

Guidewire Software, Inc.  
 Form 10-Q  
 March 01, 2013  
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UNITED STATES  
 SECURITIES AND EXCHANGE COMMISSION  
 Washington, D.C. 20549

FORM 10-Q

(Mark one)

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

For the quarterly period ended January 31, 2013

OR

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

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

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

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No   
 Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

Large accelerated filer <input type="checkbox"/>	Accelerated filer <input type="checkbox"/>
Non-accelerated filer <input checked="" type="checkbox"/> (do not check if a smaller reporting company)	Smaller reporting company <input type="checkbox"/>

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

On January 31, 2013, the registrant had 56,450,245 shares of common stock issued and outstanding.

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FORWARD-LOOKING STATEMENTS

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

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

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

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

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



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## PART I – Financial Information

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

	January 31, 2013	July 31, 2012
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$101,465	\$205,718
Restricted cash, current portion	206	3,726
Short-term investments	64,384	—
Accounts receivable	41,779	32,313
Deferred tax asset, current portion	15,430	13,442
Prepaid expenses and other current assets	6,598	7,266
Total current assets	229,862	262,465
Long-term investments	37,394	—
Property and equipment, net	11,608	11,924
Deferred tax asset, net of current portion	9,313	9,313
Other assets	511	545
<b>TOTAL ASSETS</b>	<b>\$288,688</b>	<b>\$284,247</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Accounts payable	\$6,384	\$9,781
Accrued employee compensation	18,808	26,502
Deferred revenues, current portion	43,043	52,947
Other current liabilities	5,848	3,957
Total current liabilities	74,083	93,187
Deferred revenues, net of current portion	2,014	2,569
Other liabilities	5,555	4,529
Total liabilities	81,652	100,285
<b>STOCKHOLDERS' EQUITY:</b>		
Common stock	6	5
Additional paid-in capital	224,730	207,624
Accumulated other comprehensive loss	(477	) (496
Accumulated deficit	(17,223	) (23,171
Total stockholders' equity	207,036	183,962
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b>\$288,688</b>	<b>\$284,247</b>
See accompanying Notes to Condensed Consolidated Financial Statements.		

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

	Three Months Ended January 31,		Six Months Ended January 31,	
	2013	2012	2013	2012
Revenues :				
License	\$30,752	\$25,729	\$51,564	\$46,544
Maintenance	9,210	6,805	18,580	13,911
Services	32,226	22,563	65,345	47,022
Total revenues	72,188	55,097	135,489	107,477
Cost of revenues:				
License	130	234	297	533
Maintenance	1,787	1,197	3,351	2,463
Services	29,471	19,310	55,297	37,235
Total cost of revenues	31,388	20,741	58,945	40,231
Gross profit :				
License	30,622	25,495	51,267	46,011
Maintenance	7,423	5,608	15,229	11,448
Services	2,755	3,253	10,048	9,787
Total gross profit	40,800	34,356	76,544	67,246
Operating expenses:				
Research and development	15,885	12,162	30,649	23,121
Sales and marketing	12,389	9,198	24,765	16,559
General and administrative	7,445	7,639	16,111	14,077
Total operating expenses	35,719	28,999	71,525	53,757
Income from operations	5,081	5,357	5,019	13,489
Interest income, net	132	73	222	113
Other income (expense), net	23	(319 )	164	(635 )
Income before provision for (benefit from) income taxes	5,236	5,111	5,405	12,967
Provision for (benefit from) income taxes	(265 )	1,420	(543 )	4,464
Net income	\$5,501	\$3,691	\$5,948	\$8,503
Net income per share:				
Basic	\$0.10	\$0.07	\$0.11	\$0.17
Diluted	\$0.09	\$0.06	\$0.10	\$0.15
Shares used in computing net income per share:				
Basic	55,868,308	18,433,369	55,341,176	16,499,660
Diluted	61,706,457	25,610,201	61,452,245	23,387,583
Comprehensive income:				
Foreign currency translation adjustment	\$14	\$(181 )	\$(2 )	\$(190 )
Unrealized gains on available-for-sale securities	21	—	21	—
Total comprehensive income	\$5,536	\$3,510	\$5,967	\$8,313

See accompanying Notes to Condensed Consolidated Financial Statements.





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

	Six Months Ended January 31,		
	2013	2012	
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>			
Net income	\$5,948	\$8,503	
Adjustments to reconcile net income to net cash used in operating activities:			
Depreciation and amortization	2,045	1,364	
Stock-based compensation	20,158	9,604	
Excess tax benefit from exercise of stock options and vesting of RSUs	(186	) —	
Deferred tax assets	(2,003	) 3,841	
Other noncash items affecting net income	83	—	
Changes in operating assets and liabilities:			
Accounts receivable	(9,514	) (11,565	)
Prepaid expenses and other assets	708	(529	)
Accounts payable	724	395	
Accrued employee compensation	(7,491	) (3,215	)
Other liabilities	3,101	(8,756	)
Deferred revenues	(10,464	) (11,910	)
Net cash provided by (used in) operating activities	3,109	(12,268	)
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>			
Purchase of property and equipment	(5,856	) (1,000	)
Purchases of available-for-sale securities	(115,729	) —	
Sales of available-for-sale securities	13,889	—	
Decrease in restricted cash	3,520	—	
Net cash used in investing activities	(104,176	) (1,000	)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>			
Proceeds from issuance of common stock upon exercise of stock options	5,631	2,497	
Taxes remitted on RSU awards vested	(9,197	) —	
Proceeds from issuance of common stock in connection with public offerings, net of underwriting discounts and commission	—	123,046	
Costs paid in connection with public offerings	—	(1,689	)
Excess tax benefit from exercise of stock options and vesting of RSUs	186	—	
Net cash provided by (used in) financing activities	(3,380	) 123,854	
Effect of foreign exchange rate changes on cash and cash equivalents	194	(578	)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(104,253	) 110,008	
CASH AND CASH EQUIVALENTS—Beginning of period	205,718	59,625	
CASH AND CASH EQUIVALENTS—End of period	\$101,465	\$169,633	
<b>SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:</b>			
Cash paid for interest	\$1	\$1	
Cash paid for income taxes	\$1,564	\$1,142	
<b>SUPPLEMENTAL DISCLOSURES OF NONCASH INVESTING AND FINANCING ACTIVITIES:</b>			
Accounts payable and other liabilities related to property and equipment	\$255	\$—	
Unpaid offering costs	\$—	\$1,149	
Conversion of convertible preferred stock into common stock upon initial public offering	\$—	\$36,500	

See accompanying Notes to Condensed Consolidated Financial Statements.

