of events or circumstances, the Company determines that it is more likely than not that the fair value of a reporting unit is greater than its carrying amount, then the two-step goodwill impairment test is not performed. There have been no goodwill impairments during the periods presented.

Convertible Senior Notes

In March 2018, the Company issued $400.0 million aggregate principal amount of 1.250% Convertible Senior Notes due 2025. The Company accounts for the issued Convertible Senior Notes as separate liability and equity components. The carrying amount of the equity component, representing the conversion option, was determined by deducting the fair value of the liability component from the par value of the Convertible Senior Notes as a whole. This difference represents a debt discount that is amortized to interest expense using the effective interest method over the term of the Convertible Senior Notes. The carrying amount of the liability component was calculated by measuring the fair value of a similar liability that does not have an associated convertible feature. The equity component of the Convertible Senior Notes is recorded at its initial fair value and will not be remeasured as long as it continues to meet the requirements for equity classification. The equity component is net of issuance costs and recorded in additional paid in capital.

Recently Adopted Accounting Pronouncements

Share-Based Payment Accounting (Topic 718): Improvements on Employee Share-Based Payment Accounting

In March 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No.2016-09, Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting (“ASU 2016-09”), which simplifies several aspects of the accounting for employee share-based payment transactions for both public and nonpublic entities, including the accounting for income taxes, forfeitures, and statutory tax withholding requirements, as well as classification in the statement of cash flows. The Company adopted ASU No. 2016-09 on August 1, 2017. For the three and nine months ended April 30, 2018, the provision for income taxes included tax benefits of $2.9 million and $8.0 million, respectively, in tax effects related to settled stock-based awards.

Recent Accounting Pronouncements Not Yet Adopted

Income Statement, Reporting Comprehensive Income (Topic 220): Reclassification of Certain Effects from Accumulated Other Comprehensive Income

In February 2018, the FASB issued ASU No. 2018-02, Income Statement, Reporting Comprehensive Income (Topic 220): Reclassification of Certain Effects from Accumulated Other Comprehensive Income (“ASU 2018-02”), which allows a reclassification of stranded tax effects from accumulated other comprehensive income to retained earnings, as a result of the Tax Cuts and Jobs Act (“Tax Act”). ASU 2018-02 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2018, with early adoption permitted. The Company is currently evaluating the impact of adopting the new standard for its 2019 fiscal year and subsequent periods.

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

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

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

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

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

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

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

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

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

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

Leases (Topic 842): Accounting for Leases

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842) (“ASU 2016-02”), which requires lessees to put most leases on their balance sheets but recognize the expenses on their income statements in a manner similar to current practice. ASU 2016-02 states that a lessee would recognize a lease liability for the obligation to make lease

payments and a right-to-use asset for the right to use the underlying asset for the lease term. The standard will be effective for the Company beginning August 1, 2019. The Company is currently evaluating the impact this update will have on its consolidated financial statements.

Financial Instruments (Topic 825): Recognition and Measurement of Financial Assets and Financial Liabilities

In January 2016, the FASB issued ASU No. 2016-01, Financial Instruments (Topic 825) (“ASU 2016-01”), which impacts certain aspects of recognition, measurement, and presentation and disclosure of financial instruments. Under ASU 2016-01, unconsolidated non-equity method investments shall be measured at fair value. If such investments do not have a readily determinable fair value, an election may be made to measure them at cost after considering observable price changes for similar

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instruments. The standard will be effective for the Company beginning August 1, 2018. The Company is currently evaluating the impact this update will have on its strategic equity investment in a privately-held company.

Other recent accounting pronouncements that are or will be applicable to the Company did not, or are not expected to, have a material impact on the Company's present or future financial statements.

2. Fair Value of Financial Instruments

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

	April 30, 2018			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
	(in thousands)			
U.S. Government agency securities	$22,521	$ —	$ (43)	$22,478
Commercial paper	506,732	8	(212)	506,528
Corporate bonds	351,653	44	(955)	350,742
U.S. Government bonds	72,276	—	(118)	72,158
Foreign government bonds	1,764	3	—	1,767
Certificates of deposit	83,952	53	(23)	83,982
Money market funds	66,363	—	—	66,363
Total	$1,105,261	$ 108	$ (1,351)	$1,104,018

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

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

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	April 30, 2018					
	Less Than 12 Months		12 Months or Greater		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
	(in thousands)					
U.S. Government agency securities	$7,937	$ (17)	$14,541	$ (25)	$22,478	$ (42)
Commercial paper	167,316	(212)	—	—	167,316	(212)
Corporate bonds	275,769	(916)	21,225	(40)	296,994	(956)
U.S. Government bonds	47,277	(15)	24,881	(103)	72,158	(118)
Foreign government bonds	764	—	—	—	764	—
Certificate of deposit	24,708	(23)	—	—	24,708	(23)
Total	$523,771	$ (1,183)	$60,647	$ (168)	$584,418	$ (1,351)

As of April 30, 2018, the Company had 194 investments in a gross unrealized loss position. The unrealized losses on its available-for-sale securities were primarily a result of unfavorable changes in interest rates subsequent to the initial purchase of these securities. The Company does not intend to sell, nor does it believe it will need to sell, these securities before recovering the associated unrealized losses. The Company does not consider any portion of the unrealized losses at April 30, 2018 to be other-than-temporarily impaired, nor are any unrealized losses considered to be credit losses. The Company has recorded the securities at fair value in its consolidated balance sheets, with unrealized gains and losses reported as a component of accumulated other comprehensive loss. The amount of realized gains and losses reclassified into earnings are based on the specific identification of the securities sold. The realized gains and losses from sales of securities in the periods presented were not material.

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

	April 30, 2018		
	Less Than 12 Months	12 to 24 Months	Total
	(in thousands)		
U.S. Government agency securities	$15,540	$6,938	$22,478
Commercial paper	506,528	—	506,528
Corporate bonds	211,737	139,005	350,742
U.S. Government bonds	72,158	—	72,158
Foreign government bonds	1,003	764	1,767
Money market funds	66,363	—	66,363
Certificates of deposit	66,483	17,499	83,982
Total	$939,812	$164,206	$1,104,018

Fair Value Measurement

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

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

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

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

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Available-for-sale investments

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

	April 30, 2018			
	Level 1	Level 2	Level 3	Total
	(in thousands)			
Cash equivalents:				
Commercial paper	—	341,829	—	341,829
Money market funds	66,363	—	—	66,363
U.S. Government bonds	—	9,969	—	9,969
Certificates of deposit	—	3,500	—	3,500
Short-term investments:				
U.S. Government agency securities	—	15,540	—	15,540
Commercial paper	—	164,699	—	164,699
U.S. Government bonds	—	62,189	—	62,189
Foreign government bonds		1,003		1,003
Corporate bonds	—	211,736	—	211,736
Certificates of deposit	—	62,984	—	62,984
Long-term investments:				
U.S. Government agency securities	—	6,938	—	6,938
Certificates of deposit	—	17,498	—	17,498
Corporate bonds	—	139,006	—	139,006
U.S. Government bonds	—	—	—	—
Foreign government bonds	—	764	—	764
Total	$66,363	$1,037,655	$ —	$1,104,018

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

Convertible Senior Notes

The carrying value of the Convertible Senior Notes was $310.5 million before consideration of issuance costs, which approximates their fair value at April 30, 2018. In accounting for the issuance of the notes, the Company separated the notes into liability and equity components. The carrying amount of the liability component was calculated by measuring the fair value of a similar liability that does not have an associated conversion feature. The carrying amount of the equity component representing the conversion option was determined by deducting the fair value of the liability component from the par value of the notes as a whole.

The Company estimates the fair value of the Convertible Senior Notes using commonly accepted valuation methodologies and market-based risk measurements that are indirectly observable, such as credit risk (Level 2). The Company carries the Convertible Senior Notes at face value less unamortized debt discount and issuance costs on its consolidated balance sheet, and presents the fair value for required disclosure purposes only. For further information on the Convertible Senior Notes see Note 6.

