QUALYS, INC.
Form 10-Q
May 08, 2018
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

x Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the Quarterly Period Ended March 31, 2018
o 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 001-35662

QUALYS, INC.
(Exact name of registrant as specified in its charter)

Delaware	77-0534145
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

919 E. Hillsdale Boulevard, 4th Floor, Foster City, California 94404
(Address of principal executive offices, including zip code)

(650) 801-6100
(Registrant's telephone number, including area code)

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 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, a smaller reporting company or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	x	Accelerated filer	o
Non-accelerated filer	o	(Do not check if a smaller reporting company)	
		Smaller reporting company	o
		Emerging growth company	o

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. o

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

The number of shares of the Registrant's common stock outstanding as of April 30, 2018 was 38,978,887.

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PART I. FINANCIAL INFORMATION
Item 1. Financial Statements
Qualys, Inc.
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)
(in thousands, except share and per share data)

	March 31, 2018	December 31, 2017
Assets		
Current assets:		
Cash and cash equivalents	$93,174	$86,591
Short-term investments	235,353	201,823
Accounts receivable, net of allowance of $802 and $816 as of March 31, 2018 and December 31, 2017, respectively	49,874	64,412
Prepaid expenses and other current assets	15,488	16,524
Total current assets	393,889	369,350
Long-term investments	65,363	67,224
Property and equipment, net	60,696	58,557
Deferred tax assets, net	24,085	25,066
Intangible assets, net	11,769	12,401
Goodwill	1,549	1,549
Restricted cash	1,200	1,200
Other noncurrent assets	7,061	2,178
Total assets	$565,612	$537,525
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$1,310	$1,144
Accrued liabilities	22,181	21,444
Deferred revenues, current	147,656	143,186
Total current liabilities	171,147	165,774
Deferred revenues, noncurrent	14,995	17,136
Other noncurrent liabilities	13,151	11,071
Total liabilities	199,293	193,981
Commitments and contingencies (Note 6)		
Stockholders' equity:		
Preferred stock, $0.001 par value; 20,000,000 shares authorized, no shares issued and outstanding at March 31, 2018 and December 31, 2017	—	—
Common stock, $0.001 par value; 1,000,000,000 shares authorized; 38,957,692 and 38,598,117 shares issued and outstanding at March 31, 2018 and December 31, 2017	39	39
Additional paid-in capital	316,694	304,155
Accumulated other comprehensive loss	(965)	(574)
Retained earnings	50,551	39,924
Total stockholders' equity	366,319	343,544
Total liabilities and stockholders' equity	$565,612	$537,525

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

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Qualys, Inc.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)
(in thousands, except per share data)

	Three Months Ended March 31,	
	2018	2017
Revenues	$64,878	$53,121
Cost of revenues	15,901	12,294
Gross profit	48,977	40,827
Operating expenses:		
Research and development	12,553	9,823
Sales and marketing	16,233	16,014
General and administrative	11,785	7,334
Total operating expenses	40,571	33,171
Income from operations	8,406	7,656
Other income (expense), net:		
Interest expense	(38)	(2)
Interest income	1,090	481
Other income (expense), net	193	(26)
Total other income (expense), net	1,245	453
Income before income taxes	9,651	8,109
Provision for (benefit from) income taxes	509	(13,821)
Net income	$9,142	$21,930
Net income per share:		
Basic	$0.24	$0.60
Diluted	$0.22	$0.56
Weighted average shares used in computing net income per share:		
Basic	38,789	36,493
Diluted	41,934	38,845

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

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Qualys, Inc.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)
(in thousands)

	Three Months Ended March 31,	
	2018	2017
Net income	$9,142	$21,930
Available-for-sale investments:		
Change in net unrealized loss on investments, net of tax	(407)	(62)
Less: reclassification adjustment for net realized gain (loss) included in net income, net of tax	16	(8)
Other comprehensive loss, net of tax	(391)	(70)
Comprehensive income	$8,751	$21,860

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

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Qualys, Inc.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(in thousands)

	Three Months Ended March 31,	
	2018	2017
Cash flows from operating activities:		
Net income	$9,142	$21,930
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization expense	7,043	4,820
Bad debt expense	—	10
Loss on disposal of property and equipment	7	2
Stock-based compensation	8,891	4,332
Amortization of premiums and accretion of discounts on investments	36	426
Deferred income taxes	140	(22,559)
Excess tax benefits included in deferred tax assets	—	8,368
Changes in operating assets and liabilities:		
Accounts receivable	14,538	5,375
Prepaid expenses and other assets	(2,341)	981
Accounts payable	(302)	255
Accrued liabilities	4,577	463
Deferred revenues	2,330	8,012
Other non-current liabilities	(1,072)	10
Net cash provided by operating activities	42,989	32,425
Cash flows from investing activities:		
Purchases of investments	(72,176)	(60,201)
Sales and maturities of investments	40,080	63,738
Purchases of property and equipment	(5,985)	(4,543)
Net cash used in investing activities	(38,081)	(1,006)
Cash flows from financing activities:		
Proceeds from exercise of stock options	7,933	5,602
Payments for taxes related to net share settlement of equity awards	(4,030)	(14,107)
Principal payments under capital lease obligations	(747)	—
Repurchase of common stock	(1,481)	—
Net cash provided by (used in) financing activities	1,675	(8,505)
Net increase in cash, cash equivalents and restricted cash	6,583	22,914
Cash, cash equivalents and restricted cash at beginning of period	87,791	87,937
Cash, cash equivalents and restricted cash at end of period	$94,374	$110,851
Supplemental disclosures of cash flow information:		
Cash paid for interest expense	$73	$—
Cash paid for income taxes, net of refunds	$437	$380
Non-cash investing and financing activities		
Purchases of property and equipment recorded in accounts payable and accrued liabilities	$1,127	$3,027
Purchase of assets under capital lease	$2,755	$—

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

Qualys, Inc.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 1. The Company and Summary of Significant Accounting Policies

Description of Business

Qualys, Inc. (the “Company”, "we", "us", "our") was incorporated in the state of Delaware on December 30, 1999. The Company is headquartered in Foster City, California and has majority-owned subsidiaries throughout the world. The Company is a pioneer and leading provider of cloud-based security and compliance solutions that enable organizations to identify security risks to their IT infrastructures, help protect their IT systems and applications from ever-evolving cyber-attacks and achieve compliance with internal policies and external regulations. The Company’s cloud solutions address the growing security and compliance complexities and risks that are amplified by the dissolving boundaries between internal and external IT infrastructures and web environments, the rapid adoption of cloud computing and the proliferation of geographically dispersed IT assets. Organizations can use the Company’s integrated suite of solutions delivered on its Qualys cloud platform to cost-effectively obtain a unified view of their security and compliance posture across globally-distributed IT infrastructures.

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements and condensed footnotes have been prepared by the Company in accordance with accounting principles generally accepted in the United States ("U.S. GAAP") for interim financial information as well as the instructions to Form 10-Q and the rules and regulations of the U.S. Securities and Exchange Commission ("SEC"). Certain information and note disclosures normally included in the financial statements prepared in accordance with U.S. GAAP have been condensed or omitted pursuant to such rules and regulations. The condensed consolidated balance sheet as of December 31, 2017, included herein, was derived from the audited financial statements as of that date but does not include all disclosures, including notes required by U.S. GAAP. In the opinion of management, the accompanying unaudited condensed consolidated financial statements reflect all adjustments, which include only normal recurring adjustments, necessary for the fair presentation of the financial position, results of operations and cash flows for the interim periods. The results of operations for the three month period ended March 31, 2018 are not necessarily indicative of the results of operations expected for the entire year ending December 31, 2018 or for any other future annual or interim period. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2017, filed with the SEC on February 23, 2018.

Except for the changes below, the Company has consistently applied the accounting policies, described in its Annual Report on Form 10-K for the year ended December 31, 2017, to all periods presented in the condensed consolidated financial statements.

The Company adopted Accounting Standards Codification ("ASC") 606 Revenue from Contracts with Customers with a date of initial application of January 1, 2018. The Company adopted ASC 606 using the modified retrospective method and recognized the cumulative effect as an adjustment to the opening balance of equity at January 1, 2018. Therefore, the comparative information from the prior period has not been adjusted and continues to be reported under ASC 605. The impact of adopting ASC 606 was related to the deferral of sales commission costs for new business and when customers increase their renewal orders ("upsells"). The Company previously expensed sales commissions as incurred. Under ASC 606, sales commissions cost related to new business and upsells are recorded as an asset. The Company expenses the commission cost as a selling expense on a straight-line basis over a period of five years. Five years represents the estimated life of the customer relationship taking into account factors such as peer estimates of technology lives and customer lives as well as the Company's own historical data. Applying the practical expedient in ASC 340-40-25-4, the Company expenses commissions related to contract renewals with a renewal contract term of one year or less. The current and noncurrent portions of deferred commissions are included in prepaid expenses and other current assets, and other noncurrent assets, respectively, in its condensed consolidated balance sheets.

On January 1, 2018, the Company recorded an increase to retained earnings of $2.7 million which was the net cumulative impact associated with the capitalization of sales commissions. Additionally, the Company recorded a corresponding commission asset balance of $3.5 million and a related deferred tax liability of $0.8 million. There was no impact to the Company's revenues as a result of adopting ASC 606. Without the adoption of ASC 606, commission expenses would have been $0.5 million higher in the three months ended March 31, 2018. See Note 4, "Revenue from Contracts with Customers", for additional information regarding the impact on the Company's condensed consolidated financial statements.

Recently Adopted Accounting Pronouncements

In January 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2016-01, Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities, which will impact certain aspects of recognition, measurement, presentation and disclosure of financial instruments. The ASU will impact the accounting for equity investments, financial liabilities under the fair value option, and the presentation and disclosure requirements for financial instruments. The Company adopted this ASU in its first quarter of 2018. The adoption of this ASU did not have a material impact on the Company's condensed consolidated financial statements.

In August 2016, the FASB issued ASU 2016-15, Classification of Certain Cash Receipts and Cash Payments (a consensus of the Emerging Issues Task Force), to provide guidance on the presentation of certain cash receipts and cash payments in the statement of cash flows in order to reduce diversity in existing practice. The Company adopted this ASU in its first quarter of 2018. The adoption of this ASU did not have a material impact on the Company's condensed consolidated financial statements.

In November 2016, the FASB issued ASU 2016-18, Statement of Cash Flows (Topic 230): Restricted Cash. The update provides guidance on the presentation of restricted cash or restricted cash equivalents in the statement of cash flows. The Company adopted this ASU retrospectively in its first quarter of 2018. The Company reclassified restricted cash of $1.2 million each for the three months ended March 31, 2018 and 2017, in the condensed consolidated statements of cash flows.

In January 2017, the FASB issued ASU 2017-01, Business Combinations (Topic 805): Clarifying the Definition of a Business, which revises the definition of a business and provides new guidance in evaluating when a set of transferred assets and activities is a business. The Company adopted this ASU prospectively in its first quarter of 2018. The Company will apply the provisions of the update to future acquisitions.

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Recently Issued Accounting Pronouncements Not Yet Adopted

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842), which requires lessees to recognize all leases, including operating leases, on the balance sheet as a lease asset or lease liability, unless the lease is a short-term lease. ASU 2016-02 also requires additional disclosures regarding leasing arrangements. ASU 2016-02 is effective for the Company beginning in the first quarter of fiscal 2019 and early adoption is permitted. Pursuant to the leasing criteria, most of the Company's leased space and equipment leases will be required to be accounted for as capitalized assets on the balance sheet with offsetting financing obligations. In the statement of operations, what was formerly rent expense will be bifurcated into depreciation and interest expense. The Company is currently evaluating the impact and expects the ASU will have a material impact on its condensed consolidated financial statements.

In January 2017, the FASB issued ASU 2017-04, Simplifying the Test for Goodwill Impairment (Topic 350). This standard eliminates Step 2 from the goodwill impairment test, instead requiring an entity to recognize a goodwill impairment charge for the amount by which the goodwill carrying amount exceeds the reporting unit’s fair value. This ASU is effective for interim and annual goodwill impairment tests in fiscal years beginning after December 15, 2019 with early adoption permitted. This ASU must be applied on a prospective basis. The adoption of this ASU is not expected to have a material impact on the Company's condensed consolidated financial statements.