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

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

Business

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

The Company offers a suite of applications to enable core property and casualty (“P&C”) insurance and reinsurance operations comprised of the following products: PolicyCenter, ClaimCenter and BillingCenter. The Company also provides maintenance support and provides professional services to the extent requested by its customers. The Company markets its products and services in the United States and in foreign countries through its direct sales force.

Public Offerings

On January 30, 2012, the Company closed its initial public offering (“IPO”) whereby 10,177,500 shares of common stock were sold to the public, including the underwriters’ full exercise of their overallotment option of 1,327,500 shares of common stock, at a price of \$13.00 per share. The Company received aggregate proceeds of approximately \$123.0 million from the IPO, including the exercise of the underwriters’ overallotment option, net of underwriters’ discounts and commissions, but before deduction of offering costs of approximately \$3.5 million, including \$2.8 million of capitalized costs. Upon the closing of the IPO, all shares of the Company’s outstanding convertible preferred stock automatically converted into 25,357,721 shares of common stock, and outstanding warrants to purchase 69,529 shares of convertible preferred stock at \$5.03 per share were contractually adjusted to purchase 69,529 shares of common stock at \$5.03 per share. Subsequent to the Company’s IPO and during April 2012 all eligible warrants were converted and the remainder were canceled.

On April 24, 2012, the Company closed its follow-on public offering of 9,200,000 shares of its common stock, which included 750,000 shares of common stock sold by the Company and 8,450,000 shares of common stock sold by selling stockholders, including the underwriters’ full exercise of their overallotment option from the Company and selling stockholders. The public offering price of the shares sold in the offering was \$28.25 per share. The Company received aggregate proceeds of approximately \$20.4 million from the follow-on offering, net of underwriters’ discounts and commissions applicable to the sale of shares by the Company, but before deduction of offering costs of approximately \$1.0 million payable by the Company, including \$0.7 million of capitalized costs. The Company did not receive any proceeds from the sale of shares by the selling stockholders.

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements and accompanying notes of the Company 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 intercompany balances and transactions have been eliminated in consolidation. Certain information and note disclosures normally included in annual financial statements prepared in accordance with generally accepted accounting principles in the United States of America (“U.S. GAAP”) have been condensed or omitted under the rules and regulations of the Securities and Exchange Commission (“SEC”).

These unaudited interim condensed consolidated financial statements should be read in conjunction with the Company’s audited financial statements and related notes, together with management’s discussion and analysis of financial condition and results of operations, presented in the Company’s Annual Report on Form 10-K for the fiscal year ended July 31, 2012. There have been no changes in the Company’s significant accounting policies from those that were disclosed in the Company’s audited consolidated financial statements for the fiscal year ended July 31, 2012 included in the Company’s Annual Report on Form 10-K.

Use of Estimates

The preparation of the accompanying condensed consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions about future events that affect the amounts of assets and liabilities reported, disclosures about contingent assets and liabilities, and reported amounts of revenues and expenses. Significant items subject to such estimates include revenue recognition, the useful lives of property and equipment, valuation allowance for

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deferred tax assets, stock-based compensation, annual bonus attainment, income tax uncertainties, fair value of financial instruments and contingencies. These estimates and assumptions are based on management's best estimates and judgment. Management regularly evaluates its estimates and assumptions using historical experience and other factors; however, actual results could differ significantly from these estimates.

### Fair Value of Financial Instruments

All of our investments are classified as available-for-sale securities. Investments that have an original maturity of 91 days or more at the date of purchase and a current maturity of less than one year are classified as short-term investments, while investments with a current maturity of more than one year are classified as long-term investments. Our investments are recorded at fair value in our consolidated balance sheets. Unrealized gains and losses on our available-for-sale securities are reported as a component of accumulated other comprehensive income, while realized gains and losses, other-than-temporary impairments, and credit losses are reported as a component of net income. The carrying values of the Company's financial instruments, principally cash equivalents, accounts receivable, restricted cash and accounts payable approximated their fair values due to the short period of time to maturity or repayment.

### Cash, Cash Equivalents and Restricted Cash

Cash and cash equivalents are comprised of cash and highly liquid investments with remaining maturities of 90 days or less at the date of purchase. Cash equivalents are comprised of short-term investments with an investment rating of either of the following: Moody's of A3 or higher or Standard & Poor's of A- or higher. The Company is exposed to credit risk in the event of default by the financial institutions or the issuers of these investments to the extent the amounts recorded on the balance sheet are in excess of amounts that are insured by the Federal Deposit Insurance Corporation ("FDIC"). Restricted cash is held in certificates of deposit pursuant to lease agreements, and, in prior periods, pursuant to secured letter of credit agreements as well.

### Concentration of Credit Risk

Financial instruments that potentially subject the Company to concentrations of credit risk consist of cash, cash equivalents, short-term and long-term investments, and accounts receivable. The Company maintains its cash, cash equivalents and short-term and long-term investments with high quality financial institutions with investment grade ratings.

No customer accounted for 10% or more of the Company's revenues for the three and six months ended January 31, 2013 or 2012. The Company had two customers that accounted for 20% of total accounts receivable as of January 31, 2013. The Company had no customers that accounted for 10% or more of total accounts receivable as of July 31, 2012.

### Revenue Recognition

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

Revenues are derived from three sources:

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

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

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

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

Fees are fixed or determinable. Arrangements where a significant portion of the fee is due beyond 90 days from delivery are not considered to be fixed or determinable. Revenues from such arrangements is recognized as payments become due, assuming all other revenue recognition criteria have been met. Fees from term licenses

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are generally due in annual or, in certain cases, quarterly, installments over the term of the agreement beginning on the effective date of the license. Accordingly, fees from term licenses are not considered to be fixed or determinable until they become due.

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

VSOE of fair value does not exist for the Company's software licenses; therefore, for all arrangements that do not include services that are essential to the functionality of the software, the Company allocates revenues to software licenses using the residual method. Under the residual method, the amount recognized for license fees is the difference between the total fixed and determinable fees and the VSOE of fair value for the undelivered elements under the arrangement.