3. Acquisitions

Cyence Acquisition

On November 1, 2017, the Company completed its acquisition of Cyence, Inc. ("Cyence") for an aggregate consideration of approximately $260.3 million, including approximately $146.6 million in cash, and equity consideration valued at approximately $113.7 million of newly issued Guidewire common stock and options, net of certain adjustments including a net working capital adjustment (the "Cyence Acquisition"). Through the acquisition, the Company gained a cloud-based data listening and risk analytics technology offering for the P&C insurance industry which enables underwriting new and evolving risks, such as cyber risk. This acquisition was accounted for as a

business combination. The results of Cyence's operations have been included in the Company's results of operations since November 1, 2017, the date of acquisition.

As part of the acquisition, the Company assumed certain Cyence compensation agreements, consisting of RSAs, stock options, and cash compensation, with an estimated fair value of $37.6 million. Based on the period earned prior to the acquisition date,

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$18.2 million was allocated to the purchase price, and $19.4 million relating to post-acquisition services will be recorded as operating expenses over the remaining requisite service periods. RSAs were valued based on the November 1, 2017 grant date value, and the estimated fair value of the stock options assumed by the Company was determined using the Black-Scholes option pricing model.

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

	Preliminary Purchase Consideration (in thousands)
Cash consideration paid at close	$ 146,651
Equity issued to shareholders	102,493
Issuance of replacement awards	11,205
Total preliminary purchase consideration	$ 260,349

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

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

	Preliminary Purchase Price Allocation (in thousands)	Estimated Useful Lives (in years)
Acquired assets, net of assumed liabilities	$ 8,026	
Developed technology	28,400	5
Customer contracts and related relationships	17,700	5
Order backlog	3,200	2
Trademarks	2,500	7
Goodwill	200,523	
Total preliminary purchase consideration	$ 260,349	

The goodwill of $200.5 million arising from the Cyence Acquisition consists largely of the acquired workforce and the opportunity to expand the Company's customer base. The goodwill recognized is not expected to be deductible for income tax purposes.

For the three months ended April 30, 2018, total revenue and net loss attributable to Cyence was approximately $2.9 million and $8.5 million, respectively. For the nine months ended April 30, 2018, total revenue and net loss attributable to Cyence was approximately $5.0 million and $18.2 million, respectively. The Company incurred no acquisition-related costs for the three months ended April 30, 2018 and $5.2 million of total acquisition-related costs for the nine months ended April 30, 2018 that were recognized in general and administrative expenses.

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Unaudited Pro Forma Financial Information

The following unaudited pro forma financial information presents the combined results of operations for the Company and Cyence for the three and nine months ended April 30, 2018 and 2017, after giving effect to the Cyence Acquisition as if it had occurred on August 1, 2016. The unaudited pro forma financial information includes adjustments to give effect to pro forma events that are directly attributable to the business combination and factually supportable. The unaudited pro forma financial information presented includes the business combination accounting effects resulting from the acquisition, including adjustments for the amortization of intangible assets, stock-based compensation, deferred revenue, and transaction costs on August 1, 2016 with a corresponding reduction of these amounts in the period originally recognized.

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

The unaudited pro forma financial information is as follows (in thousands):

	Three Months Ended April 30,		Nine Months Ended April 30,	
	2018	2017	2018	2017
Pro forma revenue	$140,469	$125,494	$417,360	$340,560
Pro forma net loss	$(48,622)	$(9,454)	$(106,043)	$(31,710)
Pro forma net loss per share -- basic	$(0.62)	$(0.13)	$(1.36)	$(0.43)
Pro forma net loss per share -- diluted	$(0.62)	$(0.13)	$(1.36)	$(0.43)

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

ISCS Acquisition

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

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

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

Company’s policy, practice, and experience as described above:

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	Total Purchase Price Allocation (in thousands)	Estimated Useful Lives (in years)
Acquired assets, net of assumed liabilities	$ 4,530	
Developed technology	43,300	4
Customer contracts and related relationships	7,000	9
Order backlog	3,500	4
Deferred tax assets	171	
Goodwill	96,431	
Total purchase price	$ 154,932	

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

4. Balance Sheet Components

Property and Equipment, net

Property and equipment consist of the following:

	April 30, 2018	July 31, 2017
	(in thousands)	
Computer hardware	$24,349	$21,408
Purchased software	4,173	3,855
Capitalized software development costs	2,850	1,065
Furniture and fixtures	3,979	3,253
Leasehold improvements	9,489	8,251
Total property and equipment	44,840	37,832
(Less) accumulated depreciation	(28,911)	(23,456)
Property and equipment, net	$15,929	$14,376

As of April 30, 2018 and July 31, 2017, no property and equipment was pledged as collateral. Depreciation expense, excluding the amortization of software development costs, was $2.0 million and $1.6 million for the three months ended April 30, 2018 and 2017, respectively; and was $5.7 million and $4.9 million for the nine months ended April 30, 2018 and 2017, respectively.

During the third fiscal quarter of 2017, the Company began to capitalize software development costs for technology applications that the Company will offer solely as cloud-based subscriptions. The amounts capitalized as of April 30, 2018 and July 31, 2017 were $2.9 million and $1.1 million, respectively, and primarily comprised compensation and related headcount costs for employees who were directly associated with the software development projects. During the fiscal quarter ended April 30, 2018, we continued to amortize the Company's technologies that were ready for their intended use. The Company recognized approximately $0.2 million and $0.3 million in amortization expense in cost of revenues, license and other on the accompanying condensed consolidated statements of operations during the three and nine months ended April 30, 2018. There was no such amortization during the three and nine months ended April 30, 2017.

Other Assets

The Company's other assets of $21.7 million and $20.1 million at April 30, 2018 and at July 31, 2017, respectively, include a strategic equity investment in a privately-held company of $10.7 million, which was accounted for using the cost method of accounting. Strategic investments are non-marketable equity securities, in which the Company does not have a controlling interest or the ability to exert significant influence. These investments do not have a readily determinable market value. Under the cost method of accounting, the non-marketable securities are carried at cost and

are adjusted only for other-than temporary impairments, certain distributions, and additional investments. Accordingly, if the Company were to disclose the fair value of the investment, the fair value measurement would be Level 3 in the valuation hierarchy. The Company assesses the investment for impairment when events or changes in circumstances indicate that its carrying amount may not be recoverable.

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As of April 30, 2018 and July 31, 2017, there were no indicators that the investment with carrying value of $10.7 million was impaired.

Goodwill and Intangible Assets

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

	(in thousands)
Goodwill, July 31, 2017	$ 141,851
Acquisition - Cyence	200,523
Changes in carrying value	95
Goodwill, April 30, 2018	$ 342,469

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

	April 30, 2018 (in thousands)			July 31, 2017		
	Cost	Accumulated Amortization	Net Book Value	Cost	Accumulated Amortization	Net Book Value
Amortized intangible assets:						
Acquired technology	$93,600	$ 29,205	$64,395	$65,200	$ 14,710	$50,490
Customer contracts and related relationships	35,700	5,150	30,550	18,000	1,683	16,317
Partner relationships	200	46	154	200	30	170
Trademarks	2,500	179	2,321	—	—	—
Order backlog	8,700	3,119	5,581	5,500	1,162	4,338
Total amortized intangible assets	$140,700	$ 37,699	$103,001	$88,900	$ 17,585	$71,315

Amortization expense was $7.6 million and $4.2 million for the three months ended April 30, 2018 and 2017, respectively, and was $20.1 million and $7.3 million for the nine months ended April 30, 2018 and 2017, respectively.