In February 2018, the FASB issued ASU 2018-02, Income Statement—Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income. This ASU eliminates the stranded tax effects in other comprehensive income resulting from the Tax Cuts and Jobs Act (the “TCJA”). Because the amendments only relate to the reclassification of the income tax effects of the TCJA, the underlying guidance that requires that the effect of a change in tax laws or rates be included in income from continuing operations is not affected. ASU 2018-02 is effective for us beginning in the first quarter of fiscal 2019 and early adoption is permitted. The Company is currently evaluating the impact of this ASU on its condensed consolidated financial statements.

NOTE 2. Fair Value of Financial Instruments

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. For certain of the Company's financial instruments, including certain cash equivalents, accounts receivable, accounts payable, and other current liabilities, the carrying amounts approximate their fair values due to the relatively short maturity of these balances.

The Company measures and reports certain cash equivalents, investments and derivative foreign currency forward contracts at fair value in accordance with the provisions of the authoritative accounting guidance that addresses fair value measurements. This guidance establishes a hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available. The hierarchy is broken down into three levels based on the reliability of inputs as follows:

Level 1—Valuations based on quoted prices in active markets for identical assets or liabilities.

Level 2—Valuations based on other than quoted prices in active markets for identical assets and liabilities, quoted prices for identical or similar assets or liabilities in inactive markets, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3—Valuations based on inputs that are generally unobservable and typically reflect management's estimates of assumptions that market participants would use in pricing the asset or liability.

The Company's financial instruments consist of assets and liabilities measured using Level 1 and 2 inputs. Level 1 assets include a highly liquid money market fund, which is valued using unadjusted quoted prices that are available in an active market for an identical asset. Level 2 assets include fixed-income U.S. government agency securities, commercial paper, corporate bonds, asset-backed securities and derivative financial instruments consisting of foreign currency forward contracts. The securities, bonds and commercial paper are valued using prices from independent pricing services based on quoted prices in active markets for similar instruments or on industry models using data inputs such as interest rates and prices that can be directly observed or corroborated in active markets. The foreign currency forward contracts are valued using observable inputs, such as quotations on forward foreign exchange points and foreign interest rates.

The Company's cash and cash equivalents, short-term investments, and long-term investments consist of the following:

	March 31, 2018			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
	(in thousands)			
Cash and cash equivalents:				
Cash	$78,685	$ —	$ —	$78,685
Money market funds	208	—	—	208
Commercial paper	14,284	—	(3)	14,281
Total	93,177	—	(3)	93,174
Short-term investments:				
Commercial paper	11,866	—	(7)	11,859

Corporate bonds	39,296	1	(139)	39,158
U.S. government agencies	184,613	—	(277)	184,336
Total	235,775	1	(423)	235,353
Long-term investments:				
Asset-backed securities	14,665	—	(32)	14,633
U.S. government agencies	19,091	2	(73)	19,020
Corporate bonds	32,097	1	(388)	31,710
Total	65,853	3	(493)	65,363
Total	$394,805	$ 4	$ (919)	$393,890

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Qualys, Inc.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

	December 31, 2017			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
	(in thousands)			
Cash and cash equivalents:				
Cash	$86,500	$ —	$ —	$86,500
Money market funds	91	—	—	91
Total	86,591	—	—	86,591
Short-term investments:				
Commercial paper	12,623	—	(3)	12,620
Corporate bonds	38,425	1	(64)	38,362
U.S. government agencies	151,058	—	(217)	150,841
Total	202,106	1	(284)	201,823
Long-term investments:				
Asset-backed securities	4,998	—	(12)	4,986
U.S. government agencies	24,269	—	(54)	24,215
Corporate bonds	38,198	—	(175)	38,023
Total	67,465	—	(241)	67,224
Total	$356,162	$ 1	$ (525)	$355,638

The following table shows the changes to accumulated other comprehensive loss for the three months ended March 31, 2018 (in thousands):

	Unrealized (Loss) Gain, net on Investments
Balance at December 31, 2017	$ (574)
Change in net unrealized loss on investments, net of tax	(407)
Amounts reclassified for net realized gain included in net income, net of tax	16
Other comprehensive loss, net of tax	(391)
Balance at March 31, 2018	$ (965)

The following table sets forth by level within the fair value hierarchy the fair value of the Company's available-for-sale securities measured on a recurring basis, excluding cash and money market funds:

	March 31, 2018			
	Level 1	Level 2	Level 3	Fair Value
	(in thousands)			
Commercial paper	$ —	$26,140	$ —	$26,140
U.S. government agencies	—	203,356	—	203,356
Corporate bonds	—	70,868	—	70,868
Asset-backed securities	—	14,633	—	14,633
Total	$ —	$314,997	$ —	$314,997

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Qualys, Inc.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

	December 31, 2017			
	Level 1	Level 2	Level 3	Fair Value
	(in thousands)			
Commercial paper	$—	$12,620	$ —	$12,620
U.S. government agencies	—	175,056	—	175,056
Corporate bonds	—	76,385	—	76,385
Asset-backed securities	—	4,986	—	4,986
Total	$—	$269,047	$ —	$269,047

There were no transfers between Level 1, Level 2 or Level 3 of the fair value hierarchy, as determined at the end of each reporting period.

The following summarizes the fair value of securities classified as available-for-sale by contractual, or effective, maturity:

	March 31, 2018			
	Mature within One Year	After One Year through Two Years	Over Two Years	Fair Value
	(in thousands)			
Commercial paper	$26,140	$—	$—	$26,140
U.S. government agencies	184,336	16,859	2,161	203,356
Corporate bonds	39,158	26,833	4,877	70,868
Asset-backed securities	6,162	8,471	—	14,633
Total	$255,796	$52,163	$7,038	$314,997

Derivative Financial Instruments

Derivative financial instruments are utilized by the Company to reduce foreign currency exchange risks. The Company uses foreign currency forward contracts to mitigate the impact of foreign currency fluctuations of certain non-U.S. dollar denominated asset positions, primarily cash and accounts receivable. These contracts are recorded within prepaid expenses and other current assets or accrued liabilities in the condensed consolidated balance sheets. Gains and losses resulting from currency exchange rate movements on these forward contracts are recognized in other income (expense) in the accompanying condensed consolidated statements of operations in the period in which the exchange rates change and offset the foreign currency gains and losses on the underlying exposure being hedged. The Company does not enter into derivative financial instruments for trading or speculative purposes.

At March 31, 2018, the Company had two outstanding forward contracts with notional amounts of 10.0 million Euros and 6.0 million British Pounds, respectively, which expired on April 30, 2018. At December 31, 2017, the Company had two outstanding forward contracts with notional amounts of 7.0 million Euros and 4.8 million British Pounds, respectively, which expired on January 31, 2018. These forward contracts were entered into at the end of each month, and thus the fair value of these contracts was $0 at March 31, 2018 and December 31, 2017. These derivatives did not meet the criteria to be designated as hedges. These instruments were valued using Level 2 inputs.

The following summarizes the gains (losses) recognized in Other income (expense), net on the condensed consolidated statement of operations, from forward contracts and other foreign currency transactions:

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Qualys, Inc.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

	Three Months Ended March 31,	
	2018	2017
	(in thousands)	
Net loss from forward contracts	$(578)	$(257)
Other foreign currency transactions gain	810	260
Total foreign exchange gain, net	$232	$3

NOTE 3. Property and Equipment, Net

Property and equipment, net, which includes assets under capital lease, consists of the following:

	March 31,	December 31,
	2018	2017
	(in thousands)	
Computer equipment	$80,215	$ 77,883
Computer software	21,176	20,447
Furniture, fixtures and equipment	5,408	5,075
Assets under capital lease	3,503	—
Scanner appliances	15,010	14,325
Leasehold improvements	16,348	16,067
Total property and equipment	141,660	133,797
Less: accumulated depreciation and amortization	(80,964)	(75,240)
Property and equipment, net	$60,696	$ 58,557

Physical scanner appliances and other computer equipment that are or will be subject to leases by customers have a net carrying value of $6.9 million and $6.8 million at March 31, 2018 and December 31, 2017, respectively, including assets that have not been placed in service of $1.0 million and $0.9 million, respectively. Depreciation and amortization expense relating to property and equipment, including capitalized leases, was $6.4 million and $4.7 million for the three months ended March 31, 2018 and 2017, respectively. Accumulated depreciation under capital leases was $0.2 million at March 31, 2018.

NOTE 4. Revenue from Contracts with Customers

In May 2014, the FASB issued a new standard related to revenue recognition. Under the standard, revenue is recognized when a customer obtains control of promised goods or services in an amount that reflects the consideration the entity expects to receive in exchange for those goods or services. In addition, the standard requires disclosure of the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers.

On January 1, 2018, the Company adopted ASC 606 using the modified retrospective method applied to those contracts which were not completed as of that date. Results for reporting periods beginning after January 1, 2018 are presented under ASC 606, while prior period amounts are not adjusted and continue to be reported under the accounting standards in effect for the prior period. The Company implemented internal controls and key system functionality to enable the preparation of financial information on adoption. The impact of the standard relates to the Company's accounting for sales commissions. The Company previously expensed sales commissions as incurred. Under ASC 606, the Company is required to capitalize certain contract acquisition costs consisting primarily of commissions paid related to new business and upsells. Applying the practical expedient in ASC 340-40-25-4, the Company expenses commissions related to contract renewals with a renewal contract term of one year or less.

As a result of the adoption, the Company recorded an increase to retained earnings of $2.7 million as of January 1, 2018 which was the net cumulative impact associated with the capitalization of sales commissions. Additionally, the Company recorded a corresponding commission asset balance of $3.5 million and a related deferred tax liability of $0.8 million as of January 1, 2018. There was no impact to the Company's revenues as a result of adopting ASC 606.

Incremental direct costs of obtaining a contract, which consist of sales commissions primarily for new business and upsells, are deferred and amortized over the estimated life of the customer relationship if renewals are expected and the renewal commission is not commensurate with the initial commission. The Company expenses the commission cost as a selling expense on a straight-line basis over a period of five years. The Company classifies deferred commissions as current or noncurrent based on the timing of when it expects to recognize the expense. The current and noncurrent portions of deferred commissions are included in prepaid expenses and other current assets and other noncurrent assets, respectively, in its condensed consolidated balance sheets. The Company has elected the practical expedient for sales commissions related to renewals and expenses these as and when incurred because the amortization period would have been one year or less.

Commission asset balances are as follows (in thousands):

	March 31, 2018	January 1, 2018
Commission asset, current	$845	$704
Commission asset, noncurrent	$3,142	$2,819

For the three months ended March 31, 2018, the Company recognized $0.2 million of commission expense from amortization of its commission assets. There was no impairment loss related to capitalized costs. No contract costs were capitalized in the three months ended March 31, 2017.
Contract liabilities (deferred revenue) balances are as follows (in thousands):

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Qualys, Inc.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

	March 31, 2018		
	ASC 606	Operating Leases	Total
Deferred revenue, current	$135,144	$ 12,512	$147,656
Deferred revenue, noncurrent	13,603	1,392	14,995
Total	$148,747	$ 13,904	$162,651

	January 1, 2018		
	ASC 606	Operating Leases	Total
Deferred revenue, current	$130,579	$ 12,607	$143,186
Deferred revenue, noncurrent	15,419	1,717	17,136
Total	$145,998	$ 14,324	$160,322

The Company records deferred revenue when cash payments are received or due in advance of its performance. The increase in the Company's deferred revenue balances for the three months ended March 31, 2018 is primarily driven by cash payments received or due in advance of satisfying the Company's performance obligations, offset by $55.6 million of revenue recognized in the three months ended March 31, 2018, which was included in the deferred revenue balance as of December 31, 2017.

The Company's performance obligations are typically satisfied ratably over the subscription term as its cloud-based offerings are delivered to customers electronically and over time. In addition, the Company recognizes revenues for certain limited scan arrangements on an as-used basis. The Company recognizes revenue related to the professional services as they are performed.