The VSOE of fair value for elements of an arrangement is based upon the normal pricing and discounting practices for those elements when sold separately. VSOE of fair value for maintenance is established using the stated maintenance renewal rate in the customer's contract. The Company generally enters into term licenses ranging from 3 to 7 years. For term licenses with a duration of one year or less, no VSOE of fair value for maintenance exists. The Company began using stated maintenance renewal rates in customers' contracts during fiscal year 2008. Prior to that, customers' contracts did not have stated maintenance renewal rates and the Company was unable to establish VSOE of maintenance. VSOE of fair value for services is established if a substantial majority of historical stand-alone selling prices for a service fall within a narrow price range.

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

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

When implementation services are sold with a license arrangement, the Company evaluates whether those services are essential to the functionality of the software. Prior to fiscal year 2008, implementation services were determined to be essential to the software because the implementation services were generally not available from other third party vendors. By the beginning of fiscal year 2008, third-party vendors were providing implementation services for ClaimCenter and it was concluded that implementation services generally were not essential to the functionality of the ClaimCenter software. By the beginning of fiscal year 2011, third-party vendors were providing implementation services for PolicyCenter and BillingCenter and it was concluded that implementation services were no longer essential to the functionality of the PolicyCenter and BillingCenter software.

In cases where professional services are deemed to be essential to the functionality of the software, the arrangement is accounted for using contract accounting until the essential services are complete. If reliable estimates of total project costs and the extent of progress toward completion can be made, the Company applies the percentage-of-completion method in recognizing the arrangement fee. The percentage toward completion is measured by using the ratio of service billings to date compared to total estimated service billings for the consulting services. Service billings approximate labor hours as an input measure since they are billed monthly on a time and material basis. For term licenses with license fees due in equal installments over the term, the license revenues subject to percentage of completion recognition includes only those payments that are due and payable within the reporting period. The fees related to the maintenance are recognized over the period the maintenance is provided.

When VSOE for maintenance has not been established and the arrangement includes implementation services which are deemed essential to the functionality of the software and it is reasonably assured that no loss will be incurred under the arrangement, revenues are recognized pursuant to the zero gross margin method. Under this method, revenues recognized are limited to the costs incurred for the implementation services. As a result, billed license and maintenance fees and the profit margin on the professional services are generally deferred until the essential services are completed and then recognized over the remaining term of the maintenance period.

If the Company cannot make reliable estimates of total project implementation and it is reasonably assured that no loss will be incurred under such arrangements, the zero profit margin method is applied whereby an amount of revenues equal to the incurred costs of the project is recognized as well as the incurred costs, producing a zero margin until project estimates become reliable. The percentage-of-completion method is applied when project estimates become reliable, resulting in a cumulative

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effect adjustment for deferred license revenues to the extent of progress toward completion, and the related deferred professional service margin is recognized in full as revenues. Such cumulative effect adjustment for license revenues was nil and \$3.2 million for the three and six months ended January 31, 2013, respectively, and \$0.8 million for the three and six months ended January 31, 2012, and for service revenues was nil and \$1.7 million for the three and six months ended January 31, 2013, respectively, and \$0.7 million for the three and six months ended January 31, 2012.

### Deferred Revenues

Deferred revenues represent amounts billed to or collected from customers for which the related revenues have not been recognized because one or more of the revenue recognition criteria have not been met. The current portion of deferred revenues represents the amount that is expected to be recognized as revenues within one year from the balance sheet date, and the noncurrent portion of deferred revenues represents the amount that is expected to be recognized more than one year from the balance sheet date. The Company generally invoices fees for licenses and maintenance to its customers in annual or, in certain cases, quarterly installments payable in advance. Accordingly, the deferred revenues balance does not represent the total contract value of annual or multi-year, non-cancellable arrangements.

### Income Taxes

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. Deferred tax assets related to excess tax benefits are recorded when utilized. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. The Company records a valuation allowance to reduce deferred tax assets to an amount of which realization is more likely than not.

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

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

### Stock-Based Compensation

The Company recognizes compensation expense related to its stock options and restricted stock units ("RSUs") granted to employees based on the estimated fair value of the awards on the date of grant, net of estimated forfeitures. The RSUs are subject to time-based vesting, which generally occurs over a period of 4 years, and for those awards granted prior to the Company's IPO, a performance-based condition, which was satisfied 180 days after the Company's IPO. If an employee terminates employment from the Company prior to the occurrence of the performance-based condition, the employee does not forfeit the RSUs to the extent the time-based vesting requirements were satisfied prior to termination. The options expire 10 years from the grant date. The Company estimates the grant date fair value, and the resulting stock-based compensation expense, of our stock options using the Black-Scholes option-pricing model. The grant date fair value of the stock-based awards is generally recognized using the accelerated multiple option approach over the requisite service period, which is generally the vesting period of the respective awards. Compensation cost for RSUs is generally recognized over the time-based vesting period regardless of the occurrence of the performance-based condition noted above for awards granted prior to IPO, since this condition is not subject to employment.

### Net Income per Share

For the three and six months ended January 31, 2012, the Company's basic and diluted net income per share are presented in conformity with the two-class method, which is required because the Company issued securities other than common stock that participate in dividends with the common stock ("participating securities"), to compute the net

income per share attributable to common stockholders. The Company determined that it had participating securities in the form of noncumulative convertible preferred stock for the periods up to their conversion immediately prior to the closing of the Company's IPO on January 30, 2012 when all convertible preferred shares were converted to common stock. For the three and six months ended January 31, 2013, the two-class method did not apply since the convertible preferred shares were not outstanding at any point during the period.

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The two-class method requires that the Company calculate the net income per share using net income attributable to the common stockholders, which will differ from the Company's net income. Net income attributable to the common stockholders is generally equal to the net income less assumed periodic preferred stock dividends with any remaining earnings, after deducting assumed dividends, to be allocated on a pro rata basis between the outstanding common and preferred stock as of the end of each period. The basic net income per share attributable to common stockholders is calculated by dividing the net income attributable to common stockholders by the weighted average number of shares of common stock outstanding for the period. The diluted net income per share attributable to common stockholders is computed by giving effect to all potential dilutive common stock equivalents outstanding for the period. For purposes of this calculation, convertible preferred stock, options to purchase common stock and restricted stock units are considered to be common stock equivalents.