The estimated aggregate amortization expense for existing intangible assets as of April 30, 2018, based on their current useful lives, is estimated as follows:

	Future Amortization (in thousands)
Fiscal year ending July 31,	
2018 (remainder of fiscal year)	$ 7,347
2019	29,112
2020	26,834
2021	19,965
2022	11,143
Thereafter	8,600
Total future amortization expense	$ 103,001

Accrued Employee Compensation

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Accrued employee compensation expense consists of the following:

	April 30, 2018	July 31, 2017
	(in thousands)	
Accrued bonuses	$21,132	$26,581
Accrued commission	1,718	5,228
Accrued vacation	12,966	10,873
Accrued salaries, payroll taxes and benefits	7,611	6,200
Total accrued employee compensation	$43,427	$48,882

Deferred Revenues

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

	April 30, 2018	July 31, 2017
	(in thousands)	
Deferred license and other revenues	$47,059	$23,727
Deferred maintenance revenues	44,945	47,727
Deferred services revenues	42,557	39,681
Total deferred revenues	$134,561	$111,135

Accumulated Other Comprehensive Loss

Changes in accumulated other comprehensive loss by component during the nine months ended April 30, 2018 were as follows:

	Foreign Currency Translation Adjustments	Unrealized Gain (Loss) on Available-for-Sale Securities	Total
	(in thousands)		
Balance as of July 31, 2017	$(5,630)	$ (166)	$(5,796)
Other comprehensive income (loss) before reclassification	(94)	(914)	(1,008)
Amounts reclassified from accumulated other comprehensive loss to earnings	—	(85)	(85)
Tax effect	—	291	291
Balance as of April 30, 2018	$(5,724)	$ (874)	$(6,598)

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5. Net Loss Per Share

The following table sets forth the computation of the Company's basic and diluted net loss per share:

	Three Months Ended April 30,		Nine Months Ended April 30,	
	2018	2017	2018	2017
	(in thousands, except share and per share amounts)			
Numerator:				
Net loss	$(48,622)	$ (1,819)	$(103,091)	$ (5,703)
Net loss per share:				
Basic	$(0.62)	$ (0.02)	$(1.32)	$ (0.08)
Diluted	$(0.62)	$ (0.02)	$(1.32)	$ (0.08)
Denominator:				
Weighted average shares used in computing net loss per share:				
Basic	78,777,484	74,175,603	78,246,146	73,731,132
Weighted average effect of dilutive stock options	—	—	—	—
Weighted average effect of dilutive restricted stock units	—	—	—	—
Diluted	78,777,484	74,175,603	78,246,146	73,731,132

The shares used in computing basic and diluted net loss per share includes 2,628,571 shares related to the March 2018 common stock offering.

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

	Three Months Ended April 30,		Nine Months Ended April 30,	
	2018	2017	2018	2017
Stock options to purchase common stock	615,421	895,743	605,951	978,734
Restricted stock units	3,220,916	2,906,840	3,265,584	3,050,091

Since the Company has the intent and ability to settle the principal amount of the Convertible Senior Notes in cash and any excess in shares of the Company's common stock, the Company uses the treasury stock method for calculating any potential dilutive effect of the conversion spread on diluted net income per share, if applicable. The conversion spread will have a dilutive impact on net loss per share of common stock when the average market price of the Company's common stock for a given period exceeds the conversion price of $113.75 per share for the Convertible Senior Notes. During the three months ended April 30, 2018, the Company's weighted average common stock price was below the conversion price of the Convertible Senior Notes.

6. Convertible Senior Notes

In March 2018, the Company offered and sold $400.0 million aggregate principal amount of its 1.250% Convertible Senior Notes due 2025, including the underwriters' exercise in full of their option to purchase an additional $40.0 million of the Convertible Senior Notes. The Convertible Senior Notes were issued in accordance with the First Supplemental Indenture (the "Supplemental Indenture"), dated March 13, 2018 (the "Base Indenture" and together with the Supplemental Indenture, the "Indenture") between the Company and U.S. Bank National Association, as trustee. The net proceeds from the issuance of the Convertible Senior Notes were $387.2 million, after deducting issuance costs.

The Convertible Senior Notes are unsecured obligations of the Company, and interest is payable semi-annually in arrears at a rate of 1.250% per year, on March 15 and September 15 of each year, beginning on September 15, 2018. The Convertible Senior Notes will mature on March 15, 2025 unless repurchased, redeemed, or converted prior to

such date. Prior to the close of business on the business day immediately preceding October 15, 2024, the Convertible Senior Notes are

convertible at the option of holders during certain periods, upon satisfaction of certain conditions. On or after October 15, 2024, the Convertible Senior Notes are convertible at any time until the close of business on the second scheduled trading day immediately preceding the maturity date. The Convertible Senior Notes will have an initial conversion rate of 8.7912 shares of common stock per $1,000 principal (equivalent to an initial conversion price of approximately $113.75 per share of its common stock). The conversion rate is subject to customary adjustments upon the occurrence of certain events but will not be adjusted for any accrued and unpaid interest. Upon conversion, the Company will pay or deliver, as the case may be, cash, shares of its common stock or a combination of cash and shares of its common stock, at its election.

The Company may redeem the Convertible Senior Notes, at its option, on or after March 20, 2022, at a redemption price equal to 100% of the principal amount thereof, plus accrued and unpaid interest if the last reported sale price of the Company's common stock has been at least 130% of the conversion price then in effect for at least 20 trading days (whether or not consecutive), including at least one of the 3 trading days immediately preceding the date on which the Company provides notice of redemption, during any 30 consecutive trading day period ending on, and including, the trading day immediately preceding the date on which we provide notice of redemption. No sinking fund is provided for the Notes. Upon the occurrence of a fundamental change (as defined in the Indenture) prior to the maturity date, holders may require the Company to repurchase all or a portion of the Notes for cash at a price equal to 100% of the principal amount of the notes to be repurchased, plus any accrued and unpaid interest to, but excluding, the fundamental change repurchase date.

The Convertible Senior Notes rank senior in right of payment to any of the Company's indebtedness that is expressly subordinated in right of payment to the Convertible Senior Notes, and equal in right of payment to any of its indebtedness that is not so subordinated. The Convertible Senior Notes are effectively junior in right of payment to any of the Company's secured indebtedness to the extent of the value of the assets securing such indebtedness; and structurally junior to all indebtedness and other liabilities (including trade payables) and any preferred equity of its current or future subsidiaries.
In accounting for the issuance of the Convertible Senior Notes, the Company separated the Convertible Senior Notes into liability and equity components. The carrying amount of the liability component was calculated by measuring the fair value of a similar liability that does not have an associated convertible feature. The carrying amount of the equity component representing the conversion option was determined by deducting the fair value of the liability component from the par value of the Convertible Senior Notes as a whole. The excess of the principal amount of the Convertible Senior Notes over its carrying amount is amortized to interest expense using the effective interest method over the term of the Convertible Senior Notes. The equity component of the Convertible Senior Notes is recorded as the difference between the initial proceeds less the fair value of the liability component and will not be remeasured as long as it continues to meet the requirements for equity classification. The equity component is net of issuance costs and recorded as additional paid-in capital in stockholders' equity.

The net carrying value of the liability component of the Convertible Senior Notes was as follows (in thousands):

	April 30, 2018 (in thousands)
Principal	$ 400,000
Less: unamortized debt discount and issuance costs	97,816
Net carrying amount	302,184

The net carrying value of the unamortized debt discount and issuance costs of the Convertible Senior Notes was as follows (in thousands):

	April 30, 2018 (in thousands)
Proceeds allocated to the conversion option (debt discount)	$ 88,039
Issuance Costs	9,777
Net carrying amount	97,816

The following table sets forth the interest expense recognized related to the Convertible Senior Notes (in thousands, except for percentages):

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	Three Months Ended April 30, 2018 (in thousands)
Contractual interest expense	$ 653
Amortization of debt discount	1,438
Amortization of debt issuance costs	130
Total	2,221
Effective interest rate of the liability component	5.53 %

Capped Call

The Company paid $37.2 million to purchase capped calls with certain financial institutions pursuant to capped call confirmations (the "Capped Calls"). The Capped Calls have an initial strike price of $113.75 per share, subject to certain adjustments, which corresponds to the initial conversion price of the Notes. The Capped Calls have initial cap prices of $153.13 per share, subject to certain adjustments. The Capped Calls cover, subject to anti-dilution adjustments, 3.5 million shares of common stock. By entering into the Capped Calls, the Company expects to reduce the potential dilution to its common stock (or, in the event the conversion is settled in cash, to reduce its cash payment obligation) in the event that at the time of conversion its stock price exceeds the conversion price under the Convertible Senior Notes. The Capped Calls are subject to either adjustment or termination upon the occurrence of specified extraordinary events affecting the Company, including a merger event, tender offer, and a nationalization, insolvency, or delisting involving the Company. Additionally, the Capped Calls are subject to certain specified additional disruption events that may give rise to a termination of the Capped Calls, including change in law, insolvency filing, and hedging disruptions. The Capped Calls were recorded as a reduction of the Company's additional paid-in capital in the accompanying condensed consolidated balance sheets.

7.Commitments and Contingencies

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

Leases

The Company leases certain facilities and equipment under operating leases. Lease expense for all worldwide facilities and equipment, which is being recognized on a straight-line basis over terms of the various leases, was $2.3 million and $1.8 million for the three months ended April 30, 2018 and 2017, respectively, and was $6.3 million and $5.0 million for the nine months ended April 30, 2018 and 2017, respectively.