The Company allocates the transaction price to all separate performance obligations, including transactions that are comprised of lease revenue, in proportion to the standalone selling prices ("SSP") of the goods or services underlying each of those performance obligations at contract inception. If a SSP is not directly observable, the Company determines the SSP using information that may include market conditions and other observable inputs. We typically have more than one SSP for individual products and services due to the stratification of those products and services by customers and circumstances. In these instances, we may use information such as the size of the customer and volume purchased in determining the SSP. The Company's transaction prices are typically a fixed amount for a specific period of time and majority of contracts are twelve months with certain customers signing longer term deals. In general, the Company does not offer rights of return, performance bonuses, customer loyalty programs, payments via non-cash methods, refunds, volume rebates, incentive payments, penalties, price concessions or payments or discounts contingent on future events. Consideration is fixed at the time of the contract, and governed by the price list to which that particular customer is subject. The Company’s customer and partner-specific pricing is negotiated and agreed upon via individual customer contracts. In some of its contracts, the Company incorporates tiered pricing based on the number of IP addresses the customer can scan. As customers are required to purchase larger quantities to qualify for the lower-priced tiers, the Company does not grant its customers any material rights. When customers increase their purchased quantities, the Company accounts for the additional purchased quantities and related price change prospectively as the pricing does not impact subscription services previously provided. Physical equipment (scanners and private cloud platforms) are accounted for as operating leases and revenue is recognized over the subscription term.

Accounts receivable, net, consists of the following (in thousands):

	March 31, 2018	January 1, 2018
ASC 606 receivables	$46,234	$60,984
Operating lease receivables	4,442	4,244
Less: allowance for doubtful accounts	(802)	(816)
Total accounts receivable, net	$49,874	$64,412

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The Company's payment terms vary by the type and location of its customer and the products or services offered. The term between invoicing and when payment is due is not significant. For certain products or services and customer types, the Company requires payment before the products or services are delivered to the customer.

The following table sets forth the expected revenue from all remaining performance obligations as of March 31, 2018 (in thousands):

	ASC 606 Revenues	Operating Lease Revenues	Total Revenues
2018 (remaining nine months)	$ 8,290	$ 261	$ 8,551
2019	14,724	1,068	15,792
2020	7,980	387	8,367
2021	2,498	43	2,541
2022	1,775	20	1,795
2023 and thereafter	1,213	4	1,217
Total	$ 36,480	$ 1,783	$ 38,263

Revenue allocated to remaining performance obligations represents contracted revenue that has not yet been recognized, which includes unearned revenue and amounts that will be invoiced and recognized as revenue in future periods. Remaining performance obligations represents the transaction price of firm orders for which service has not been performed and excludes unexercised renewals.

From time to time, the Company enters into contracts with customers that extend beyond one year with certain of its customers electing to pay for more than one year of services upon contract execution. For any discounts associated with these multiple year contracts, the Company does not consider these contracts to contain a financing component as its customers typically initiate the longer terms, and the Company's reasoning for entering into the longer terms is not based on financing.

Revenues by sales channel are as follows:

	Three Months Ended March 31, 2018		
	ASC 606 Revenues	Operating Lease Revenues	Total Revenues
Direct	$34,968	$ 3,742	$ 38,710
Partner	24,235	1,933	26,168
Total	$59,203	$ 5,675	$ 64,878

	Three Months Ended March 31, 2017		
	ASC 606 Revenues	Operating Lease Revenues	Total Revenues

Direct	$27,620	$ 3,394	$ 31,014
Partner	20,259	1,848	22,107
Total	$47,879	$ 5,242	$ 53,121

The Company utilizes partners to enable and accelerate the adoption of its cloud platform by increasing its distribution capabilities and market awareness of its cloud platform as wells as by targeting geographic regions outside the reach of its direct sales force. The Company's channel partners maintain relationships with their customers throughout the territories in which they operate and provide their customers with services and third-party solutions to help meet those customers’ evolving security and compliance requirements. As such, these partners may offer the Company's IT security and compliance solutions in conjunction with one or more of their own products or services and act as a conduit through which the Company can connect with these prospective customers to offer its solutions. For sales involving a channel partner, the channel partner engages with the prospective customer directly and involves

the Company's sales team as needed to assist in developing and closing an order. When a channel partner secures a sale, the Company sells the associated subscription to the channel partner who in turn resells the subscription to the customer. Sales to channel partners are made at a discount and revenues are recorded at this discounted price over the subscription terms. The Company does not have any influence or specific knowledge of its partners' selling terms with their customers. See Note 11, "Segment Information and Information about Geographic Area" for disaggregation of revenue by geographic area.

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NOTE 5. Goodwill and Intangible Assets, Net

Intangible assets consist primarily of developed technology and patent licenses acquired in business combinations. Acquired intangibles are amortized on a straight-line basis over the respective estimated useful lives of the assets.

The carrying values of intangible assets are as follows (in thousands, except for years):

				March 31, 2018	
	Weighted Average Life (Years)	Weighted Remaining Average Life (Years)	Cost	Accumulated Amortization	Net Book Value
Developed technology	5	4.5	$12,156	$(1,068)	$11,088
Patent licenses	14	6.4	1,388	(747)	641
Total intangibles subject to amortization			$13,544	$(1,815)	11,729
Intangible assets not subject to amortization					40
Total intangible assets, net					$11,769

				December 31, 2017	
	Weighted Average Life (Years)	Weighted Remaining Average Life (Years)	Cost	Accumulated Amortization	Net Book Value
Developed technology	5	4.8	$14,067	$(2,371)	$11,696
Patent Licenses	14	6.7	1,388	(723)	665
Total intangibles subject to amortization			$15,455	$(3,094)	12,361
Intangible assets not subject to amortization					40
Total intangible assets, net					$12,401

Intangible asset amortization expense was $0.6 million and $0.1 million for the three months ended March 31, 2018 and 2017, respectively.

As of March 31, 2018, the Company expects amortization expense in future periods to be as follows (in thousands):

2018 (remaining nine months)	$ 1,899
2019	2,531
2020	2,531
2021	2,531
2022	2,071
2023 and thereafter	166
	$ 11,729

Total expected future amortization expense

Goodwill, which is not subject to amortization, totaled $1.5 million as of each of March 31, 2018 and December 31, 2017.

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NOTE 6. Commitments and Contingencies

Leases

The Company leases certain computer equipment and its corporate office and data center facilities under non-cancelable operating leases for varying periods through 2028. In January 2018, the Company entered into a $3.5 million financing arrangement for data center storage equipment, accounted for as a capital lease, with an implied interest rate of 5%.

The following are the minimum annual lease payments due under these leases at March 31, 2018 (in thousands):

	Operating Leases	Capital Leases
	(in thousands)	
2018 (remaining nine months)	$6,912	$940
2019	5,786	1,770
2020	5,407	130
2021	4,662	54
2022	4,140	—
2023 and thereafter	22,000	—
Total minimum lease payments	$48,907	2,894
Less: amount representing interest		(139)
Present value of minimum payments		2,755
Less: current portion		(1,289)
Capital lease obligations, noncurrent		$1,466

Rent expense was $2.2 million and $1.9 million for the three months ended March 31, 2018 and 2017, respectively. Although certain of the operating lease agreements provide for rent free periods or escalating rent payments over the terms of the leases, rent expense under these agreements is recognized on a straight-line basis over the term of the lease, starting when the Company takes possession of the property from the landlord. As of March 31, 2018 and December 31, 2017, the Company had accrued $10.2 million and $9.5 million, respectively, of deferred rent related to these agreements, which is reflected in accrued liabilities and other non-current liabilities in the accompanying condensed consolidated balance sheets.
On October 14, 2016, the Company entered into a lease agreement for its new headquarters office facility. The lease payments commenced on May 1, 2018 and the lease has a ten-year term through April 30, 2028. The total commitment of $38.6 million is payable monthly with escalating rental payments throughout the lease term. In connection with this lease, the Company has provided the landlord with a $1.2 million standby letter of credit to secure the Company’s obligations through the end of the lease term, which was classified as restricted cash in the accompanying condensed consolidated balance sheets.

Indemnifications
The Company from time to time enters into certain types of contracts that contingently require it to indemnify various parties against claims from third parties. These contracts primarily relate to (i) the Company's by-laws, under which it must indemnify directors and executive officers, and may indemnify other officers and employees, for liabilities arising out of their relationship, (ii) contracts under which the Company must indemnify directors and certain officers

for liabilities arising out of their relationship, and (iii) contracts under which the Company may be required to indemnify customers or resellers from certain liabilities arising from potential infringement of intellectual property rights, as well as potential damages caused by limited product defects. To date, the Company has not incurred and has not recorded any liability in connection with such indemnifications.

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The Company maintains director and officer insurance, which may cover certain liabilities arising from its obligation to indemnify its directors.

Contingencies

The Company regularly licenses technology from various third party licensors. From time to time, the Company is audited by its licensors for compliance with the terms of the license agreements. During the quarter ended March 31, 2018, the Company commenced discussions with one of its vendors with respect to compliance with the terms of the license agreement. The Company intends to cooperate with the licensor while defending itself vigorously to bring the review process to a resolution. The Company accrues for losses on individual matters that are both probable and reasonably estimable. Estimates are based on currently available information and assumptions. Significant judgment is required in both the determination of probability and the determination of whether a matter is reasonably estimable. The Company’s estimates may change and actual expenses could differ in the future as additional information becomes available or as the Company reaches agreements with its vendors. Management currently estimates that it has sufficiently accrued for licensing agreement matters and that the range of loss (in excess of amounts accrued) is not significant.

NOTE 7. Stock-based Compensation

Equity Incentive Plans

2012 Equity Incentive Plan

Under the 2012 Equity Incentive Plan (the "2012 Plan"), the Company is authorized to grant to eligible participants incentive stock options (“ISOs”), non-statutory stock options (“NSOs”), stock appreciation rights ("SARs"), restricted stock awards ("RSAs"), restricted stock units ("RSUs"), performance units and performance shares equivalent to up to 11,791,139 shares of common stock. Options may be granted with an exercise price that is at least equal to the fair market value of the Company's stock at the date of grant and are exercisable when vested. As of March 31, 2018, 4,186,394 shares were available for grant under the 2012 Plan.

2000 Equity Incentive Plan

Under the 2000 Equity Incentive Plan (the "2000 Plan"), the Company was authorized to grant to eligible participants either ISOs or NSOs. The 2000 Plan was terminated in connection with the closing of the Company's initial public offering, and accordingly, no shares are currently available for grant under the 2000 Plan. The 2000 Plan continues to govern outstanding awards granted thereunder.