For the three and six months ended January 31, 2013, the Company calculated basic net income per share by dividing the net income by the weighted average number of shares of common stock outstanding for the period. The diluted net income per share is computed by giving effect to all potential dilutive common stock equivalents outstanding for the period. For purposes of this calculation, options to purchase common stock and restricted stock units are considered to be common stock equivalents.

## 2. Fair Value of Financial Instruments

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

	January 31, 2013			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
	(in thousands)			
U.S. agency securities	\$38,049	\$7	\$—	\$38,056
Commercial paper	76,935	15	—	76,950
Corporate bonds	23,142	6	(6	) 23,142
U.S. government bonds	4,832	—	—	4,832
Foreign government bonds	802	—	(1	) 801
Money market funds	29,936	—	—	29,936
Municipal debt securities	4,390	4	(3	) 4,391
Total	\$178,086	\$32	\$(10	) \$178,108
	July 31, 2012			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
	(in thousands)			
Money market funds	105,107	—	—	105,107
Certificates of deposit	3,726	—	—	3,726
Total	108,833	—	—	108,833

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

	As of January 31, 2013		12 Months or Greater		Total	Gross
	Less Than 12 Months		Fair Value	Gross		
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(in thousands)					
Corporate bonds	\$14,011	\$(6 )	\$—	\$—	\$14,011	\$(6 )
Foreign government bonds	801	(1 )	—	—	801	(1 )
Municipal debt securities	2,097	(3 )	—	—	2,097	(3 )
Total	\$16,909	\$(10 )	\$—	\$—	\$16,909	\$(10 )

As of January 31, 2013, the Company had 21 investments in an unrealized loss position. The unrealized losses on our available-for-sale securities were primarily a result of unfavorable changes in interest rates subsequent to the initial purchase of these securities. We do not intend to sell, nor do we believe we will need to sell, these securities before we recover the associated unrealized losses. We do not consider any portion of the unrealized losses at January 31, 2013 to be an other-than-temporary impairment, nor do we consider any of the unrealized losses to be credit losses. The following table summarizes the expected maturities of the Company's available-for-sale securities as of January 31, 2013:

	Expected maturities for the year ending July 31,			Total
	2013	2014	2015	
	(in thousands)			
U.S. agency securities	\$15,829	\$7,252	\$14,975	\$38,056
Commercial paper	69,377	7,573	—	76,950
Corporate bonds	3,505	17,573	2,064	23,142
U.S. government bonds	—	1,006	3,826	4,832
Foreign government bonds	—	801	—	801
Money market funds	29,936	—	—	29,936
Municipal debt securities	—	1,183	3,208	4,391
Total	\$118,647	\$35,388	\$24,073	\$178,108

Fair value is defined as the exchange price that would be received for an asset or an exit price paid to transfer a liability in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Valuation techniques used to measure fair value must maximize the use of observable inputs and minimize the use of unobservable inputs. The current accounting guidance for fair value measurements defines a three-level valuation hierarchy for disclosures as follows:

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

Level 2—Inputs other than quoted prices included within Level I that are observable, unadjusted quoted prices in markets that are not active, or other inputs that are observable or can be corroborated by observable market data; and  
Level 3—Unobservable inputs that are supported by little or no market activity, which require the Company to develop its own assumptions.

The categorization of a financial instrument within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement. The carrying value of the Company's accounts receivable, accounts payable and accrued liabilities approximates their fair value due to the short-term nature of these instruments and is based on Level 2 inputs.

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

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

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

We did not own any Level 3 financial assets or liabilities as of January 31, 2013 or July 31, 2012.

The following tables summarize the Company's financial assets measured at fair value on a recurring basis, by level within the fair value hierarchy as of January 31, 2013:

	January 31, 2013			
	Level 1	Level 2	Level 3	Total
	(in thousands)			
Assets				
Cash equivalents:				
U.S. agency securities	\$—	\$6,000	\$—	\$6,000
Commercial paper	—	40,394	—	40,394
Money market funds	29,936	—	—	29,936
Short-term investments:				
U.S. agency securities	—	12,332	—	12,332
Commercial paper	—	36,556	—	36,556
Corporate bonds	—	14,695	—	14,695
Foreign government bonds	—	801	—	801
Long-term investments:				
U.S. agency securities	—	19,724	—	19,724
Corporate bonds	—	8,447	—	8,447
U.S. government bonds	—	4,832	—	4,832
Municipal debt securities	—	4,391	—	4,391
Total assets	\$29,936	\$148,172	\$—	\$178,108

The following table summarizes the Company's financial assets measured at fair value on a recurring basis, by level within the fair value hierarchy as of July 31, 2012:

	July 31, 2012			
	Level 1	Level 2	Level 3	Total
	(in thousands)			
Assets				
Cash equivalents:				
Money market funds	\$105,107	\$—	\$—	\$105,107
Certificates of deposit	3,726	—	—	3,726
Total assets	\$108,833	\$—	\$—	\$108,833

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## 3. Balance Sheet Components

Property and equipment consist of the following:

	January 31, 2013 (in thousands)	July 31, 2012
Computer hardware	\$8,093	\$8,125
Software	3,952	3,599
Furniture and fixtures	2,025	1,854
Leasehold improvements	5,692	5,600
Total property and equipment	19,762	19,178
Less accumulated depreciation and amortization	(8,154	) (7,254
Property and equipment, net	\$11,608	\$11,924

As of January 31, 2013 and July 31, 2012, no property and equipment was pledged as collateral against borrowings.

Amortization of leasehold improvements is included in depreciation expense.