In December 2017, the Company entered into a new lease agreement for its potential future headquarter facility. The lease term is expected to commence on December 1, 2018, for a period of 10.5 years. Total payments committed under the lease amount to $132.1 million. In connection with this lease agreement, the Company also entered into an irrevocable stand-by letter of credit to guarantee the $1.8 million security deposit.

Legal Proceedings

From time to time, the Company is involved in various legal proceedings and receives claims, arising from the normal course of business activities. The Company has not accrued for estimated losses in the accompanying condensed consolidated financial statements as the Company has determined that no provision for liability nor disclosure is required related to any claim against the Company because: (a) there is not a reasonable possibility that a loss exceeding amounts already recognized (if any) may be incurred with respect to such claim; (b) a reasonably possible

loss or range of loss cannot be estimated; or (c) such estimate is immaterial. The Company has not recorded any accrual for claims as of April 30, 2018 or July 31, 2017. The Company expenses legal fees in the period in which they are incurred.

Indemnification

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

The Company has not had to reimburse any of its customers for losses related to indemnification provisions and no material claims against the Company were outstanding as of April 30, 2018 or July 31, 2017. For several reasons, including the lack of prior indemnification claims and the lack of a monetary liability limit for certain infringement cases under various Software Licenses, the Company cannot estimate the amount of potential future payments, if any, related to indemnification provisions.

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

8.Stock-Based Compensation Expense and Shareholders’ Equity

Stock-Based Compensation Expense

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

	Three Months Ended April 30,		Nine Months Ended April 30,	
	2018	2017	2018	2017
	(in thousands)			
Total stock-based compensation	$23,820	$17,433	$68,469	$54,344
Net impact of capitalized stock-based compensation	19	(236)	25	(683)
Total stock-based compensation expense	$23,839	$17,197	$68,494	53,661
Stock-based compensation expense was charged to the following categories:				
Cost of license and other revenues	$274	$90	$706	$231
Cost of maintenance revenues	462	416	1,398	1,265
Cost of services revenues	5,310	4,459	15,982	13,969
Research and development	7,236	4,508	19,845	13,625
Sales and marketing	4,527	3,992	13,768	12,498
General and administrative	6,030	3,732	16,795	12,073
Total stock-based compensation expense	$23,839	$17,197	$68,494	$53,661

As of April 30, 2018, total unamortized stock-based compensation cost for our options and Stock Awards were as follows:

	As of April 30, 2018	
	Unrecognized Expense (in thousands)	Weighted Average Expected Recognition Period (in years)
Stock Options	$6,732	2.3

Stock Awards	172,830	2.4
	$179,562	

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Stock Awards

A summary of the Company's Stock Awards activity under the Company's equity incentive plans is as follows:

	Stock Awards Outstanding		
	Number of Stock Awards Outstanding	Weighted Average Grant Date Fair Value	Aggregate Intrinsic Value (in thousands) (1)
Balance as of July 31, 2017	2,634,085	$ 56.62	$ 190,076
Granted	1,714,276	$ 78.69	
Released	(965,699)	$ 56.07	$ 76,291
Canceled	(192,365)	$ 62.72	
Balance as of April 30, 2018	3,190,297	$ 68.26	$ 268,726
Expected to vest as of April 30, 2018	3,190,297	$ 68.26	$ 268,726

(1) Aggregate intrinsic value at each period end represents the total market value of Stock Awards at the Company's closing stock price of $84.62 and $72.16 on April 30, 2018 and July 31, 2017, respectively. Aggregate intrinsic value for released RSUs represents the total market value of released Stock Awards at date of release.

Certain executives and employees of the Company received PSUs and TSR PSUs in addition to RSUs. The PSUs included performance-based conditions and vest over a four-year period. The TSR PSUs are subject to total shareholder return rankings relative to the software companies in the S&P Index for a specified performance period or specified performance periods, and vest at the end of three years. In select cases, certain TSR PSUs are also subject to performance-based conditions.

RSAs are issued and outstanding upon grant; however, vesting is based on continued employment and achievement of certain milestones. The weighted average grant date fair value is based on the market value of our common stock on the date of grant.

Stock Options

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

	Stock Options Outstanding			
	Number of Stock Options Outstanding	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (in years)	Aggregate Intrinsic Value (1) (in thousands)
Balance as of July 31, 2017	555,636	$ 22.17	4.0	$ 27,777
Granted	137,057			
Exercised	(93,973)	$ 11.23		$ 6,430
Canceled	(1,970)			
Balance as of April 30, 2018	596,750	$ 21.14	4.5	$ 37,883
Vested and expected to vest as of April 30, 2018	596,750	$ 21.14	4.5	$ 37,883
Exercisable as of April 30, 2018	468,280	$ 22.48	3.5	$ 29,099

(1) Aggregate intrinsic value at each period end represents the difference between the Company's closing stock prices of $84.62 and $72.16 on April 30, 2018 and July 31, 2017, respectively, and the exercise price of outstanding options. Aggregate intrinsic value for exercised options represents the difference between the Company's stock

price at date of exercise and the exercise price.

Valuation of Awards

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TSR PSUs

The fair values of our TSR PSUs were estimated at the date of grant using the Monte Carlo simulation model which included the following assumptions:

	Three Months Ended April 30,		Nine Months Ended April 30,	
	2018	2017	2018	2017
Expected term (in years)	*	*	2.88	2.66-2.88
Risk-free interest rate	*	*	1.44%	0.89%-1.34%
Expected volatility of the Company	*	*	28.0%	30.2%-31.5%
Average expected volatility of the peer companies in the S&P Index	*	*	34.7%	36.9%-37.0%
Expected dividend yield	*	*	—%	—%

*There were no TSR PSUs granted during the three months ended April 30, 2018 and 2017.

The number of TSR PSUs that may ultimately vest will vary based on the relative performance of the Company's total shareholder return rankings relative to the software companies in the S&P Index for a specified performance period or specified performance periods. The Monte Carlo methodology incorporates into the valuation all possible outcomes, including that the Company's relative performance may result in no shares vesting. As a result, stock-based compensation expense is recognized regardless of the ultimate achievement of the plan's performance metrics. The expense will be reversed only in the event that a grantee is terminated prior to satisfying the requisite service period.

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

Common Stock Reserved for Issuance

As of April 30, 2018 and July 31, 2017, the Company was authorized to issue 500,000,000 shares of common stock with a par value of $0.0001 per share and, of these, 80,259,688 and 75,007,625 shares of common stock were issued and outstanding, respectively. As of April 30, 2018 and July 31, 2017, the Company had reserved shares of common stock for future issuance as follows:

	April 30, 2018	July 31, 2017
Exercise of stock options to purchase common stock	596,750	555,636
Vesting of restricted stock awards	2,945,450	2,634,085
Shares available under stock plans	21,626,676	18,453,674
Total common stock reserved for issuance	25,168,876	21,643,395

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9.Income Taxes

The Company recognized income tax expense of $20.6 million and a benefit of $1.1 million for the three months ended April 30, 2018 and 2017, respectively. The increase in tax expense for the three months ended April 30, 2018 compared to the same period a year ago was primarily due to the increase in permanent differences for non-deductible executive compensation and acquisition-related expenses offset by tax benefits related to research and development credits and excess tax benefits. The effective tax rate of (73.6)% for the three months ended April 30, 2018, differs from the statutory U.S. federal income tax rate of 26.9% mainly due to permanent differences for stock-based compensation, including excess tax benefits, research and development credits, the tax rate differences between the United States and foreign countries, foreign withholding taxes, certain non-deductible expenses including executive compensation, and acquisition-related expenses.

The Company recognized income tax expense of $46.6 million and income tax benefit of $4.8 million for the nine months ended April 30, 2018 and 2017, respectively. The increase in tax expense for the nine months ended April 30, 2018 compared to the same period a year ago was primarily due to the impact of the Tax Cuts and Jobs Act (“Tax Act”), including discrete tax expense of $34.0 million related to the remeasurement of net deferred tax assets offset by the discrete tax benefit of $5.4 million related to the release of valuation allowance against certain deferred tax assets that are more likely than not to be realized and the increase in permanent differences for non-deductible executive compensation and acquisition-related expenses and offset by tax benefits related to research and development credits and excess tax benefits. The effective tax rate of (82.4)% for the nine months ended April 30, 2018 differs from the statutory U.S. federal income tax rate of 26.9% mainly due to the impact from the Tax Act and permanent differences for stock-based compensation, including excess tax benefits, research and development credits, the tax rate differences between the United States and foreign countries, foreign withholding taxes, certain non-deductible expenses including executive compensation, and acquisition-related expenses.