Stock-based compensation

The following table shows a summary of the stock-based compensation expense included in the condensed consolidated statements of operations for the three months ended March 31, 2018 and 2017:

	Three Months Ended March 31,	
	2018	2017
	(in thousands)	

Cost of revenues	$654	$501
Research and development	1,841	1,221
Sales and marketing	1,401	1,084
General and administrative	4,995	1,526
Total stock-based compensation	$8,891	$4,332

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As of March 31, 2018, the Company had $14.5 million of total unrecognized employee compensation cost related to unvested options that it expects to recognize over a weighted-average period of 2.2 years, and $41.8 million of unrecognized employee compensation cost related to unvested awards that it expects to recognize over a weighted-average period of 2.9 years. Compensation cost is recognized on a straight-line basis over the service period. Forfeitures are estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

Stock Option Plan Activity

A summary of the Company's stock option activity is as follows:

	Outstanding Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (Years)	Aggregate Intrinsic Value
				(in thousands)
Balance as of December 31, 2017	4,495,891	$ 25.29	6.6	$ 153,129
Granted	61,850	$ 59.95		
Exercised	(286,597)	$ 27.68		
Canceled	(83,608)	$ 38.62		
Balance as of March 31, 2018	4,187,536	$ 25.37	6.5	$ 198,395,610
Vested and expected to vest - March 31, 2018	3,969,350	$ 24.76	6.4	$ 190,509,569
Exercisable - March 31, 2018	2,895,704	$ 21.89	5.7	$ 147,268,457

Restricted Stock

A summary of the Company's RSU and RSA activity is as follows:

	Outstanding RSUs and RSAs	Weighted Average Grant Date Fair Value Per Share
Balance as of December 31, 2017	1,410,588	$ 40.34
Granted	92,232	$ 59.95
Vested	(158,561)	$ 37.96
Canceled	(54,410)	$ 39.92
Balance as of March 31, 2018	1,289,849	$ 42.05
Outstanding and expected to vest - March 31, 2018	1,124,366	$ 41.45

NOTE 8. Net Income Per Share

The computations for basic and diluted net income per share are as follows:

	Three Months Ended March 31,	
	2018	2017
	(in thousands, except per share data)	
Numerator:		
Net income	$9,142	$21,930
Denominator:		
Weighted-average shares used in computing net income per share:		
Basic	38,789	36,493
Effect of potentially dilutive securities:		
Common stock options	2,503	2,176
Restricted stock units	642	176
Diluted	41,934	38,845
Net income per share:		
Basic	$0.24	$0.60
Diluted	$0.22	$0.56

Potentially dilutive securities not included in the calculation of diluted net income per share because doing so would be antidilutive are as follows:

	Three Months Ended March 31,	
	2018	2017
	(in thousands)	
Common stock options	109	1,432
Restricted stock units	—	53
	109	1,485

NOTE 9. Stockholder's Equity

Share Repurchase Program

On February 5, 2018, the Company's Board of Directors authorized a $100.0 million share repurchase program, which was announced on February 12, 2018. The stock repurchase authorization does not have an expiration date. The Company's stock repurchases may be effected from time to time through open market purchases. Repurchased shares are retired and reclassified as authorized and unissued shares of common stock. On retirement of the repurchased

shares, common stock is reduced by an amount equal to the number of shares being retired multiplied by the par value. The excess of the cost of treasury stock that is retired over its par value is first allocated as a reduction to additional paid-in capital based on the initial public offering price of the stock, with the remaining excess to retained earnings.

During the three months ended March 31, 2018, the Company repurchased 21,288 shares for approximately $1.5 million. All share repurchases were made using cash resources. As of March 31, 2018, approximately $98.5 million remained available for share repurchases pursuant to the Company's share repurchase program.

NOTE 10. Income Taxes

Our tax provision for income taxes for interim periods is determined using an estimate of our annual effective tax rate, adjusted for discrete items, if any, that arise during the period. Each quarter, we update our estimate of the annual effective tax rate, and if the estimated annual effective tax rate changes, we make a cumulative adjustment in such period.

Our quarterly tax provision, and estimate of our annual effective tax rate, is subject to variation due to several factors, including variability in pre-tax income (or loss), the mix of jurisdictions to which such income relates, changes in how we do business, and tax law developments. Our estimated effective tax rate for the year differs from the U.S. statutory rate of 21% primarily due to non-deductible stock-based compensation expense, state taxes, foreign income subject to different tax rates than the U.S., and the benefit of U.S. federal income tax credits.

The Company recorded an income tax provision of $0.5 million and income tax benefit of $13.8 million for the three months ended March 31, 2018 and 2017, respectively. The Company's effective income tax rate was approximately 5.3% and (170.4)% for the three months ended March 31, 2018 and 2017, respectively.

On December 22, 2017, the Tax Cuts and Jobs Act (the “2017 Tax Act”) was enacted into law. The new legislation contains significant tax provisions that affect the Company, including a one-time repatriation tax on accumulated foreign earnings, a reduction of the corporate income tax rate from 35% to 21%, which was effective January 1, 2018, and a change from a worldwide tax system to a modified territorial system.

In accordance with Staff Accounting Bulletin No. 118 ("SAB 118"), the effects of the 2017 Tax Act may be adjusted within a one-year measurement period from the enactment date of the 2017 Tax Act for items that were previously reported as provisional estimates, or where a provisional estimate could not be made. The income tax provision for the three months ended March 31, 2018, does not reflect any adjustment to the provisional estimates recorded in the year ended December 31, 2017. The Company will continue to assess forthcoming guidance and accounting interpretations on the effects of the 2017 Tax Act and expects to complete its analysis within the measurement period in accordance with the SEC guidance. Such analysis includes both the implications of the newly introduced provisions for Global Intangible Low Tax Income and the detailed analysis of historical foreign earnings and potential correlative adjustments to verify the one-time transition tax does not apply.

As of March 31, 2018, the Company had unrecognized tax benefits of $5.3 million, of which $3.0 million, if recognized, would favorably impact the Company's effective tax rate. As of December 31, 2017, the Company had unrecognized tax benefits of $5.1 million, of which $2.8 million, if recognized, would favorably impact the Company's effective tax rate. The Company does not anticipate a material change in its unrecognized tax benefits in the next 12 months.

NOTE 11. Segment Information and Information about Geographic Area

The Company operates in one segment. The Company’s chief operating decision maker is the Chairman, President and Chief Executive Officer, who makes operating decisions, assesses performance and allocates resources on a consolidated basis. All of the Company’s principal operations and decision-making functions are located in the United States.

Revenues by geographic area, based on the location of the customer, are as follows (in thousands):

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	Three Months Ended March 31, 2018		
	ASC 606 Revenues	Operating Lease Revenues	Total Revenues
United States	$40,308	$ 4,006	$ 44,314
Foreign	18,895	1,669	20,564
Total	$59,203	$ 5,675	$ 64,878

	Three Months Ended March 31, 2017		
	ASC 606 Revenues	Operating Lease Revenues	Total Revenues
United States	$33,882	$ 3,579	$ 37,461
Foreign	13,997	1,663	15,660
Total	$47,879	$ 5,242	$ 53,121

Property and equipment, net, by geographic area, are as follows:

	March 31, 2018	December 31, 2017
	(in thousands)	
United States	$51,573	$ 50,785
Foreign	9,123	7,772
Total property and equipment, net	$60,696	$ 58,557

NOTE 12. Subsequent Event

On April 1, 2018, the Company announced that it had acquired certain assets of Singapore-based 1Mobility, expanding the Company’s domain expertise in passive scanning and deep packet inspection as well as accelerating its entrance into the mitigation and response segment, natively from the Qualys cloud platform. Total purchase consideration related to the acquisition was $4.0 million in cash, of which $0.6 million is payable in the future subject to terms and conditions of the purchase agreement. The acquisition will be accounted for as a business combination.

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

This Quarterly Report on Form 10-Q, including this Management’s Discussion and Analysis of Financial Condition and Results of Operations, should be read in conjunction with (1) our condensed consolidated financial statements (unaudited) and the related notes included elsewhere in this report, and (2) the audited consolidated financial statements and the related notes and management’s discussion and analysis of financial condition and results of operations included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2017, filed with the Securities and Exchange Commission, or SEC, on February 23, 2018.

In addition to historical information, this Quarterly Report on Form 10-Q contains “forward-looking” statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act. Forward-looking statements generally relate to future events or our future financial or operating performance. In some cases, it is possible to identify forward-looking statements because they contain words such as “anticipates,” “believes,” “contemplates,” “continue,” “could,” “estimates,” “expects,” “future,” “intends,” “likely,” “may,” “plans,” “potential,” “predic “should,” “target,” or “will,” or the negative of these words or other similar terms or expressions that concern our expectations, strategy, plans or intentions. Forward-looking statements contained in this Quarterly Report on Form 10-Q include, but are not limited to, statements about:

- our financial performance, including our revenues, costs, expenditures, growth rates, operating expenses and ability to generate positive cash flow to fund our operations and sustain profitability;
- anticipated technology trends, such as the use of cloud solutions;
- our ability to adapt to changing market conditions;
- economic and financial conditions, including volatility in foreign exchange rates;
- our ability to diversify our sources of revenues, including selling additional solutions to our existing customers and our ability to pursue new customers;
- the effects of increased competition in our market;
- our ability to innovate and enhance our cloud solutions and platform and introduce new solutions;
- our ability to effectively manage our growth;
- our anticipated investments in sales and marketing, our infrastructure, new solutions, and research and development, and acquisitions;
- maintaining and expanding our relationships with channel partners;
- our ability to maintain, protect and enhance our brand and intellectual property;
- costs associated with defending intellectual property infringement and other claims;
- our ability to attract and retain qualified employees and key personnel, including sales and marketing personnel;
- our ability to successfully enter new markets and manage our international expansion;
- our expectations, assumptions and conclusions related to our provision for income taxes, our deferred tax assets and our effective tax rate; and
- other factors discussed in this Quarterly Report on Form 10-Q in the sections titled “Risk Factors” and “Management's Discussion and Analysis of Financial Condition and Results of Operations.”

We have based the forward-looking statements contained in this Quarterly Report on Form 10-Q primarily on our current expectations and projections about future events and trends that we believe may affect our business, financial condition, results of operations and prospects. The results, events and circumstances reflected in these forward-looking statements are subject to risks, uncertainties, assumptions, and other factors including those described in Part II, Item 1A (Risk Factors) of this Quarterly Report and those discussed in other documents we file with the SEC. Moreover, we operate in a very competitive and rapidly changing environment. New risks and uncertainties emerge from time to time, and it is not possible for us to predict all risks and uncertainties that could have an impact on the forward-looking statements used herein. We cannot provide assurance that the results, events, and

circumstances reflected in the forward-looking statements will be achieved or occur, and actual results, events or circumstances could differ materially from those described in the forward-looking statements.

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Overview

We are a pioneer and leading provider of a cloud-based platform delivering security and compliance solutions that enable organizations to identify security risks to their information technology (IT) infrastructures, help protect their IT systems and applications from ever-evolving cyber-attacks and achieve compliance with internal policies and external regulations. Our cloud solutions address the growing security and compliance complexities and risks that are amplified by the dissolving boundaries between internal and external IT infrastructures and web environments, the rapid adoption of cloud computing and the proliferation of geographically dispersed IT assets. Our integrated suite of security and compliance solutions delivered on our Qualys cloud platform enables our customers to identify their IT assets, collect and analyze large amounts of IT security data, discover and prioritize vulnerabilities, recommend remediation actions and verify the implementation of such actions. Organizations use our integrated suite of solutions delivered on our Qualys cloud platform to cost-effectively obtain a unified view of their security and compliance posture across globally-distributed IT infrastructures as our solution offers a single platform for information security, application security, endpoint, developer security and cloud teams.

We were founded and incorporated in December 1999 with a vision of transforming the way organizations secure and protect their IT infrastructure and applications and initially launched our first cloud solution, Vulnerability Management (VM), in 2000. As VM gained acceptance, we introduced new solutions to help customers manage increasing IT security and compliance requirements. Today, the suite of solutions offered on our cloud platform, which we refer to as the Qualys Cloud Apps, includes: Asset Inventory (AI), CMDB Sync (SYN), VM, Continuous Monitoring (CM), Cloud Agent Platform (CAP), Threat Protection (TP), Security Configuration Assessment (SCA), Indication of Compromise (IOC), Policy Compliance (PC), PCI Compliance (PCI), Security Assessment Questionnaire (SAQ), File Integrity Monitoring (FIM), Web Application Scanning (WAS) and Web Application Firewall (WAF). Our VM solutions (including VM, AI, SYN, CM, TP, Cloud Agent for VM, allocated scanner revenue and Qualys Private Cloud Platform) have provided a substantial majority of our revenues to date, representing 74% of our revenues for the three months ended March 31, 2018.

We provide our solutions through a software-as-a-service model, primarily with renewable annual subscriptions. These subscriptions require customers to pay a fee in order to access our cloud solutions. We invoice our customers for the entire subscription amount at the start of the subscription term, and the invoiced amounts are treated as deferred revenues and are recognized ratably over the term of each subscription. We continue to experience significant revenue growth from existing customers as they renew and purchase additional subscriptions.

Our revenues increased to $64.9 million in the three months ended March 31, 2018 from $53.1 million for the comparable period in 2017, representing an increase of $11.8 million or 22%.

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Key Metric

In addition to measures of financial performance presented in our condensed consolidated financial statements, we monitor the key metric set forth below to help us evaluate growth trends, establish budgets, measure the effectiveness of our sales and marketing efforts and assess operational efficiencies.