Accrued employee compensation consists of the following:

	January 31, 2013 (in thousands)	July 31, 2012
Accrued bonuses	\$6,000	\$12,718
Accrued commission	2,460	4,068
Accrued vacation	5,815	5,684
Payroll accruals	4,533	4,032
Total	\$18,808	\$26,502

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## 4. Net Income per Share

The following table sets forth the computation of the Company's basic and diluted net income per share for the three and six months ended January 31, 2013 and 2012:

	Three Months Ended January 31,		Six Months Ended January 31,	
	2013	2012	2013	2012 <sup>(2)</sup>
	(in thousands, except share and per share amounts)			
Numerator:				
Net income	\$5,501	\$3,691	\$5,948	\$8,503
Non-cumulative dividends to preferred stockholders	—	(751)	—	(1,574)
Undistributed earnings allocated to preferred stockholders	—	(1,642)	—	(4,122)
Net income, basic	5,501	1,298	5,948	2,807
Adjustments to net income for dilutive options and restricted stock options	—	241	—	593
Net income, diluted	\$5,501	\$1,539	\$5,948	\$3,400
Net income per share:				
Basic	\$0.10	\$0.07	\$0.11	\$0.17
Diluted	\$0.09	\$0.06	\$0.10	\$0.15
Denominator:				
Weighted average shares used in computing net income per share:				
Basic	55,868,308	18,433,369	55,341,176	16,499,660
Weighted average effect of diluted stock options	3,668,115	3,565,468	3,958,906	3,597,819
Weighted average effect of dilutive restricted stock units	2,170,034	3,559,165	2,152,163	3,248,528
Weighted average effect of dilutive stock warrants (1)	—	52,199	—	41,576
Diluted	61,706,457	25,610,201	61,452,245	23,387,583

(1) Series C convertible preferred stock warrants were automatically converted to equivalent common stock warrants upon the Company's IPO on January 24, 2012 and were converted or cancelled as of April 30, 2012.

(2) Amounts shown for basic earnings per share during the six month period ended January 31, 2012 are revised for a correction in the net income allocation calculation under the two-class method.

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

	Three Months Ended January 31,		Six Months Ended January 31,	
	2013	2012	2013	2012
Stock options to purchase common stock	338,712	788,238	269,040	649,263
Restricted stock units	—	—	12,417	—

## 5. Commitments and Contingencies

There has been no material change in the Company's contractual obligations and commitments other than in the ordinary course of business since the Company's fiscal year ended July 31, 2012. See the Annual Report on Form 10-K for the fiscal year ended July 31, 2012 for additional information regarding our contractual obligations.



Leases

The Company leases certain facilities and equipment under operating leases. On December 5, 2011, the Company entered into a seven-year lease for a facility to serve as its corporate headquarters, located in Foster City, California, for approximately

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97,674 square feet of space which commenced on August 1, 2012. In connection with this lease, the Company opened a letter of credit with Silicon Valley Bank for \$1.2 million.

Lease expense for all worldwide facilities and equipment, which is being recognized on a straight-line basis over terms of the various leases, was \$1.2 million and \$2.4 million during the three and six months ended January 31, 2013, respectively, and \$1.0 million and \$1.9 million for the three and six months ended January 31, 2012, respectively. This expense was reduced by sublease income of \$0.3 million and \$0.6 million for the three and six months ended January 31, 2012, respectively.

### Letters of Credit

In addition to the unsecured letter of credit noted above, the Company had an unsecured letter of credit agreement related to a customer arrangement for Polish Zloty 10.0 million (approximately \$3.2 million as of January 31, 2013) to secure contractual commitments and prepayments. No amounts were outstanding under our unsecured letters of credit as of January 31, 2013 or July 31, 2012.

The Company had no outstanding secured letters of credit as of January 31, 2013. As of July 31, 2012, the Company had three outstanding letters of credit required by certain customers to secure contractual commitments and prepayments. These letters of credit were fully secured by cash balances, which we classified as restricted cash in our consolidated balance sheets as of July 31, 2012.

### Legal Proceedings

In December 2007, Accenture Global Services GmbH and Accenture LLP (collectively, "Accenture") filed a lawsuit against the Company in the U.S. District Court for the District of Delaware, (the "Delaware Court") titled Accenture Global Services GmbH and Accenture LLP v. Guidewire Software, Inc., Case No 07-826-SLR. Accenture alleged infringement of U.S. Patent No. 7,013,284, ("the '284 patent"), among others, by the Company's products; trade-secret misappropriation; and tortious interference with business relations. Accenture sought damages and an injunction. The Company denied Accenture's claims, and it asserted counterclaims seeking a declaration that the Company's products do not infringe either patent, that the patents are invalid and that the '284 patent is unenforceable. The Company also asserted counterclaims against Accenture for breach of contract and trade secret misappropriation. In March 2011, the USPTO granted a third re-examination against the '284 patent, after having rejected all claims in the '284 patent on two prior re-examinations.

On May 31, 2011, the Delaware Court granted the Company's motion for summary judgment finding that Accenture's '284 patent is invalid. In July 2011, Accenture filed an appeal to the Federal Circuit Court of Appeals (the "Appeals Court") of the Delaware Court's judgment of invalidity of the '284 patent. We believe that the Delaware Court was correct in finding the '284 patent invalid and we intend to vigorously defend the Delaware Court's judgment in the appeal. On August 6, 2012, the oral argument of this appeal was held by the Appeals Court and their ruling is pending. However, at this time, the Company is unable to predict the likelihood of success of Accenture's appeal.

In October 2011, the Company agreed with Accenture to resolve all outstanding patent litigation concerning their respective insurance claims management software. In connection with the settlement, the Company has paid \$10.0 million to Accenture with a potential additional payment based on the final outcome of Accenture's pending appeal regarding the validity of its '284 patent. If Accenture is successful in its appeal, the Company has agreed to pay them an additional \$20.0 million. At any time prior to an initial determination by the appeals court, the Company may instead pay Accenture \$15.0 million to discharge this potential obligation. If Accenture is not successful in its appeal, no further payments would be due in connection with the settlement. As part of the settlement, the Company also agreed to a royalty free cross license of all then-current patents and patent applications. The Company expensed the \$10.0 million litigation provision in fiscal year 2011.

In addition to the matters described above, from time to time, the Company is involved in various other legal proceedings and receives claims from time to time, arising from the normal course of business activities. The Company has accrued for estimated losses in the accompanying condensed consolidated financial statements for matters with respect to which we believe the likelihood of an adverse outcome is probable and the amount of the loss

is reasonably estimable.

**Indemnification**

The Company sells software licenses and services to its customers under contracts (“Software License”). Each Software License contains the terms of the contractual arrangement with the customer and generally includes certain provisions for defending the customer against any claims that the Company’s software infringes upon a patent, copyright, trademark, or other proprietary right of a third party. The Software License also indemnifies the customer against losses, expenses, and liabilities

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from damages that may be assessed against the customer in the event the Company's software is found to infringe upon such third party rights.