During the three months ended April 30, 2018, the increase in unrecognized tax benefits from the beginning of the period was $4.2 million. Accordingly, as of April 30, 2018, the Company had unrecognized tax benefits of $6.6 million that, if recognized, would affect the Company’s effective tax rate.

On December 22, 2017, the Tax Act was enacted into law which changed U.S. tax law, including, but not limited to: (1) reducing the U.S. federal corporate income tax rate from 35% to 21%; (2) requiring companies to pay a one-time transition tax on certain unrepatriated earnings of foreign subsidiaries; (3) generally eliminating U.S. federal corporate income taxes on dividends from foreign subsidiaries; (4) capitalizing R&D expenses which are amortized over five to 15 years; and (5) other changes to how foreign and domestic earnings are taxed.

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

The Tax Act includes a provision to tax global intangible low-taxed income of foreign subsidiaries and a base erosion abuse tax measure that taxes certain payments between a U.S. corporation and its foreign subsidiaries. These provisions of the Tax Act will be effective for the Company beginning August 1, 2018. The Company is in the process of completing its analysis of the deferred tax accounting on global intangible low-taxed income and has not recorded provisional amounts. The Company is still evaluating an accounting policy to record amounts as deferred taxes or as period costs related to this provision. The SEC staff issued Staff Accounting Bulletin No. 118 which provides for a measurement period of up to one year after the enactment date of the Tax Act to finalize the related income tax impacts. The Company expects to complete the accounting for the Tax Act during this measurement period.

10.Segment Information

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

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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,	
	2018	2017	2018	2017
	(in thousands)			
United States	$92,040	$80,239	$266,296	$191,594
Canada	10,065	12,359	36,718	41,208
Other Americas	6,415	3,869	14,575	12,965
Total Americas	108,520	96,467	317,589	245,767
United Kingdom	5,442	4,499	24,094	22,463
Other EMEA	11,625	10,344	28,803	28,094
Total EMEA	17,067	14,843	52,897	50,557
Total APAC	14,882	12,126	41,942	36,860
Total revenues	$140,469	$123,436	$412,428	$333,184

No country or region, other than those presented above, accounted for more than 10% of revenues during the three and nine months ended April 30, 2018 and 2017.

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

	April 30, 2018	July 31, 2017
	(in thousands)	
Americas	$457,985	$224,667
EMEA	3,371	2,747
APAC	43	128
Total	$461,399	$227,542

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

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

Overview

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

We sell our products to a wide variety of global P&C insurers ranging from some of the largest global insurance carriers or their subsidiaries to national and regional carriers. Our customer engagement is led by our direct sales team and supported by our system integrator (“SI”) partners. We maintain and continue to grow our sales and marketing efforts globally, and maintain regional sales centers in the Americas, Europe and Asia. Strong customer relationships are a key driver of our success given the long-term nature of our engagements and the importance of customer references for new sales. We continue to focus on deepening our customer relationships through continued successful product implementations, robust product support, strategic engagement on new products and technologies, and ongoing account management.

Our sales cycles for new and existing customers remain protracted as customers are deliberate and the decision making and product evaluation process is long. These evaluation periods can extend further if the customer purchases multiple products or assesses the benefits of a cloud-based subscription in addition to our more traditional on-premises licensing models. Sales to new customers also involve extensive customer due diligence and reference checks. We must earn credibility with each successful implementation as we expand our sales operations, market products that have been acquired or newly introduced, and expand the ways we deliver our software. The success of our sales efforts relies on continued improvements and enhancements to our current products, the introduction of new products, and the continued development of relevant local content and the automated tools that we believe are optimal for updating that content.

To date, we have primarily licensed our software under term license contracts. We generally price our licenses based on the amount of direct written premiums (“DWP”) that will be managed by our solutions. Our term licenses for both recurring term license and maintenance fees are typically invoiced annually in advance or, in certain cases, quarterly. Term licenses that are greater than one year are characterized by extended payment terms. We assess whether a fee is fixed or determinable at the outset of the arrangement, primarily based on the payment terms associated with the transaction. For term licenses with extended payment terms, term license fees are not considered to be fixed and determinable until they become due or payment is received, resulting in a deferral of the related revenues until this

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

We also offer cloud-based subscriptions. Currently, these subscriptions may be for terms greater than two years, and we anticipate that a majority of these arrangements will be billed annually or quarterly in advance, although in some instances additional fees may be assessed in arrears as customers increase their DWP. Revenues derived from these subscriptions are recognized ratably over the contractual term beginning after the subscription is effectively provisioned, which is the date our software service

is made available to customers. We anticipate that sales of subscriptions will increase as a percentage of annual sales as we sell more cloud-based services. As a result of the ratable recognition of revenues associated with subscriptions, a significant shift from term licenses to subscriptions will adversely affect our reported revenue growth. As this relatively new sales model matures, we may decide to change certain terms to remain competitive or otherwise meet market demands.

To extend our technology leadership in the global market, we continue to invest in research and development to enhance and improve our current products, introduce new products, and advance our ability to deploy cost-effectively each of our products in the cloud. Continued investment in product innovation is critical as we seek to assist our customers in their IT goals, maintain our competitive advantage, grow our revenues, expand internationally, and meet evolving customer demands. In certain cases, we will also acquire skills and technologies to accelerate our time to market for new products and solutions.

Our track record of success with customers and their implementations is central to maintaining our strong competitive position. We rely on our services teams and SI partners to meet our customers' implementation needs. Our services organization comprises on-site, near-shore, and off-shore technical experts. The services organization seeks to ensure that teams with the right combination of product and language skills are utilized in the most efficient way. Our partnerships with leading SIs allows us to increase efficiency and scale while reducing customer implementation costs. Our extensive relationships with SIs and industry partners have strengthened and expanded in line with the interest in and adoption of our products. We encourage our partners to co-market, pursue joint sales initiatives, and drive broader adoption of our technology, helping us grow our business more efficiently. We continue to grow our services organization and invest time and resources in increasing the number of qualified consultants employed by our SI partners, develop relationships with new SIs in existing and new markets, and ensure that all partners are ready to assist with implementing our products.

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

Acquisitions

On November 1, 2017, we completed the acquisition of Cyence, Inc. ("Cyence"), for an aggregate consideration of approximately $260.3 million, including approximately $146.6 million in cash and equity consideration valued at approximately $113.7 million of newly issued Guidewire common stock and options, net of certain adjustments. Through the acquisition we gained a cloud-based data listening and risk analytics technology that enables the P&C insurance industry to grow by underwriting new and evolving risks, such as cyber risk, that have gone underinsured or uninsured. This acquisition was accounted for as a business combination. The results of Cyence's operations have been included in our results of operations since November 1, 2017, the date of acquisition.

In February 2017, we completed the acquisition of ISCS, Inc. ("ISCS"), for cash consideration, net of certain adjustments, of approximately $154.9 million. Through the acquisition we gained a cloud-based, all-in-one transactional platform that combines policy, claims and billing management functionality for P&C insurers. Re-branded InsuranceNow, this platform enhances our ability to serve P&C insurers that have less complex businesses, require the functionality of a suite, and prefer cloud-based delivery. We will continue to invest in this platform, improving its scalability and performance, reducing its cost to implement and deliver, adapting it for international markets, and integrating it with our data and analytics and digital products. The results of ISCS's operations have been included in our results of operations since February 16, 2017, the date of acquisition.

Seasonality

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

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growth will be adversely affected. The seasonal nature of our sales and the concentration of such sales in our fiscal fourth quarter increases this impact.

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

Public Offerings

On March 13, 2018, we closed a public offering of 2,628,571 shares of our common stock, including the underwriters' exercise in full of their option to purchase additional shares of our common stock. The public offering price of the shares sold in the offering was $87.50 per share. Our stockholders did not sell any shares in this public offering. Concurrently, we offered and sold $400.0 million aggregate principal amount of our 1.250% Convertible Senior Notes due 2025, including the underwriters' exercise in full of their option to purchase additional Convertible Senior Notes. Net of issuance costs, we received net proceeds of approximately $220.9 million related to the common stock offering and $387.2 million related to the convertible note offering.