	Three Months Ended March 31,	
	2018	2017
	(in thousands, except percentages)	
Adjusted EBITDA	$24,618	$16,808
Percentage of revenues	38 %	32 %

Adjusted EBITDA

We monitor Adjusted EBITDA, a non-GAAP financial measure, to analyze our financial results and believe that it is useful to investors, as a supplement to U.S. GAAP measures, in evaluating our ongoing operational performance and enhancing an overall understanding of our past financial performance. We believe that Adjusted EBITDA helps illustrate underlying trends in our business that could otherwise be masked by the effect of the income or expenses that we exclude in Adjusted EBITDA. Furthermore, we use this measure to establish budgets and operational goals for managing our business and evaluating our performance. We also believe that Adjusted EBITDA provides an additional tool for investors to use in comparing our recurring core business operating results over multiple periods with other companies in our industry.

Adjusted EBITDA should not be considered in isolation from, or as a substitute for, financial information prepared in accordance with U.S. GAAP. We calculate Adjusted EBITDA as net income before (1) other (income) expense, net, which includes interest income, interest expense and other income and expense, (2) provision for (benefit from) income taxes, (3) depreciation and amortization of property and equipment, (4) amortization of intangible assets, (5) stock-based compensation, (6) non-recurring expenses and (7) acquisition-related expenses that do not reflect ongoing costs of operating the business.

The following unaudited table presents the reconciliation of net income to Adjusted EBITDA for the three months ended March 31, 2018 and 2017:

	Three Months Ended March 31,	
	2018	2017
	(in thousands)	
Net income	$9,142	$21,930
Depreciation and amortization of property and equipment	6,410	4,727
Amortization of intangible assets	633	93
Interest expense	38	2
Provision for (benefit from) income taxes	509	(13,821)
EBITDA	16,732	12,931
Stock-based compensation	8,891	4,332

Other (income) expense, net	(1,283)	(455)
Acquisition-related expense[1]	278	—
Adjusted EBITDA	$24,618	$16,808

(1) Adjusted EBITDA for the three months ended March 31, 2018 excludes approximately $0.3 million of compensation expense from the acquisition of NetWatcher.

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Limitations of Adjusted EBITDA

Adjusted EBITDA, a non-GAAP financial measure, has limitations as an analytical tool, and should not be considered in isolation from or as a substitute for the measures presented in accordance with U.S. GAAP. Some of these limitations are:

- Adjusted EBITDA does not reflect certain cash and non-cash charges that are recurring;
- Adjusted EBITDA does not reflect income tax payments that reduce cash available to us;
- Adjusted EBITDA excludes depreciation and amortization of property and equipment and, although these are non-cash charges, the assets being depreciated and amortized may have to be replaced in the future; and
- Other companies, including companies in our industry, may calculate Adjusted EBITDA differently or not at all, which reduces its usefulness as a comparative measure.

Because of these limitations, Adjusted EBITDA should be considered alongside other financial performance measures, including revenues, net income, cash flows from operating activities and our financial results presented in accordance with U.S. GAAP.

Key Components of Results of Operations

Revenues

We derive revenues from the sale of subscriptions to our security and compliance solutions, which are delivered on our cloud platform. Subscriptions to our solutions allow customers to access our cloud-based security and compliance solutions through a unified, web-based interface. Customers generally enter into one year renewable subscriptions. The subscription fee entitles the customer to an unlimited number of scans for a specified number of devices or web applications and, if requested by a customer as part of their subscription, a specified number of physical or virtual scanner appliances. Our physical and virtual scanner appliances are requested by certain customers as part of their subscriptions in order to scan IT infrastructures within their firewalls and do not function without, and are not sold separately from, subscriptions for our solutions. In some limited cases, we also provide certain computer equipment used to extend our Qualys cloud platform into our customers' private cloud environment. Customers are required to return physical scanner appliances and computer equipment if they do not renew their subscriptions.

We typically invoice our customers for the entire subscription amount at the start of the subscription term. Invoiced amounts are reflected on our condensed consolidated balance sheets as accounts receivable or as cash when collected, and as deferred revenues until earned and recognized ratably over the subscription period. Accordingly, deferred revenues represent the amount billed to customers that has not yet been earned or recognized as revenues, pursuant to subscriptions entered into in current and prior periods.

Cost of Revenues

Cost of revenues consists primarily of personnel expenses, comprised of salaries, benefits, performance-based compensation and stock-based compensation, for employees who operate our data centers and provide support services to our customers. Other expenses include depreciation of data center equipment and physical scanner appliances and computer hardware provided to certain customers as part of their subscriptions, expenses related to the use of third-party data centers, amortization of third-party technology licensing fees, amortization of intangibles related to acquisitions, maintenance support, fees paid to contractors who supplement or support our operations center personnel and overhead allocations. We expect to continue to make capital investments to expand and support our data center operations, which will increase the cost of revenues in absolute dollars.

Operating Expenses

Research and Development

Research and development expenses consist primarily of personnel expenses, comprised of salaries, benefits, performance-based compensation and stock-based compensation, for our research and development teams. Other expenses include third-party contractor fees, amortization of intangibles related to acquisitions and overhead allocations. All research and development costs are expensed as incurred. We expect to continue to devote substantial resources to research and development in an effort to continuously improve our existing solutions as well as develop new solutions and capabilities and expect that research and development expenses will increase in absolute dollars.

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Sales and Marketing

Sales and marketing expenses consist primarily of personnel expenses, comprised of salaries, benefits, sales commissions, performance-based compensation and stock-based compensation for our worldwide sales and marketing teams. Other expenses include marketing and promotional events, lead-generation marketing programs, public relations, travel, software licenses and overhead allocations. All costs are expensed as incurred, including sales commissions. Sales commissions are expensed in the quarter in which the related order is received and are paid in the month subsequent to the end of that quarter, which results in increased expenses prior to the recognition of related revenues. Our new sales personnel are typically not immediately productive, and the resulting increase in sales and marketing expenses we incur when we add new personnel may not result in increased revenues if these new sales personnel fail to become productive. The timing of our hiring of sales personnel, or the participation in new marketing events or programs, and the rate at which these generate incremental revenues, may affect our future operating results. We expect to continue to significantly invest in additional sales personnel worldwide and also in more marketing programs to support new solutions on our platform, which will increase sales and marketing expenses in absolute dollars.

General and Administrative

General and administrative expenses consist primarily of personnel expenses, comprised of salaries, benefits, performance-based compensation and stock-based compensation, for our executive, finance and accounting, legal and human resources teams, as well as professional services, insurance, fees, and software licenses. We expect that general and administrative expenses will increase in absolute dollars, as we continue to add personnel and incur professional services to support our growth and compliance with legal requirements.

Other Income (Expense), Net

Our other income (expense), net consists primarily of interest and investment income from our short-term and long-term investments; foreign exchange gains and losses, the majority of which result from fluctuations between the U.S. dollar and the Euro, British Pound and Indian Rupee; losses on disposal of property and equipment; and impairment of long-lived assets.

Provision for Income Taxes

We are subject to federal, state and foreign income taxes for jurisdictions in which we operate, and we use estimates in determining our provision for these income taxes and deferred tax assets. Earnings from our non-U.S. activities are subject to income taxes in the local country which are generally higher than U.S. tax rates, and may be subject to U.S. income taxes.

Our tax provision from income taxes for interim periods is determined using an estimate of our annual effective tax rate, adjusted for discrete items, if any, that arise during the period. Each quarter, we update our estimate of the annual effective tax rate, and if the estimated annual effective tax rate changes, we make a cumulative adjustment in such period. Our estimated effective rate for the year differs from the U.S. statutory rate of 21% primarily due to non-deductible stock-based compensation expense, state taxes, foreign income subject to different tax rates than the U.S., and the benefit of U.S. federal income tax credits.

On December 22, 2017, the Tax Cuts and Jobs Act (the “2017 Tax Act”) was enacted into law. The new legislation contains significant tax provisions that affect us, including a one-time repatriation tax on accumulated foreign earnings, a reduction of the corporate income tax rate from 35% to 21%, which was effective January 1, 2018, and a change from a worldwide tax system to a modified territorial system.

In accordance with Staff Accounting Bulletin No. 118 ("SAB 118"), the effects of the 2017 Tax Act may be adjusted within a one-year measurement period from the enactment date of the 2017 Tax Act for items that were previously reported as provisional estimates, or where a provisional estimate could not be made. The income tax provision for the three months ended March 31, 2018, does not reflect any adjustment to the provisional estimates recorded in the year ended December 31, 2017. We will continue to assess forthcoming guidance and accounting interpretations on the effects of the 2017 Tax Act and expect to complete our analysis within the measurement period in accordance with the SEC guidance. Such analysis includes both the implications of the newly introduced provisions for Global Intangible

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Low Tax Income and the detailed analysis of historical foreign earnings and potential correlative adjustments to verify the one-time transition tax does not apply.

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the tax impact of timing differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carry-forwards. Deferred tax assets and liabilities are measured using statutory tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period when the statutory rate change is enacted into law.

We assess the likelihood that deferred tax assets will be realized, and we recognize a valuation allowance if it is more likely than not that some portion of the deferred tax assets will not be recognized. This assessment requires judgment as to the likelihood and amounts of future taxable income.

Sales Taxes

We present our revenues net of sales tax in our condensed consolidated statements of operations.

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Results of Operations

The following tables set forth selected condensed consolidated statements of operations data for each of the periods presented.

	Three Months Ended March 31,	
	2018	2017
	(in thousands)	
Condensed Consolidated Statements of Operations data:		
Revenues	$64,878	$53,121
Cost of revenues [1]	15,901	12,294
Gross profit	48,977	40,827
Operating expenses:		
Research and development [1]	12,553	9,823
Sales and marketing [1]	16,233	16,014
General and administrative [1]	11,785	7,334
Total operating expenses	40,571	33,171
Income from operations	8,406	7,656
Other income (expense), net	1,245	453
Income before income taxes	9,651	8,109
Provision for (benefit from) income taxes	509	(13,821)
Net income	$9,142	$21,930

(1) Includes stock-based compensation as follows:

	Three Months Ended March 31,	
	2018	2017
	(in thousands)	
Cost of revenues	$654	$501
Research and development	1,841	1,221
Sales and marketing	1,401	1,084
General and administrative	4,995	1,526
Total stock-based compensation	$8,891	$4,332

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The following table sets forth selected condensed consolidated statements of operations data for each of the periods presented as a percentage of revenues.

	Three Months Ended March 31,	
	2018	2017
Revenues	100 %	100 %
Cost of revenues	25	23
Gross profit	75	77
Operating expenses:		
Research and development	19	19
Sales and marketing	25	30
General and administrative	18	14
Total operating expenses	62	63
Income from operations	13	14
Other income (expense), net	2	1
Income before income taxes	15	15
Provision for (benefit from) income taxes	1	(26)
Net income	14 %	41 %

Comparison of Three Months Ended March 31, 2018 and 2017

Revenues

	Three Months Ended March 31,		Change	
	2018	2017	$	%
	(in thousands, except percentages)			
Revenues	$64,878	$53,121	$11,757	22%

Revenues increased $11.8 million for the three months ended March 31, 2018 compared to the three months ended March 31, 2017, due to an increase in the purchase of subscriptions from existing customers and new customer subscriptions entered into after March 31, 2017. Of the total increase of $11.8 million, $6.9 million was from customers in the United States and the remaining $4.9 million was from customers in foreign countries. We expect revenue growth from existing and new customers to continue. The growth in revenues reflects the continued demand for our solutions. There was no impact to our revenues as a result of adopting Accounting Standards Codification ("ASC") 606. See Note 4, “Revenue from Contracts with Customers”, to the unaudited condensed consolidated financial statements in Part I, Item 1 of this Quarterly Report on Form 10-Q for additional information.