The Company has not had to reimburse any of its customers for losses related to indemnification provisions and no material claims against the Company are outstanding as of January 31, 2013 and July 31, 2012. For several reasons, including the lack of prior indemnification claims and the lack of a monetary liability limit for certain infringement cases under the Software License, the Company cannot estimate the amount of potential future payments, if any, related to indemnification provisions.

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

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

##### Stock-based Compensation Expenses

Stock-based compensation expenses related to all employee and non-employee stock-based awards was as follows:

	Three Months Ended January 31,		Six Months Ended January 31,	
	2013	2012	2013 <sup>(1)</sup>	2012 <sup>(1)</sup>
Stock-based compensation expenses:	(in thousands)			
Cost of maintenance revenues	\$340	\$113	\$601	\$185
Cost of services revenues	3,439	1,055	6,055	1,741
Research and development	2,446	1,258	4,488	2,103
Sales and marketing	1,942	527	3,593	1,024
General and administrative	2,207	3,339	5,421	4,551
Total stock-based compensation expenses	\$10,374	\$6,292	\$20,158	\$9,604

<sup>(1)</sup> Expenses shown include \$1.0 million of expense recognized in 2013 related to the modification of RSUs upon accelerated vesting terms for the retirement of one of the Company's officers, as well as \$1.2 million of expense recognized in 2012 related to the satisfaction of performance-based criteria upon successful close of the Company's IPO.

As of January 31, 2013, total unrecognized compensation cost, adjusted for estimated forfeitures, was as follows:

	As of January 31, 2013	
	Unrecognized Expense	Average Expected Recognition Period
	(in thousands)	(in years)
Restricted stock units	\$40,541	1.4
Stock options	4,050	1.2
	\$44,591	

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## RSUs

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

	RSUs Outstanding	
	Number of RSUs Outstanding	Weighted Average Grant Date Fair Value
Balance as of July 31, 2012	3,992,177	\$8.00
Granted	1,454,569	31.67
Released	(835,322	) 8.48
Cancelled	(116,641	) 16.46
Balance as of January 31, 2013	4,494,783	\$15.35

The fair value of RSUs released during the three and six months ended January 31, 2013 was \$14.5 million and \$25.5 million, respectively.

## Stock Options

The options exercisable as of January 31, 2013 include options that are exercisable prior to vesting. The total intrinsic value of options exercised was approximately \$20.2 million and \$8.2 million for the three months ended January 31, 2013 and 2012, respectively, and \$53.1 million and \$9.9 million for the six months ended January 31, 2013 and 2012, respectively.

	Stock Options Outstanding		Weighted Average Contractual Life	Aggregate Intrinsic Value <sup>(1)</sup>
	Number of Stock Options Outstanding	Weighted Average Exercise Price	(in years)	(in thousands)
Balance as of July 31, 2012	6,486,641	\$3.74	6.1	\$142,321
Granted	339,912	31.86		
Exercised	(1,949,448	) 2.88		
Cancelled	(35,694	) 9.27		
Balance as of January 31, 2013	4,841,411	\$6.02	6.1	\$131,224
Vested and expected to vest as of January 31, 2013	4,754,015	\$5.84	6.1	\$129,734
Exercisable as of January 31, 2013	4,451,540	\$4.25	5.8	\$128,523

Aggregate intrinsic value represents the difference between the Company's closing stock price of \$33.12 and

<sup>(1)</sup> \$25.66 on January 31, 2013 and July 31, 2012, respectively, against the exercise price of outstanding, in-the-money options.

## Valuation of Awards

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

	Three Months Ended January 31,		Six Months Ended January 31,	
	2013	2012	2013	2012
Expected life (in years)	5.5	6.0 - 6.1	5.1 - 6.0	5.9 - 6.1
Risk-free interest rate	0.7%	1.2%	0.6% - 0.8%	1.1% - 1.2%
Expected volatility	47.7%	45.0% - 45.2%	45.1% - 48.7%	44.5% - 45.2%
Expected dividend yield	—%	—%	—%	—%



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## Common Stock Reserved for Issuance

As of January 31, 2013 and July 31, 2012, the Company was authorized to issue 500,000,000 shares of common stock with a par value of \$0.0001 per share. As of January 31, 2013 and July 31, 2012, the Company had reserved shares of common stock, on an as-if-converted basis, for issuance as follows:

	January 31, 2013	July 31, 2012
Exercise of stock options to purchase common stock	4,841,411	6,486,641
Vesting of restricted stock units	4,494,783	3,992,177
Issuances of shares available under stock plans	9,107,725	7,655,332
Total common stock reserved for issuance	18,443,919	18,134,150

## Equity Incentive Plans

In February 2007, the Company's board of directors ("Board") adopted and the stockholders approved the 2006 Stock Plan ("2006 Plan") as an amendment and restatement of the stockholder-approved 2002 Stock Option/Stock Issuance Plan, as amended, providing for the issuance of incentive and nonstatutory options to employees and nonemployees of the Company and under which 14,074,904 shares had been reserved for issuance as of January 31, 2013.

In July 2009, the Board adopted and the stockholders approved the 2009 Stock Plan ("French Plan"). Under the French Plan, 31,000 shares had been reserved for issuance as of January 31, 2013. The number of shares exercised and issued under the French Plan reduced the corresponding number of shares available under the 2006 Plan.

In June 2010, the Board adopted and the stockholders approved the 2010 Restricted Stock Unit Plan ("2010 Plan"). As of January 31, 2013, the Company had reserved 4,265,637 shares of common stock for issuance under the 2010 Plan.

On September 14, 2011, the Board, upon the recommendation of the Compensation Committee of the Board ("Committee"), adopted the 2011 Stock Plan ("2011 Plan"), which was subsequently approved by the Company's stockholders in January 2012. The 2011 Plan provides flexibility to the Committee to use various equity-based incentive awards as compensation tools to motivate the Company's workforce. The Company had initially reserved 7,500,000 shares of its common stock for the issuance of awards under the 2011 Plan. In addition, the number of shares remaining available for grant under the 2006 Plan and 2010 Plan immediately prior to the closing of the IPO were added to the shares available under the 2011 Plan. The number of shares remaining available for grant under the French Plan expired upon the IPO. The 2011 Plan provides that the number of shares reserved and available for issuance under the plan will automatically increase each January 1, beginning on January 1, 2013, by up to 5% of the outstanding number of shares of the Company's common stock on the immediately preceding December 31. This number is subject to adjustment in the event of a stock split, stock dividend or other defined changes in the Company's capitalization. With the adoption of the 2011 Plan upon the completion of the Company's IPO, both option and RSU grants now reduce the 2011 Plan reserve. As of January 31, 2013, the Company had reserved 11,248,544 shares of common stock for issuance under the 2011 Plan.