Key Business Metrics

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

Four-Quarter Recurring Revenues

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

	Four quarters ended							
	April 30, 2018	January 31, 2018	October 31, 2017	July 31, 2017	April 30, 2017	January 31, 2017	October 31, 2016	July 31, 2016
	(in thousands)							
Term license and other revenues	$258,954	$272,328	$253,792	$258,322	$237,919	$220,494	$210,278	$208,430
Maintenance revenues	75,460	73,568	71,041	68,643	66,958	64,776	62,451	59,931
Total four-quarter recurring revenues	$334,414	$345,896	$324,833	$326,965	$304,877	$285,270	$272,729	$268,361

Operating Cash Flows and Capital Expenditures

We monitor our cash flows from operating activities and cash used for capital expenditures, as a key measure of our overall business performance, which enables us to analyze our financial performance without the effects of certain non-cash items such as depreciation and amortization and stock-based compensation expenses. Additionally, operating cash flows takes into account the impact of changes in deferred revenues, which reflects the receipt of cash

payment for products before they are recognized as revenues. Our operating cash flows are significantly impacted by the timing of invoicing and collections of accounts receivable, the size of annual bonus payment, as well as payments of payroll and other taxes. As a result, our operating cash flows fluctuate significantly on a year over year basis. Cash provided by our operations was $36.6 million and $51.5 million for the nine months ended April 30, 2018 and 2017, respectively. Additionally, cash used for capital expenditures was $6.6 million and $3.6 million

for the nine months ended April 30, 2018 and 2017, respectively. Our capital expenditures consisted of purchases of property and equipment, most of which was computer hardware, software, capitalized software development costs, and leasehold improvements. For a further discussion of our operating cash flows, see “Liquidity and Capital Resources-Cash Flows.”

Critical Accounting Policies and Estimates

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

- Revenue recognition policies;
- Stock-based compensation;
- Income taxes;
- Business combinations; and
- Long-lived assets, intangible assets, and goodwill impairment.

While we continue to evaluate our significant accounting policies to determine which ones involve the most judgment and complexity, there have been no changes to our significant accounting policies and estimates described in our Annual Report on Form 10-K that have had a material impact on our condensed consolidated financial statements and related notes. During our first fiscal quarter of 2018, we elected to change our accounting policy to account for the forfeitures and tax effects from stock-based compensation awards as they occur. The change was applied on a modified retrospective basis with a net cumulative effect adjustment of $1.0 million recorded to our retained earnings balance as of August 1, 2017. Please refer to Management’s Discussion and Analysis of Financial Condition and Results of Operations contained in our Annual Report on Form 10-K filed on September 19, 2017 for a complete discussion of our critical accounting policies and estimates.

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Results of Operations

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

	Three Months Ended April 30,				Nine Months Ended April 30,			
	2018	As a % of total revenues	2017	As a % of total revenues	2018	As a % of total revenues	2017	As a % of total revenues
	(in thousands)							
Revenues:								
License and other	$50,359	36 %	$58,971	48 %	$164,673	40 %	$161,767	49 %
Maintenance	18,749	13	16,858	14	56,789	14	49,972	15
Services	71,361	51	47,607	38	190,966	46	121,445	36
Total revenues	140,469	100	123,436	100	412,428	100	333,184	100
Cost of revenues:								
License and other	9,742	7	5,208	4	25,497	6	10,419	3
Maintenance	3,828	3	3,480	3	10,888	3	9,884	3
Services	60,751	43	42,780	35	168,599	41	113,995	34
Total cost of revenues	74,321	53	51,468	42	204,984	50	134,298	40
Gross profit:								
License and other	40,617	29	53,763	44	139,176	34	151,348	46
Maintenance	14,921	10	13,378	11	45,901	11	40,088	12
Services	10,610	8	4,827	3	22,367	5	7,450	2
Total gross profit	66,148	47	71,968	58	207,444	50	198,886	60
Operating expenses:								
Research and development	46,787	33	34,090	27	126,155	30	94,865	29
Sales and marketing	30,378	22	28,788	23	85,949	21	77,808	23
General and administrative	18,170	13	13,429	11	57,907	14	40,649	12
Total operating expenses	95,335	68	76,307	61	270,011	65	213,322	64
Loss from operations	(29,187)	(21)	(4,339)	(3)	(62,567)	(15)	(14,436)	(4)
Interest income	3,762	3	1,400	1	7,247	2	4,286	1
Interest expense	(2,228)	(2)	(6)	—	(2,239)	(1)	(6)	—
Other income (expense), net	(356)	—	11	—	1,040	—	(335)	—
Loss before income taxes	(28,009)	(20)	(2,934)	(2)	(56,519)	(14)	(10,491)	(3)
Provision for (benefit from) income taxes	20,613	15	(1,115)	(1)	46,572	11	(4,788)	(1)
Net loss	$(48,622)	(35)%	$(1,819)	(1)%	$(103,091)	(25)%	$(5,703)	(2)%

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Revenues

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

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

Licenses and Other

A substantial majority of our license and other revenues consist of term license fees. We also recognize revenue from sales of subscriptions and perpetual licenses. Our term license revenues are primarily generated through annual license fees that recur during the term of the contract. Since fiscal year 2017, a substantial majority of our term licenses have been sold with a contract of a two-year committed term with optional annual renewals. Term license revenues are generally recognized upon the earlier of when payment is due or cash is received from our customers.

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

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

We generally price our software based on the amount of direct written premiums, or DWP, that will be managed by our software. A majority of our term license customers are billed annually in advance and we currently bill our cloud-based subscription customers similarly, but terms may change as our cloud business matures and the market develops. We invoice our perpetual license customers either in full at contract signing or on an installment basis.

Maintenance

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

Professional Services

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

	Three Months Ended April 30,					
	2018		2017			
	Amount	% of total revenues	Amount	% of total revenues	Change ($)	(%)
	(in thousands, except percentages)					
Revenues:						
License and other	$50,359	36 %	$58,971	48 %	$(8,612)	(15)%
Maintenance	18,749	13 %	16,858	14 %	1,891	11 %
Services	71,361	51 %	47,607	38 %	23,754	50 %

Total revenues	$140,469	100	%	$123,436	100	%	$17,033	14	%

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	Nine Months Ended April 30,					
	2018		2017			
	Amount	% of total revenues	Amount	% of total revenues	Change ($)	(%)
	(in thousands, except percentages)					
Revenues:						
License and other	$164,673	40 %	$161,767	49 %	$2,906	2 %
Maintenance	56,789	14 %	49,972	15 %	6,817	14%
Services	190,966	46 %	121,445	36 %	69,521	57%
Total revenues	$412,428	100 %	$333,184	100 %	$79,244	24%

License and Other Revenues

License and other revenues decreased $8.6 million during the three months ended April 30, 2018 compared to the same period a year ago, primarily due to the timing of our term and perpetual orders and the receipt of annual license fees in advance of the invoice due dates.

License and other revenues increased $2.9 million during the nine months ended April 30, 2018 compared to the same period a year ago, primarily driven by additional software licenses and subscriptions to new and existing customers which were partially offset by the timing of invoicing and the receipt of license fees in advance of the invoice due dates.

Our license and other revenues are primarily comprised of term license revenues. Our reported license revenues in any given period may be positively impacted by early payments due in future periods and negatively impacted by early payments made in preceding periods. While term licenses remain our predominant licensing model, we anticipate subscriptions to grow as a percentage of annual sales in future periods. Due to the delayed and ratable recognition of subscription revenues, growth in subscription revenues will lag behind the growth of subscription sales and will impact the comparative growth of our reported revenues.