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Cost of Revenues

	Three Months Ended March 31,		Change	
	2018	2017	$	%
	(in thousands, except percentages)			
Cost of revenues	$15,901	$12,294	$3,607	29%
Percentage of revenues	25 %	23 %		
Gross profit percentage	75 %	77 %		

Cost of revenues increased $3.6 million for the three months ended March 31, 2018 compared to the three months ended March 31, 2017, primarily due to an increase in personnel expenses of $1.6 million, driven by the increase in the number of employees to support the continued growth of our business; a $0.7 million increase in depreciation expense related to additional computer hardware and software; a $0.6 million increase in amortization expense related to acquired technology resulting from our business acquisitions; increased third-party software license and maintenance expense of $0.4 million; and increased data center costs of $0.3 million as our business continues to grow.

Research and Development Expenses

	Three Months Ended March 31,		Change	
	2018	2017	$	%
	(in thousands, except percentages)			
Research and development	$12,553	$9,823	$2,730	28%
Percentage of revenues	19 %	19 %		

Research and development expenses increased $2.7 million for the three months ended March 31, 2018 compared to the three months ended March 31, 2017, primarily due to an increase in personnel expenses of $2.1 million, driven by additional employees hired to support the growth of our business; increased related facilities costs and expenses of $0.4 million to support our research and development activities; and increased third-party software license and maintenance expense of $0.1 million as our business continues to grow. We continue to significantly invest in and expand our research and development teams to continuously improve our platform and existing solutions, as well as develop new solutions and capabilities.

Sales and Marketing Expenses

	Three Months Ended March 31,		Change	
	2018	2017	$	%
	(in thousands, except percentages)			
Sales and marketing	$16,233	$16,014	$219	1%
Percentage of revenues	25 %	30 %		

Sales and marketing expenses increased $0.2 million for the three months ended March 31, 2018 compared to the three months ended March 31, 2017, primarily due to an increase in headcount expense of $1.1 million driven by additional employees hired to support the growth of our business; increased third-party software license and maintenance expense of $0.7 million; and increased depreciation related to computer software of $0.4 million. These increases were partially offset by a decrease in tradeshow expenses of $1.1 million as well as a decrease of

commission expense of $0.8 million resulting from the adoption of ASC 606, resulting in us capitalizing commissions on new business and upsells in the three months ended March 31, 2018 versus expensing all commissions in the three months ended March 31, 2017.

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General and Administrative Expenses

	Three Months Ended March 31,		Change	
	2018	2017	$	%
	(in thousands, except percentages)			
General and administrative	$11,785	$7,334	$4,451	61%
Percentage of revenues	18%	14%		

General and administrative expenses increased $4.5 million for the three months ended March 31, 2018 compared to the three months ended March 31, 2017, primarily driven by higher stock-based compensation of $3.5 million; increased consulting and outside services fees of $0.5 million; and increased third-party software license and maintenance expense of $0.4 million to support the growth of our business.

Total Other Income (Expense), Net

	Three Months Ended March 31,		Change	
	2018	2017	$	%
	(in thousands, except percentages)			
Total other income (expense), net	$1,245	$453	$792	175%
Percentage of revenues	2%	1%		

Total other income (expense), net increased by $0.8 million for the three months ended March 31, 2018 compared to the three months ended March 31, 2017, primarily due to an increase in interest income as our cash and investment balances increased year over year.

Income Taxes

	Three Months Ended March 31,		Change	
	2018	2017	$	%
	(in thousands, except percentages)			
Provision for (benefit from) income taxes	$509	$(13,821)	$14,330	(104)%
Effective Tax Rate	5.3%	(170.4)%		

We recorded an income tax provision of $0.5 million and income tax benefit of $13.8 million for the three months ended March 31, 2018 and 2017, respectively. The increase in income tax provision for the three months ended March 31, 2018 is primarily due to a reduction in the amount of excess benefits of stock-based compensation realized during the quarter, a year-over-year increase in income before taxes and non-deductible stock-based compensation as a result of changes in the tax law for executive compensation.

Liquidity and Capital Resources

At March 31, 2018, our principal source of liquidity was cash, cash equivalents, and short-term and long-term investments of $393.9 million, including $7.8 million held outside of the United States by our foreign subsidiaries. We do not anticipate that we will need funds generated from foreign operations to fund our domestic operations. However, if we repatriate these funds, we could be subject to foreign withholding taxes.

We have experienced positive cash flows from operations during the three months ended March 31, 2018 and 2017. We believe our existing cash, cash equivalents, short-term and long-term investments, and cash from operations will be sufficient to fund our operations for at least the next twelve months. Our future capital requirements will depend

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on many factors, including our rate of revenue growth, the expansion of our sales and marketing activities, the timing, type and extent of our spending on research and development efforts, international expansion and investment in data centers. We may also seek to invest in or acquire complementary businesses or technologies.

Cash Flows

The following summary of cash flows for the periods indicated has been derived from our condensed consolidated financial statements included elsewhere in this report:

	Three Months Ended March 31,	
	2018	2017
	(in thousands)	
Cash provided by operating activities	$42,989	$32,425
Cash used in investing activities	(38,081)	(1,006)
Cash provided by (used in) financing activities	1,675	(8,505)
Net increase in cash and cash equivalents	$6,583	$22,914

Cash Flows from Operating Activities

For the three months ended March 31, 2018, cash flows from operating activities of $43.0 million primarily resulted from our net income of approximately $9.1 million, as adjusted for non-cash items including stock-based compensation of $8.9 million and depreciation and amortization expense of $7.0 million; and a decrease in our accounts receivable of $14.5 million due to the timing of customer payments.

In the three months ended March 31, 2017, cash flows from operating activities of $32.4 million primarily resulted from our net income of approximately $21.9 million, as adjusted by an increase in deferred revenues of $8.0 million attributable to our continued growth, and a decrease in our accounts receivable of $5.4 million. These working capital increases were further increased by non-cash items including excess tax benefits included in deferred tax assets of $8.4 million, depreciation and amortization expense of $4.8 million and stock-based compensation of $4.3 million. These increases were partially offset by additions to deferred income tax assets of $22.6 million.

Cash Flows from Investing Activities

For the three months ended March 31, 2018, cash used in investing activities of $38.1 million was attributable to purchases of investments, net of sales and maturities of $32.1 million, and $6.0 million of cash used for capital expenditures, including computer hardware and software for our data centers to support our growth and development, and to purchase physical scanner appliances and computer hardware provided to certain customers as part of their subscriptions.

In the three months ended March 31, 2017, cash used in investing activities of $1.0 million was attributable to $4.5 million of cash used for capital expenditures, including computer hardware and software for our data centers to support our growth and development. This increase was partially offset by sales and maturities of investments, net of purchases of $3.5 million.

Cash Flows from Financing Activities

For the three months ended March 31, 2018, cash provided by financing activities of $1.7 million was attributable to $7.9 million of proceeds from the exercise of stock options, offset by employee payroll taxes paid related to net share settlement of equity awards of $4.0 million, share repurchases of $1.5 million and principal payments under capital lease obligations of $0.7 million.

In the three months ended March 31, 2017, cash used in financing activities of $8.5 million was attributable to payments for taxes related to employee net share settlement of equity awards of $14.1 million, offset by the proceeds from the exercise of stock options of $5.6 million.

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Contractual Obligations

Our principal commitments consist of obligations under our outstanding leases for office space, third-party data centers, office equipment and capital leases. The following table summarizes our contractual cash obligations, including future interest payments, at March 31, 2018 and the effect such obligations are expected to have on our liquidity and cash flows in future periods:

	Payment Due by Period				
Contractual Obligations	Total	2018 (remaining nine months)	2019-2020	2021-2022	2023 and thereafter
	(in thousands)				
Operating lease obligations	$48,907	$ 6,912	$ 11,193	$ 8,802	$ 22,000
Capital lease obligations	2,894	940	1,900	54	—
Total	$51,801	$ 7,852	$ 13,093	$ 8,856	$ 22,000

On October 14, 2016, we entered into a lease agreement (included in the table above) for our new headquarters office facility. The lease payments commenced on May 1, 2018 and the lease has a ten-year term through April 2028. The total commitment of $38.6 million is payable monthly with escalating rental payments throughout the lease term. In connection with this lease, we have provided the landlord with a $1.2 million standby letter of credit to secure our obligations through the end of the lease term, which was classified as restricted cash in the accompanying condensed consolidated balance sheets.

Operating lease obligations represent our obligations to make payments under the lease agreements for our facilities, data centers, and office equipment leases. During the three months ended March 31, 2018, we made regular payments on our operating lease obligations of $1.0 million.

Capital lease obligations represent financing on data center storage equipment. During the three months ended March 31, 2018, we made regular principal payments on our capital lease obligations of $0.7 million.

Off-Balance Sheet Arrangements

During the periods presented, we did not have, nor do we currently have, any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities.

Recent Accounting Pronouncements

See Note 1 to the unaudited condensed consolidated financial statements in Part I, Item 1 of this Quarterly Report on Form 10-Q for a discussion of recent accounting pronouncements.

Critical Accounting Policies and Estimates

Our condensed consolidated financial statements are prepared in accordance with U.S. GAAP. The preparation of these financial statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, expenses and related disclosures. On an ongoing basis, we evaluate our estimates and assumptions. Our actual results may differ from these estimates under different assumptions or conditions.

We believe that of our significant accounting policies, which are described in the notes to our consolidated financial statements in our Annual Report on Form 10-K for the fiscal year ended December 31, 2017, filed with the SEC on February 23, 2018, the accounting policies related to revenue recognition, income taxes and stock-based compensation involve the greatest degree of judgment and complexity and have the greatest potential impact on our consolidated financial statements. A critical accounting policy is one that is material to the presentation of our consolidated financial statements and requires us to make difficult, subjective or complex judgments for uncertain matters that could have a material effect on our financial condition and results of operations. Accordingly, these are the policies we believe are the most critical to aid in fully understanding and evaluating our financial condition and results of operations. Except for the changes below, there have been no material changes to our critical accounting policies and estimates as compared to the critical accounting policies and estimates as described in our Annual Report on Form 10-K for the fiscal year ended December 31, 2017, filed with the SEC on February 23, 2018.

We adopted ASC 606 Revenue from Contracts with Customers with a date of initial application of January 1, 2018. We adopted ASC 606 using the modified retrospective method and recognized the cumulative effect as an adjustment to the opening balance of equity at January 1, 2018. Therefore, the comparative information has not been adjusted and continues to be reported under ASC 605. The significant impact of adopting ASC 606 was related to the deferral of sales commission costs for new business and when customers increase their renewal orders (“upsells”). We previously expensed sales commission as incurred. Under ASC 606, sales commissions cost related to new business and upsells are recorded as an asset. We expense the commission cost as a selling expense on a straight-line basis over a period of five years. Five years represents the estimated life of the customer relationship taking into account factors such as peer estimates of technology lives and customer lives as well as our own historical data. Applying the practical expedient in ASC 340-40-25-4, we expense commissions related to contract renewals with a renewal contract term of one year or less. The current and noncurrent portions of deferred commissions are included in prepaid expenses and other current assets, and other noncurrent assets, respectively, in our condensed consolidated balance sheets.

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Item 3. Quantitative and Qualitative Disclosures about Market Risk

We have domestic and international operations and we are exposed to market risks in the ordinary course of our business. These risks primarily include interest rate, foreign exchange and inflation risks, as well as risks relating to changes in the general economic conditions in the countries where we conduct business. To reduce certain of these risks, we monitor the financial condition of our large customers and limit credit exposure by collecting subscription fees in advance.

Foreign Currency Risk

Our results of operations and cash flows have been and will continue to be subject to fluctuations because of changes in foreign currency exchange rates, particularly changes in exchange rates between the U.S. dollar and the Euro, British Pound, and Indian Rupee, the currencies of countries where we currently have our most significant international operations. A portion of our invoicing is denominated in the Euro, British Pound and Japanese Yen. Our expenses in international locations are generally denominated in the currencies of the countries in which our operations are located.

Derivative financial instruments are utilized by the Company to reduce foreign currency exchange risks. We use foreign currency forward contracts to partially mitigate the impact of fluctuations in cash and accounts receivable balances denominated in Euros and British Pounds. We do not use these contracts for speculative or trading purposes, nor are they designated as hedges. These contracts typically have a maturity of one month, and we record gains and losses from these instruments in other income (expense), net. The effect of an immediate 10% adverse change in foreign exchange rates would not be material to our financial condition, operating results or cash flows.