The shares the Company issues under the 2011 Plan will be authorized but unissued shares or shares that are reacquired. The shares of common stock underlying any awards under the 2011 Plan, 2010 Plan and 2006 Plan that are forfeited, canceled, held back upon exercise or settlement of an award to satisfy the exercise price or tax withholding, reacquired by the Company prior to vesting, satisfied without any issuance of stock or are otherwise terminated (other than by exercise) are added back to the shares of common stock available for issuance under the 2011 Plan. The shares of common stock underlying any outstanding awards under the French Plan that are forfeited, canceled or otherwise not issued will expire and not be available for future issuance.

No awards may be granted under the 2011 Plan after the date that is 10 years from the effectiveness of the plan. No awards under the 2011 Plan were granted prior to the Company's IPO. Following the closing of the IPO, no additional awards will be made under the 2006 Plan, French Plan and 2010 Plan.

## 7. Income Taxes

The benefit from income taxes for the three and six months ended January 31, 2013 was \$0.3 million and \$0.5 million, respectively. The provision for income taxes for the three and six months ended January 31, 2012 was \$1.4 million and \$4.5 million, respectively. The changes are primarily due to the reinstatement of federal research and development

credits of \$1.6 million, the benefit from incentive stock option (ISO) tax deduction, and the decrease in year-to-date income before tax. The effective tax rate of (5.1)% and (10.0)% for the three and six months ended January 31, 2013 differs from the statutory U.S.



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federal income tax rate of 35% mainly due to the reasons discussed above, as well as permanent differences for stock based compensation, the impact of state income taxes, and the tax rate differences between the United States and foreign countries and foreign tax credits.

The Company provides U.S. income taxes on the earnings of foreign subsidiaries, unless the subsidiaries' earnings are considered indefinitely reinvested outside the United States. As of January 31, 2013, U.S. income taxes were not provided for on the cumulative total of \$10.7 million undistributed earnings from certain foreign subsidiaries. As of January 31, 2013, the unrecognized deferred tax liability for these earnings was approximately \$0.9 million.

During the six months ended January 31, 2013, unrecognized tax benefits increased \$1.6 million from the beginning of the period. Accordingly, as of January 31, 2013, the Company had unrecognized tax benefits of \$2.7 million that, if recognized, would affect the Company's effective tax rate.

## 8. Segment Information

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

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

	Three Months Ended January 31,		Six Months Ended January 31,	
	2013	2012	2013	2012
	(in thousands)			
United States	\$36,823	\$30,882	\$72,210	\$63,281
Canada	10,984	8,359	21,065	12,975
Australia	3,433	3,451	7,472	10,117
United Kingdom	6,708	3,605	12,079	6,836
Other	14,240	8,800	22,663	14,268
Total revenues	\$72,188	\$55,097	\$135,489	\$107,477

No other country accounted for more than 10% of revenues during the three and six months ended January 31, 2013 and 2012.

The following table sets forth the Company's property and equipment, net by geographic region:

	January 31, 2013	July 31, 2012
	(in thousands)	
North America	\$11,274	\$11,522
Europe	322	388
Asia Pacific	12	14
Total net property and equipment	\$11,608	\$11,924

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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 do not undertake, and specifically disclaim, any obligation to update any forward-looking statements to reflect the occurrence of events or circumstances after the date of such statements except as required by law.

Overview

We are a leading provider of core system software to the global property and casualty ("P&C") insurance and reinsurance industry. Our solutions serve as the transactional systems-of-record for, and enable the key functions of, a P&C insurance carrier's business: underwriting and policy administration, claims management and billing. Since our inception, our mission has been to empower P&C insurance carriers to transform and improve their businesses by replacing their legacy core systems with our software platform.

We derive our revenues from licensing our software applications, providing maintenance support and providing professional services to the extent requested by our customers. Our license revenues are primarily generated through annual license fees that recur during the term of our multi-year contracts. These multi-year contracts have an average term of approximately five years and are renewed on an annual or multi-year basis. In certain cases, when required by a customer, we license our software on a perpetual basis. In addition, certain of our multi-year term licenses provide the customer with the option to purchase a perpetual license at the end of the initial contract term. We generally price our licenses based on the amount of direct written premiums ("DWP") that will be managed by our solutions. We typically invoice our customers annually in advance or, in certain cases, quarterly for both recurring term license and maintenance fees, and we invoice our perpetual license customers either in full at contract signing or on an installment basis and invoice related maintenance fees annually, in advance. Our focus is to encourage recurring term license arrangements instead of perpetual license arrangements, and we have historically experienced seasonal variations in our revenues as a result of increased customer orders in our second and fourth fiscal quarters and subsequent annual fees.

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

We face a number of risks in the execution of our strategy, including reliance on sales to a relatively small number of large customers, variances in the mix amongst our components of revenues, possibly resulting in lower gross margin from services revenues as compared to license and maintenance revenues, and the overall impact of weakening economic conditions on the insurance industry. We believe that our focus on continued product innovation and customer wins and renewals will support the expansion of our license sales and reduce the impact from weakened economic conditions. We sell our core system software primarily through our direct sales force. Our sales cycle for new customers is typically 12 to 24 months and may take longer.

Opportunities, Challenges, & Risks

Since August 2010, our license revenues from new orders and subsequent annual payments have generally been recognized when payment is due from our customers. Historically, and to a lesser extent during fiscal years 2013, 2012 and 2011, our license revenues from existing orders have been recognized under three methods: under the residual method upon the earlier of payment being due and payable or cash being received from our customers, under

the percentage-of-completion method as we complete customer implementations of our software, or under the zero gross margin method as we complete customer implementations of our software. During the three months ended January 31, 2013 and 2012, our license revenues accounted for 42% and 47% of our total revenues, respectively, and our recurring term license revenues accounted for 96% and 77% of our total license revenues, respectively. During the six months ended January 31, 2013 and 2012, our license revenues accounted for 38% and 43% of our total revenues, respectively, and our recurring term license revenues accounted for 97% and 69% of our total license revenues, respectively.