	Three Months Ended April 30,					
	2018		2017			
	Amount	% of License and other revenues	Amount	% of License and other revenues	Change ($)	(%)
	(in thousands, except percentages)					
License and other revenues:						
Term and other	$44,649	89 %	$58,023	98 %	$(13,374)	(23)%
Perpetual	5,710	11 %	948	2 %	4,762	502 %
Total license and other revenues	$50,359	100 %	$58,971	100 %	$(8,612)	(15)%

	Nine Months Ended April 30,					
	2018		2017			
	Amount	% of License and other revenues	Amount	% of License and other revenues	Change ($)	(%)
	(in thousands, except percentages)					
License and other revenues:						

Term and other	$156,023	95 %	$155,391	96 %	$632	—%
Perpetual	8,650	5 %	6,376	4 %	2,274	36%
Total license and other revenues	$164,673	100 %	$161,767	100 %	$2,906	2 %

Term license and other revenues decreased by $13.4 million during the three months ended April 30, 2018 compared to the year ago period, primarily attributable to: (i) the timing of revenue recognition associated with the first annual license fee from an existing Tier 1 customer recognized in the third quarter of fiscal 2017, whereas, the second annual license fee is expected in the fourth quarter of the current fiscal year, and (ii) a net decrease of $4.4 million due to the effect of license fees received in advance of the invoice due dates. These decreases were partially offset by additional software licenses and subscriptions to new and existing customers.

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Term license and other revenues increased by $0.6 million during the nine months ended April 30, 2018, compared to the same period a year ago, primarily attributable to the net increase in revenues from new and existing customer engagements, mostly offset by: (i) the timing of revenue recognition associated with the first annual license fee from an existing Tier 1 customer recognized in the third quarter of fiscal 2017, whereas, the second annual license fee is expected in the fourth quarter of the current fiscal year, and (ii) a net decrease of $5.9 million due to the effect of license fees received in advance of the invoice due dates.

Perpetual license revenues accounted for approximately 11% and 2% of total license and other revenue during the three months ended April 30, 2018 and 2017, respectively, and 5% and 4% during the nine months ended April 30, 2018 and 2017. We anticipate that revenues from the sale and delivery of perpetual licenses will continue to represent a small percentage of our total license and other revenues. Nevertheless, we expect perpetual license revenues to remain volatile across quarters due to the large amount of perpetual revenue that may be generated from a single customer order.

Additionally, our license revenues may fluctuate based on the timing of large orders or if our customers pay their annual license fees in advance of the invoice due date either of which may cause an unexpected increase in revenues in one quarter which can reduce revenue growth rates in future periods. Finally, we anticipate that the small amount of our license and other revenues derived from cloud-delivered software services will increase over time. As a result of the delayed and ratable nature of subscription revenues, near-term revenue growth rates will be negatively impacted as compared to growing term license or perpetual revenue.

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

Services Revenues
Services revenues increased $23.8 million and $69.5 million during the three and nine months ended April 30, 2018, primarily as a result of a net increase in billings from new and existing customer engagements performed during the period and, billings associated with engagements relating to the implementation of previously acquired products, such as InsuranceNow.
Historically, we have relied on our network of third-party SI partners to facilitate new sales and implementations of our products. We believe this model will continue to serve us well and we intend, in the future, to continue to expand our network of SI partners and the number of trained consultants with whom we work.
While not essential to the functionality of the service, for a period of time implementations of InsuranceNow or InsuranceSuite Cloud will require significantly greater levels of participation by our services professionals than is currently necessary for on-premise versions of our products. With respect to InsuranceSuite Cloud, our obligation to manage the platform in production requires us to have a much greater familiarity with its configuration and integrations. As a result, we intend to control implementation work until effective processes have been established to reduce any risk we face in managing a production environment for a system we have not implemented. At the time of acquisition, ISCS had few third-party resources to assist with implementations of InsuranceNow. While we are actively qualifying and training consultants from existing and new partners to assist with such implementations, we have taken, and for the foreseeable future we expect to take, primary responsibility for InsuranceNow implementations.
As we gain experience with the deployment and maintenance of cloud solutions, we intend to leverage our SI partners more effectively and replicate more closely our current division of labor applicable with on-premise implementations. During this period, however, we anticipate higher levels of growth for our service revenues.

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

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Deferred Revenues

	As of April 30, 2018	July 31, 2017	Change	
	Amount	Amount	($)	(%)
	(in thousands, except percentages)			
Deferred revenues:				
Deferred license and other revenues	$47,059	$23,727	$23,332	98 %
Deferred maintenance revenues	44,945	47,727	(2,782)	(6)%
Deferred services revenues	42,557	39,681	2,876	7 %
Total deferred revenues	$134,561	$111,135	$23,426	21 %

Deferred License and Other Revenues

The $23.3 million increase in deferred license and other revenues was primarily a result of the combined effect of net increases in term license billings related to new and existing contracts which will be recognized when all revenue recognition criteria are met as well as increases in deferrals associated with subscription contracts that are recognized on a ratable basis.

Deferred Maintenance Revenues

The $2.8 million decrease in deferred maintenance revenues compared to the prior fiscal year end was primarily driven by the timing of the recognition of revenues in excess of new billings during the nine months ended April 30, 2018, and reflects the seasonal nature of our billings of maintenance revenues. Additionally, subscription arrangements include maintenance as part of the subscription service and are not priced or reported separately. As a result, an increase in the mix of subscription orders in the future will reduce the growth in maintenance revenues and may impact the growth in deferred maintenance revenues.

Deferred Services Revenues

The $2.9 million increase in deferred services revenues was primarily driven by increased services billings mainly composed of ongoing InsuranceNow implementations related to acquired contracts which are being deferred until go-live, partially offset by net recognition in previously deferred billings.

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

Cost of Revenues and Gross Profit

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

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

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Cost of Revenues:

	Three Months Ended April 30,			
	2018	2017	Change	
	Amount	Amount	($)	(%)
	(in thousands, except percentages)			
Cost of revenues:				
License and other	$9,742	$5,208	$4,534	87%
Maintenance	3,828	3,480	348	10%
Services	60,751	42,780	17,971	42%
Total cost of revenues	$74,321	$51,468	$22,853	44%
Includes stock-based compensation of:				
Cost of license and other revenues	$274	$90	$184	
Cost of maintenance revenues	462	416	46	
Cost of services revenues	5,310	4,459	851	
Total	$6,046	$4,965	$1,081	

	Nine Months Ended April 30,			
	2018	2017	Change	
	Amount	Amount	($)	(%)
	(in thousands, except percentages)			
Cost of revenues:				
License and other	$25,497	$10,419	$15,078	145%
Maintenance	10,888	9,884	1,004	10 %
Services	168,599	113,995	54,604	48 %
Total cost of revenues	$204,984	$134,298	$70,686	53 %
Includes stock-based compensation of:				
Cost of license and other revenues	$706	$231	$475	
Cost of maintenance revenues	1,398	1,265	133	
Cost of services revenues	15,982	13,969	2,013	
Total	$18,086	$15,465	$2,621	

The $22.9 million increase in cost of revenues during the three months ended April 30, 2018, compared to the same period a year ago, was primarily attributable to increases in the cost of service revenues of $18.0 million, and to a lesser extent, increases in our costs of license and other revenues of $4.5 million.

The increase in our cost of license and other revenues was primarily attributable to increases of $2.0 million in headcount related expenses to, and cloud infrastructure costs incurred in order to, support the growth of our Guidewire Production Services and cloud operations, and to a lesser extent, increase related to the amortization of acquired intangibles of $1.9 million. We anticipate higher cost of license and other revenues as we continue to invest in our cloud operations.

Cost of maintenance revenues grew modestly primarily due to the increase in staff required to support our term and perpetual license customers in line with our term and perpetual license sales activities.

Our cost of services revenues increased in line with the net increase in billings from new and existing customer engagements performed during the period. This included billings associated with engagements relating to the implementation of previously acquired products such as InsuranceNow, which in aggregate resulted in increases in

headcount related expenses of $13.7 million and increases in expenses for billable third-party consultants and sub-contractors of $4.9 million.

We had 818 professional service employees and 116 technical support and licensing operations employees at April 30, 2018 compared to 719 professional services employees and 83 technical support and licensing operations employees at April 30, 2017.

The $70.7 million increase in cost of revenues during the nine months ended April 30, 2018, compared to the same period a year ago, was primarily attributable to increases in our cost of service revenues of $54.6 million and increases in the costs of license and other revenues of $15.1 million.