Interest Rate Sensitivity

We have $393.9 million in cash, cash equivalents and short-term and long-term investments at March 31, 2018. Cash and cash equivalents include cash held in banks, highly liquid money market funds, U.S. government agency securities, and commercial paper. Investments consist of fixed-income U.S. government agency securities, corporate bonds, asset-backed securities and commercial paper. We determine the appropriate balance sheet classification of our investments at the time of purchase and reevaluate such designation at each balance sheet date. We classify our investments as either short-term or long-term based on each instrument's underlying contractual maturity date.

The primary objectives of our investment activities are the preservation of principal and support of our liquidity requirements. We do not enter into investments for trading or speculative purposes. Our investments are subject to market risk due to changes in interest rates, which may affect the interest income we earn and the fair market value. We do not believe that a 10% increase or decrease in interest rates would have a material impact on our operating results or cash flows.

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Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and our Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of March 31, 2018. The term “disclosure controls and procedures,” as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission’s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company’s management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on the evaluation of our disclosure controls and procedures as of March 31, 2018, our Chief Executive Officer and Chief Financial Officer concluded that, as of such date, our disclosure controls and procedures were effective at the reasonable assurance level.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting identified in connection with the evaluation required by Rule 13a-15(d) and 15d-15(d) of the Exchange Act that occurred during the period covered by this report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. We implemented internal controls to ensure we adequately evaluated our contracts and properly assessed the impact of the new accounting standard related to revenue recognition on our financial statements. There were no significant changes to our internal control over financial reporting due to the adoption of the new standard.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings

From time to time we may become involved in legal proceedings or be subject to claims arising in the ordinary course of our business. We are not presently a party to any legal proceedings that, if determined adversely to us, would individually or taken together have a material adverse effect on our business, operating results, financial condition or cash flows. Regardless of the outcome, litigation can have an adverse impact on us because of defense and settlement costs, diversion of management resources and other factors.

Item 1A. Risk Factors

An investment in our common stock involves a high degree of risk. You should carefully consider the risks and uncertainties described below, and all other information contained in this Quarterly Report on Form 10-Q, including our condensed consolidated financial statements and the related notes, before making a decision to invest in our common stock. Our business, operating results, financial condition, or prospects could be materially and adversely affected by any of these risks and uncertainties. In that case, the trading price of our common stock could decline, and you might lose all or part of your investment. In addition, the risks and uncertainties discussed below are not the only ones we face. Our business, operating results, financial performance or prospects could also be harmed by risks and uncertainties not currently known to us or that we currently do not believe are material.

Subscriptions to our Vulnerability Management solutions generate most of our revenues, and if we are unable to continue to renew and grow subscriptions for these solutions, our operating results would suffer.

We derived approximately 74% of our revenues from subscriptions to our VM solutions for the three months ended March 31, 2018.

We expect to continue to derive a significant majority of our revenues from subscriptions to our VM solutions. As a result, the market demand for our VM solutions is critical to our continued success. Demand for these solutions is affected by a number of factors beyond our control, including continued market acceptance of our solution for existing and new use cases, the timing of development and release of new products or services by our competitors, technological change, and growth or contraction in our market. Our inability to renew or increase subscriptions for this solution or a decline in price of this solution would harm our business and operating results more seriously than if we derived significant revenues from a variety of solutions.

Our quarterly operating results may vary from period to period, which could result in our failure to meet expectations with respect to operating results and cause the trading price of our stock to decline.

Our operating results have historically varied from period to period, and we expect that they will continue to do so as a result of a number of factors, many of which are outside of our control, including:

- the level of demand for our solutions;
- publicity regarding security breaches generally and the level of perceived threats to IT security;
- expenses associated with our existing and new products and services;
- changes in customer renewals of our solutions;
- the extent to which customers subscribe for additional solutions;
- seasonal buying patterns of our customers;
- security breaches, technical difficulties or interruptions with our service;
- changes in the growth rate of the IT security and compliance market;
-

the timing and success of new product or service introductions by us or our competitors or any other changes in the competitive landscape of our industry, including consolidation among our competitors;

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- the introduction or adoption of new technologies that compete with our solutions;
- decisions by potential customers to purchase IT security and compliance products or services from other vendors;
- the amount and timing of operating costs and capital expenditures related to the operations and expansion of our business;
- the timing of sales commissions relative to the recognition of revenues;
- the announcement or adoption of new regulations and policy mandates or changes to existing regulations and policy mandates;
- failure of our products and services to operate as designed;
- price competition;
- the length of our sales cycle for our products and services;
- insolvency or credit difficulties confronting our customers, affecting their ability to purchase or pay for our solutions;
- timely invoicing or changes in billing terms of customers;
- timing of deals signed within the quarter;
- pace and cost of hiring employees;
- changes in foreign currency exchange rates;
- general economic conditions, both domestically and in the foreign markets in which we sell our solutions;
- future accounting pronouncements or changes in our accounting policies;
- our ability to integrate any products or services that we may acquire in the future into our product suite or migrate existing customers of any companies that we may acquire in the future to our products and services;
- our effective tax rate;
- the amount and timing of income tax credits that we recognize resulting from excess tax benefits related to stock-based compensation;
- the timing of expenses related to the development or acquisition of technologies, services or businesses; and
- potential goodwill and intangible asset impairment charges associated with acquired businesses.

Each factor above or discussed elsewhere in this Quarterly Report on Form 10-Q or the cumulative effect of some of these factors may result in fluctuations in our operating results. This variability and unpredictability could result in our failure to meet expectations with respect to operating results, or those of securities analysts or investors, for a particular period. In addition, a significant percentage of our operating expenses are fixed in nature and based on forecasted trends in revenues. Accordingly, in the event of shortfalls in revenues, we are generally unable to mitigate the negative impact on margins in the short term by reducing our operating expenses. If we fail to meet or exceed expectations for our operating results for these or any other reasons, the trading price of our common stock could fall and we could face costly lawsuits, including securities class action suits.

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If the market for cloud solutions for IT security and compliance does not evolve as we anticipate, our revenues may not grow and our operating results would be harmed.

Our success depends to a significant extent on the willingness of organizations to increase their use of cloud solutions for their IT security and compliance. However, the market for cloud solutions for IT security and compliance is at an early stage relative to on-premise solutions, and as such, it is difficult to predict important market trends, including the potential growth, if any, of the market for cloud security and compliance solutions. To date, some organizations have been reluctant to use cloud solutions because they have concerns regarding the risks associated with the reliability or security of the technology delivery model associated with these solutions. If other cloud service providers experience security incidents, loss of customer data, disruptions in service delivery or other problems, the market for cloud solutions as a whole, including our solutions, may be negatively impacted. Moreover, many organizations have invested substantial personnel and financial resources to integrate on-premise software into their businesses, and as a result may be reluctant or unwilling to migrate to a cloud solution. Organizations that use on-premise security products, such as network firewalls, security information and event management products or data loss prevention solutions, may also believe that these products sufficiently protect their IT infrastructure and deliver adequate security. Therefore, they may continue spending their IT security budgets on these products and may not adopt our security and compliance solutions in addition to or as a replacement for such products.

If the market for cloud solutions for IT security and compliance does not evolve in the way we anticipate or if customers do not recognize the benefits of our cloud solutions over traditional on-premise enterprise software products, and as a result we are unable to increase sales of subscriptions to our solutions, then our revenues may not grow or may decline, and our operating results would be harmed.

If we do not successfully anticipate market needs and opportunities or are unable to enhance our solutions and develop new solutions that meet those needs and opportunities on a timely or cost-effective basis, we may not be able to compete effectively and our business and financial condition may be harmed.

The IT security and compliance market is characterized by rapid technological advances, customer price sensitivity, short product and service life cycles, intense competition, changes in customer requirements, frequent new product introductions and enhancements and evolving industry standards and regulatory mandates. Any of these factors could create downward pressure on pricing and gross margins, and could adversely affect our renewal rates, as well as our ability to attract new customers. Our future success will depend on our ability to enhance existing solutions, introduce new solutions on a timely and cost-effective basis, meet changing customer needs, extend our core technology into new applications, and anticipate and respond to emerging standards and business models. We must also continually change and improve our solutions in response to changes in operating systems, application software, computer and communications hardware, networking software, data center architectures, programming tools and computer language technology.

We may not be able to anticipate future market needs and opportunities or develop enhancements or new solutions to meet such needs or opportunities in a timely manner or at all. The market for cloud solutions for IT security and compliance is relatively new, and it is uncertain whether our new solutions will gain market acceptance.

Our solution enhancements or new solutions could fail to attain sufficient market acceptance for many reasons, including:

- failure to timely meet market demand for product functionality;
- inability to identify and provide intelligence regarding the attacks or techniques used by cyber-attackers;
- inability to inter-operate effectively with the database technologies, file systems or web applications of our prospective customers;

- defects, errors or failures;
- delays in releasing our enhancements or new solutions;
- negative publicity about their performance or effectiveness;
- introduction or anticipated introduction of products by our competitors;
- poor business conditions, causing customers to delay IT security and compliance purchases;

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- easing or changing of external regulations related to IT security and compliance; and
- reluctance of customers to purchase cloud solutions for IT security and compliance.

Furthermore, diversifying our solutions and expanding into new IT security and compliance markets will require significant investment and planning, require that our research and development and sales and marketing organizations develop expertise in these new markets, bring us more directly into competition with security and compliance providers that may be better established or have greater resources than we do, require additional investment of time and resources in the development and training of our channel partners and entail significant risk of failure.

If we fail to anticipate market requirements or fail to develop and introduce solution enhancements or new solutions to satisfy those requirements in a timely manner, such failure could substantially decrease or delay market acceptance and sales of our present and future solutions and cause us to lose existing customers or fail to gain new customers, which would significantly harm our business, financial condition and results of operations.

If we fail to continue to effectively scale and adapt our platform to meet the performance and other requirements of our customers, our operating results and our business would be harmed.

Our future growth depends upon our ability to continue to meet the expanding needs of our customers as their use of our cloud platform grows. As these customers gain more experience with our solutions, the number of users and the number of locations where our solutions are being accessed may expand rapidly in the future. In order to ensure that we meet the performance and other requirements of our customers, we intend to continue to make significant investments to develop and implement new proprietary and third-party technologies at all levels of our cloud platform. These technologies, which include databases, applications and server optimizations, and network and hosting strategies, are often complex, new and unproven. We may not be successful in developing or implementing these technologies. To the extent that we do not effectively scale our platform to maintain performance as our customers expand their use of our platform, our operating results and our business may be harmed.

Our current research and development efforts may not produce successful products or enhancements to our platform that result in significant revenue, cost savings or other benefits in the near future, if at all.

We must continue to dedicate significant financial and other resources to our research and development efforts if we are to maintain our competitive position. However, developing products and enhancements to our platform is expensive and time consuming, and there is no assurance that such activities will result in significant new marketable products or enhancements to our platform, design improvements, cost savings, revenue or other expected benefits. If we spend significant resources on research and development and are unable to generate an adequate return on our investment, our business and results of operations may be materially and adversely affected.

Our platform, website and internal systems may be subject to intentional disruption or other security incidents that could result in liability and adversely impact our reputation and future sales.

We and our service providers could be a target of cyber-attacks or other malfeasance designed to impede the performance of our solutions, penetrate our network security or the security of our cloud platform or our internal systems, misappropriate proprietary information and/or cause interruptions to our services. Our solutions, platforms, and system may also suffer security incidents as a result of non-technical issues, including intentional or inadvertent breaches by our employees or service providers. Because our operations involve providing IT security solutions to our customers, we may be targeted for cyber-attacks and other security incidents. If an actual or perceived breach of our security measures or those of our service providers occurs, it could adversely affect the market perception of our solutions, negatively affecting our reputation, and may expose us to the loss of information, litigation, regulatory actions and possible liability. Any such actual or perceived security breach could also divert the efforts of our

technical and management personnel. In addition, any such actual or perceived security breach could impair our ability to operate our business and provide solutions to our customers. If this happens, our reputation could be harmed, our revenues could decline and our business could suffer.