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Our maintenance revenues are generally recognized over the committed maintenance term. Our maintenance fees are invoiced annually, typically priced as a fixed percentage of the associated license fees and generate lower gross margins than our license revenues. Our maintenance revenues accounted for 13% and 12% of our total revenues during the three months ended January 31, 2013 and 2012, respectively, and 14% and 13% of our total revenues during the six months ended January 31, 2013 and 2012, respectively.

We generally charge services fees on a time and materials basis and revenues are typically recognized upon delivery of our services. We derive our services revenues primarily from implementation services performed for our customers, revenues related to reimbursable travel expenses and training fees. Our services revenues generate lower gross margins than our license and maintenance revenues and accounted for 45% and 41% of our total revenues during the three months ended January 31, 2013 and 2012, respectively. Our services revenues accounted for 48% and 44% of our total revenues during the six months ended January 31, 2013 and 2012, respectively.

We enter into multi-year renewable contracts to license our software and provide technical support and unspecified upgrades to our software as they become available. Regardless of contract length, we typically invoice our customers for annual and, in certain cases, quarterly amounts at the contract signing and at each anniversary date. Our deferred revenues consist only of amounts that have been invoiced, but not yet recognized as revenues. As a result, deferred revenues and change in deferred revenues are incomplete measures of the strength of our business and are not necessarily indicative of our future performance. Further, we expect to recognize our current deferred services revenue into income but do not expect significant deferrals of services revenue in future periods. Deferred license and service revenues related to projects under contract accounting as of January 31, 2013 were \$4.2 million and \$3.4 million, respectively, while deferred license and service revenues as of July 31, 2012 were \$10.2 million and \$5.6 million, respectively. Such deferral is in accordance with our Revenue Recognition policy as described in Note 1 to the consolidated financial statements.

In October 2012, we announced the introduction of Guidewire Live™, a network connecting Guidewire customers to one another, curated external content, and expert tools. Guidewire Live delivers relevant context to P & C insurance professionals based on who they are and the problems they are trying to solve. Guidewire Live is deployed as a cloud-based, instant-on solution that can be used by Guidewire customers within days, without the need for an implementation project. Guidewire Live enables insurers to compare their operational performance versus their peers. While we have incurred expenses to develop and market Guidewire Live, initial revenue expectations for fiscal 2013 are modest.

We have historically experienced seasonal variations in our revenues as a result of increased customer orders in our second and fourth fiscal quarters and subsequent annual fees. We generally see increased orders in our second fiscal quarter, which is the quarter-ended January 31, due to customer buying patterns. We also see increased orders in our fourth fiscal quarter due to efforts by our sales team to achieve annual incentives. As a result, a significantly higher percentage of our annual license fees are invoiced and recognized as revenues during those quarters at contract inception or in the subsequent quarter when the annual license payment is due and in subsequent years upon the anniversary of the contract date. We generally expect these seasonal trends to continue in the future, which may cause quarterly fluctuations in our results of operations and certain financial metrics. Our perpetual license revenues are not consistent from quarter to quarter. We expect that perpetual license revenues recognized in fiscal 2013 will be significantly lower than those recognized in prior periods, due to continued adoption of recurring term licenses, and our continued emphasis away from perpetual licenses.

Our quarterly growth in revenues may not match up to new orders we receive in a given quarter. This mismatch is primarily due to the following reasons:

- for the initial year of a multi-year term license, we generally recognize revenues when payment is due and payment may not be due until a subsequent fiscal quarter;
- we may enter into license agreements with specified terms for product upgrades or functionality, which may require us to delay revenue recognition until the period in which the upgrade or functionality is delivered;
- we may separately negotiate renewals of contracts which may have differing terms and conditions from the original contract; and
- we may enter into license agreements with other contractual terms that may affect the timing of revenue recognition.

For example, we received new orders for both term and perpetual licenses in the fourth quarter of fiscal year 2011 that committed future product functionality that was delivered in the first quarter of fiscal year 2012. As a result, our license revenues in the first quarter of fiscal year 2012 were \$7.2 million higher than they would have been had the functionality been delivered in the fourth fiscal quarter of fiscal year 2011.

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In addition, our revenue may fluctuate if our customers make an early payment of their annual fees. For example, during the three months ended January 31, 2012, we recognized \$2.5 million of revenue upon early payment of annual fees from one customer, which would have been otherwise recognized during the three months ended April 30, 2012. Product implementations, the primary driver of our services revenues, typically last 6 to 24 months and may take longer. No customer accounted for 10% or more of our revenues for the three and six months ended January 31, 2013 or 2012. Our ten largest customers accounted for 38% and 42% of our total revenues for the three months ended January 31, 2013 and 2012, respectively, and 35% and 42% of our total revenues for the six months ended January 31, 2013 and 2012, respectively. We count as customers distinct buying entities, which may include multiple national or regional subsidiaries of large, global P&C insurance carriers.

We generated revenues of \$72.2 million and \$55.1 million in the three months ended January 31, 2013 and 2012, respectively, and revenues of \$135.5 million and \$107.5 million in the six months ended January 31, 2013 and 2012, respectively. We generate the majority of our revenues in the United States and Canada. Our revenues from outside the United States and Canada as a percentage of total revenues were 34% and 29% in the three months ended January 31, 2013 and 2012, respectively, and 31% and 29% in the six months ended January 31, 2013 and 2012, respectively. We generated net income of \$5.5 million and \$3.7 million in the three months ended January 31, 2013 and 2012, respectively, and \$5.9 million and \$8.5 million in the six months ended January 31, 2013 and 2012, respectively.

Key Business Metrics

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

Four-Quarter Recurring Revenues

We measure four-quarter recurring revenues by adding the total term license revenues and total maintenance revenues recognized in the preceding four quarters ended in the stated period and excluding perpetual license revenues, revenues from perpetual buyout rights and services revenues. This metric allows us to better understand the trends in our recurring revenues because it typically reduces the variations in any particular quarter caused by seasonality, the effects of the annual invoicing of our term licenses and certain effects of contractual provisions that may accelerate or delay revenue recognition in some cases. Our four-quarter recurring revenues for each of the eight periods presented were:

Four quarters ended

1/31/2013 10/31/2012 7/31/2012 4/30/2012 1/31/2012 10/31/2011 7/31/2011 4/30/2011