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The increase in our cost of license and other revenues was primarily attributable to increases of $8.9 million related to the amortization of acquired intangible assets and to a lesser extent, $4.5 million related to combined increases of $2.9 million resulting from increases in the cost of headcount related expenses to, and cloud infrastructure costs incurred in order to, support the growth of our Guidewire Production Services and cloud operations. We anticipate higher cost of license and other revenues as we continue to invest in our cloud operations.
Cost of maintenance revenues grew modestly primarily due to the increase in staff required to support our term and perpetual license customers in line with our term and perpetual license sales activities.
Our cost of services revenues increased in line with the net increase in billings from new and existing customer engagements performed during the period including billings associated with engagements relating to the implementation of previously acquired products such as InsuranceNow which in aggregate resulted in increased costs for headcount and related employee expenses of $38.8 million and increases in expenses for billable third-party consultants and sub-contractors of $15.3 million.

Gross Profit:

	Three Months Ended April 30,					
	2018		2017		Change	
	Amount	Margin %	Amount	Margin %	($)	(%)
	(in thousands, except percentages)					
Gross profit:						
License and other	$40,617	81 %	$53,763	91 %	$(13,146)	(24)%
Maintenance	14,921	80 %	13,378	79 %	1,543	12 %
Services	10,610	15 %	4,827	10 %	5,783	*
Total gross profit	$66,148	47 %	$71,968	58 %	$(5,820)	(8)%

* Not meaningful

	Nine Months Ended April 30,					
	2018		2017		Change	
	Amount	Margin %	Amount	Margin %	($)	(%)
	(in thousands, except percentages)					
Gross profit:						
License and other	$139,176	85 %	$151,348	94 %	$(12,172)	(8)%
Maintenance	45,901	81 %	40,088	80 %	5,813	15 %
Services	22,367	12 %	7,450	6 %	14,917	200 %
Total gross profit	$207,444	50 %	$198,886	60 %	$8,558	4 %

Our gross margin decreased to 47% and 50% during the three and nine months ended April 30, 2018, respectively, compared to 58% and 60% for the corresponding prior year periods. The decreases in our gross margin were primarily driven by changes in the mix between higher gross margin license revenues and lower gross margin service revenues and lower license and other margins. The decline in our license and other margins are primarily attributable to the increase in our costs associated with amortization of acquired intangible assets, headcount and cloud infrastructure costs incurred in order to support the growth of our Guidewire Production Services and cloud operations. These decreases were partially offset by improved services margins compared to the same period a year ago.

We expect gross margins will decrease for the full fiscal year 2018 compared to fiscal year 2017 as we currently expect the mix of our lower margin services revenues will be significantly higher in fiscal 2018 than in fiscal 2017. We also intend to continue to invest in our Guidewire Production Services and cloud operations, which will impact license and other margins. Finally, we also anticipate that increases in our costs associated with the amortization of intangible assets will contribute to lower margins.

Operating Expenses

Our operating expenses consist of research and development, sales and marketing, and general and administrative expenses. The largest components of our operating expenses are compensation and benefit expenses for our employees, including stock-based awards and, to a lesser extent, professional services, and rent and facility costs. We allocate overhead such as IT support, information security, facility, and other administrative costs to all functional departments based on

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headcount. As a result, general overhead expenses are reflected in cost of revenue and each functional operating expense.

	Three Months Ended April 30,					
	2018		2017		Change	
	Amount	% of total revenues	Amount	% of total revenues	($)	(%)
	(in thousands, except percentages)					
Operating expenses:						
Research and development	$46,787	33 %	$34,090	27 %	$12,697	37%
Sales and marketing	30,378	22 %	28,788	23 %	1,590	6 %
General and administrative	18,170	13 %	13,429	11 %	4,741	35%
Total operating expenses	$95,335	68 %	$76,307	61 %	$19,028	25%
Includes stock-based compensation of:						
Research and development	$7,236		$4,508		$2,728	
Sales and marketing	4,527		3,992		535	
General and administrative	6,030		3,732		2,298	
Total	$17,793		$12,232		$5,561	

	Nine Months Ended April 30,					
	2018		2017		Change	
	Amount	% of total revenues	Amount	% of total revenues	($)	(%)
	(in thousands, except percentages)					
Operating expenses:						
Research and development	$126,155	30 %	$94,865	29 %	$31,290	33%
Sales and marketing	85,949	21 %	77,808	23 %	8,141	10%
General and administrative	57,907	14 %	40,649	12 %	17,258	42%
Total operating expenses	$270,011	65 %	$213,322	64 %	$56,689	27%
Includes stock-based compensation of:						
Research and development	$19,845		$13,625		$6,220	
Sales and marketing	13,768		12,498		1,270	
General and administrative	16,795		12,073		4,722	
Total	$50,408		$38,196		$12,212	

Research and Development

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

The $12.7 million increase in research and development expenses during the three months ended April 30, 2018, as compared to the same period in the prior year, was primarily attributable to the net effect from increases in our headcount and related employee expenses of $12.9 million, partially offset by the capitalization of internal use software development costs of $0.7 million related to the development of new cloud-based technologies.

The $31.3 million increase in research and development expenses during the nine months ended April 30, 2018, as compared to the same period in the prior year, was primarily attributable to the net effect from increases in our headcount and related employee expenses of $32.6 million, partially offset by the capitalization of internal use

software development costs of $1.8 million related to the development of a new cloud-based technologies.
Our research and development headcount was 718 at April 30, 2018 compared with 574 at April 30, 2017. The increase in headcount reflects our continued investment in our products, and includes 108 employees gained through the ISCS and Cyence acquisitions.

We expect our research and development expenses to continue to increase in absolute dollars as we continue to hire aggressively in research and development, and continue to dedicate substantial internal resources to develop, improve and expand the functionality of our solutions. Research and development expenses may also increase if we pursue additional acquisitions.

Sales and Marketing

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

The $1.6 million increase in sales and marketing expenses during the three months ended April 30, 2018, compared to the same period a year ago, was primarily attributable to the net effect from increased costs for our headcount and related employee expenses of $2.7 million and increased amortization expense associated with recently acquired intangible assets of $1.5 million, partially offset by lower sales commission expenses of $2.6 million. Commission expenses in the current period are in line with the seasonal nature of our sales cycle, whereas the same period a year ago included commission expenses related to a large order from an existing Tier 1 customer which occurred in the third quarter of fiscal 2017.

The $8.1 million increase in sales and marketing expenses during the nine months ended April 30, 2018, compared to the same period a year ago, was primarily attributable to the net effect from increased costs for our headcount and related employee expenses of $6.0 million and increased amortization expenses associated with recently acquired intangible assets of $3.9 million, partially offset by lower sales commission expenses of $2.4 million. Commission expenses in the current period are in line with the seasonal nature of our sales cycle, whereas the same period a year ago included commission expenses related to a large order from an existing Tier 1 customer which occurred in the third quarter of fiscal 2017.

Our sales and marketing headcount was 321 at April 30, 2018 compared with 301 at April 30, 2017.

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

General and Administrative

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

The $4.7 million increase in our general and administrative expenses during the three months ended April 30, 2018, compared to the same period a year ago, was primarily attributable to increased costs for our headcount and related employee expenses of $4.1 million and, to a lesser extent, increased costs of $0.7 million resulting from professional service expenses associated with the implementation of certain phases of new global finance enterprise resource planning systems and other costs associated with the adoption of new accounting standards.

The $17.3 million increase in general and administrative expenses during the nine months ended April 30, 2018, compared to the same period a year ago, was primarily attributable the combined effect from increased costs of $10.0 million associated with fees for professional services associated with new global finance enterprise resource planning systems and other costs associated with the adoption of new accounting standards, and increased costs for our headcount and related employee expenses of $7.1 million.

Our general and administrative headcount was 246 at April 30, 2018 compared with 186 at April 30, 2017.

We expect that our general and administrative expenses will increase in absolute dollars as we continue to invest in personnel and corporate infrastructure and systems required to support our strategic initiatives, the growth of our business, and our compliance and reporting obligations.

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Other Income (Expense)

	Three Months Ended April 30,			
	2018	2017	Change	
	Amount	Amount	($)	(%)
	(in thousands, except percentages)			
Interest income	$3,762	$1,400	$2,362	169%
Interest expense	$(2,228)	$(6)	$(2,222)	*
Other income (expense), net	$(356)	$11	$(367)	*

* Not meaningful

	Nine Months Ended April 30,			
	2018	2017	Change	
	Amount	Amount	($)	(%)
	(in thousands, except percentages)			
Interest income	$7,247	$4,286	$2,961	69%
Interest expense	$(2,239)	$(6)	$(2,233)	*
Other income (expense), net	$1,040	$(335)	$1,375	