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Our business depends substantially on retaining our current customers, and any reduction in our customer renewals or revenues from such customers could harm our future operating results.

We offer our Qualys cloud platform and integrated suite of solutions pursuant to a software-as-a-service model, and our customers purchase subscriptions from us that are generally one year in length. Our customers have no obligation to renew their subscriptions after their subscription period expires, and they may not renew their subscriptions at the same or higher levels or at all. As a result, our ability to grow depends in part on customers renewing their existing subscriptions and purchasing additional subscriptions and solutions. Our customers may choose not to renew their subscriptions to our solutions or purchase additional solutions due to a number of factors, including their satisfaction or dissatisfaction with our solutions, the prices of our solutions, the prices of products or services offered by our competitors, reductions in our customers' spending levels due to the macroeconomic environment or other factors. If our customers do not renew their subscriptions to our solutions, renew on less favorable terms, or do not purchase additional solutions or subscriptions, our revenues may grow more slowly than expected or decline and our results of operations may be harmed.

If we are unable to continue to attract new customers and grow our customer base, our growth could be slower than we expect and our business may be harmed.

We believe that our future growth depends in part upon increasing our customer base. Our ability to achieve significant growth in revenues in the future will depend, in large part, upon continually attracting new customers and obtaining subscription renewals to our solutions from those customers. If we fail to attract new customers our revenues may grow more slowly than expected and our business may be harmed.

If we are unable to sell subscriptions to additional solutions, our future revenue growth may be harmed and our business may suffer.

We will need to increase the revenues that we derive from our current and future solutions other than VM for our business and revenues to grow as we expect. Revenues from our other solutions such as Policy Compliance, PCI Compliance, Security Assessment Questionnaire, Web Application Scanning, and Web Application Firewall have been relatively modest compared to revenues from our VM solutions. Our future success depends in part on our ability to sell subscriptions to these additional solutions to existing and new customers. This may require more costly sales and marketing efforts and may not result in additional sales. If our efforts to sell subscriptions to additional solutions to existing and new customers are not successful, our business may suffer.

Our sales cycle can be long and unpredictable, and our sales efforts require considerable time and expense. As a result, revenues may vary from period to period, which may cause our operating results to fluctuate and could harm our business.

The timing of sales of subscriptions for our solutions can be difficult to forecast because of the length and unpredictability of our sales cycle, particularly with large transactions. We sell subscriptions to our security and compliance solutions primarily to IT departments that are managing a growing set of user and compliance demands, which has increased the complexity of customer requirements to be met and confirmed during the sales cycle and prolonged our sales cycle. Further, the length of time that potential customers devote to their testing and evaluation, contract negotiation and budgeting processes varies significantly, which has also made our sales cycle long and unpredictable. The length of the sales cycle for our solutions typically ranges from six to twelve months but can be more than eighteen months. In addition, we might devote substantial time and effort to a particular unsuccessful sales effort, and as a result we could lose other sales opportunities or incur expenses that are not offset by an increase in revenues, which could harm our business.

Adverse economic conditions or reduced IT spending may adversely impact our business.

Our business depends on the overall demand for IT and on the economic health of our current and prospective customers. Economic weakness, customer financial difficulties, and constrained spending on IT security may result in decreased revenue and earnings. Such factors could make it difficult to accurately forecast our sales and operating results and could negatively affect our ability to provide accurate forecasts to our contract manufacturers. In addition, continued governmental budgetary challenges in the United States and Europe and geopolitical turmoil in many parts of the world have and may continue to put pressure on global economic conditions and overall spending on IT security. General economic weakness may also lead to longer collection cycles for payments due from our customers, an increase in customer bad debt, restructuring initiatives and associated expenses, and impairment of

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investments. Furthermore, the continued weakness and uncertainty in worldwide credit markets, including the sovereign debt situation in certain countries in the European Union, may adversely impact our customers' available budgetary spending, which could lead to delays in planned purchases of our solutions.

Uncertainty about future economic conditions also makes it difficult to forecast operating results and to make decisions about future investments. Future or continued economic weakness for us or our customers, failure of our customers and markets to recover from such weakness, customer financial difficulties, and reductions in spending on IT security could have a material adverse effect on demand for our platform and consequently on our business, financial condition and results of operations.

Our security and compliance solutions are delivered from five data centers, and any disruption of service at these facilities would interrupt or delay our ability to deliver our solutions to our customers which could reduce our revenues and harm our operating results.

We currently host substantially all of our solutions from third-party data centers located in the United States, Switzerland, the Netherlands and India. These facilities are vulnerable to damage or interruption from earthquakes, hurricanes, floods, fires, cybersecurity attacks, terrorist attacks, employee negligence, power losses, telecommunications failures and similar events. The facilities also could be subject to break-ins, sabotage, intentional acts of vandalism and other misconduct. The occurrence of a natural disaster, an act of terrorism or misconduct, a decision to close the facilities without adequate notice or other unanticipated problems could result in interruptions in our services.

Some of our data centers are not currently redundant and we may not be able to rapidly move our customers from one data center to another, which may increase delays in the restoration of our service for our customers if an adverse event occurs. We have added data center facilities to provide additional capacity for our cloud platform and to enable disaster recovery. We continue to build out these facilities; however, these additional facilities may not be operational in the anticipated time-frame and we may incur unplanned expenses.

Additionally, our existing data center facilities providers have no obligations to renew their agreements with us on commercially reasonable terms, or at all. If we are unable to renew our agreements with the facilities providers on commercially reasonable terms or if in the future we add additional data center facility providers, we may experience costs or downtime in connection with the loss of an existing facility or the transfer to, or addition of, new data center facilities.

Any disruptions or other performance problems with our solutions could harm our reputation and business and may damage our customers’ businesses. Interruptions in our service delivery might reduce our revenues, cause us to issue credits to customers, subject us to potential liability and cause customers to terminate their subscriptions or not renew their subscriptions.

If we are unable to increase market awareness of our company and our new solutions, our revenues may not continue to grow, or may decline.

We have a limited operating history, particularly in certain markets and solution offerings, and we believe that we need to continue to develop market awareness in the IT security and compliance market. Market awareness of our capabilities and solutions is essential to our continued growth and success in all of our markets, particularly for the large enterprise, service provider and government markets. If our marketing programs are not successful in creating market awareness of our company and our full suite of solutions, our business, financial condition and results of operations may be adversely affected, and we may not be able to achieve our expected growth.

We face competition in our markets, and we may lack sufficient financial or other resources to maintain or improve our competitive position.

We compete with a large range of established and emerging vulnerability management vendors, compliance vendors and data security vendors in a highly fragmented and competitive environment. We face significant competition for each of our solutions from companies with broad product suites and greater name recognition and resources than we have, as well as from small companies focused on specialized security solutions.

We compete with large and small public companies, such as FireEye, Inc., Imperva, Inc., International Business Machines Corporation, Micro Focus International plc, Rapid7, Inc. and Symantec Corporation, as well as privately

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held security providers including Barracuda Networks Inc., BeyondTrust Software, Inc., Carbon Black, Inc., CrowdStrike Inc., Tanium Inc., Tenable Network Security, Inc., Tripwire, Inc. and Trustwave Holdings, Inc. We also seek to replace IT security and compliance solutions that organizations have developed internally. As we continue to extend our cloud platform's functionality by further developing security and compliance solutions, such as web application scanning and firewalls, we expect to face additional competition in these new markets. Our competitors may also attempt to further expand their presence in the IT security and compliance market and compete more directly against one or more of our solutions.

We believe that the principal competitive factors affecting our markets include product functionality, breadth of offerings, flexibility of delivery models, ease of deployment and use, total cost of ownership, scalability and performance, customer support and extensibility of platform. Many of our existing and potential competitors have competitive advantages, including:

- greater brand name recognition;
- larger sales and marketing budgets and resources;
- broader distribution networks and more established relationships with distributors and customers;
- access to larger customer bases;
- greater customer support resources;
- greater resources to make acquisitions;
- greater resources to develop and introduce products that compete with our solutions;
- greater resources to meet relevant regulatory requirements; and
- substantially greater financial, technical and other resources.

As a result, our competitors may be able to respond more quickly and effectively than we can to new or changing opportunities, technologies, standards or customer requirements. With the introduction of new technologies, the evolution of our service and new market entrants, we expect competition to intensify in the future.

In addition, some of our larger competitors have substantially broader product offerings and can bundle competing products and services with other software offerings. As a result, customers may choose a bundled product offering from our competitors, even if individual products have more limited functionality than our solutions. These competitors may also offer their products at a lower price as part of this larger sale, which could increase pricing pressure on our solutions and cause the average sales price for our solutions to decline. These larger competitors are also often in a better position to withstand any significant reduction in capital spending, and will therefore not be as susceptible to economic downturns.

Furthermore, our current and potential competitors may establish cooperative relationships among themselves or with third parties that may further enhance their resources and product and services offerings in the markets we address. In addition, current or potential competitors may be acquired by third parties with greater available resources. As a result of such relationships and acquisitions, our current or potential competitors might be able to adapt more quickly to new technologies and customer needs, devote greater resources to the promotion or sale of their products and services, initiate or withstand substantial price competition, take advantage of other opportunities more readily or develop and expand their product and service offerings more quickly than we do. For all of these reasons, we may not be able to compete successfully against our current or future competitors.

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If our solutions fail to help our customers achieve and maintain compliance with regulations and industry standards, our revenues and operating results could be harmed.

We generate a portion of our revenues from solutions that help organizations achieve and maintain compliance with regulations and industry standards. For example, many of our customers subscribe to our security and compliance solutions to help them comply with the security standards developed and maintained by the Payment Card Industry Security Standards Council, or the PCI Council, which apply to companies that store cardholder data. Industry organizations like the PCI Council may significantly change their security standards with little or no notice, including changes that could make their standards more or less onerous for businesses. Governments may also adopt new laws or regulations, or make changes to existing laws or regulations, that could impact the demand for or value of our solutions.

If we are unable to adapt our solutions to changing regulatory standards in a timely manner, or if our solutions fail to assist with or expedite our customers' compliance initiatives, our customers may lose confidence in our solutions and could switch to products offered by our competitors. In addition, if regulations and standards related to data security, vulnerability management and other IT security and compliance requirements are relaxed or the penalties for non-compliance are changed in a manner that makes them less onerous, our customers may view government and industry regulatory compliance as less critical to their businesses, and our customers may be less willing to purchase our solutions. In any of these cases, our revenues and operating results could be harmed.

We may not maintain profitability in the future.

We may not be able to sustain or increase our growth or maintain profitability in the future. We plan to continue to invest in our infrastructure, new solutions, research and development and sales and marketing, and as a result, we cannot assure you that we will maintain profitability. We may incur losses in the future for a number of reasons, including without limitation, the other risks and uncertainties described in this Quarterly Report on Form 10-Q. Additionally, we may encounter unforeseen operating expenses, difficulties, complications, delays and other unknown factors that may result in losses in future periods. If our revenue growth does not meet our expectations in future periods, our financial performance may be harmed and we may not again achieve or maintain profitability in the future.

The sales prices of our solutions are subject to competitive pressures and may decrease, which may reduce our gross profits and adversely impact our financial results.

The sales prices for our solutions may decline for a variety of reasons, including competitive pricing pressures, discounts, a change in our mix of solutions and subscriptions, anticipation of the introduction of new solutions or subscriptions, or promotional programs. Competition continues to increase in the market segments in which we participate, and we expect competition to further increase in the future, thereby leading to increased pricing pressures. Larger competitors with more diverse product and service offerings may reduce the price of products or subscriptions that compete with ours or may bundle them with other products and subscriptions. Additionally, although we price our products and subscriptions worldwide in U.S. dollars, Euros, British Pounds and Japanese Yen, currency fluctuations in certain countries and regions may negatively impact actual prices that partners and customers are willing to pay in those countries and regions, or the effective prices we realize in our reporting currency. We cannot assure you that we will be successful in developing and introducing new offerings with enhanced functionality on a timely basis, or that our new product and subscription offerings, if introduced, will enable us to maintain our prices and gross profits at levels that will allow us to maintain positive gross margins and profitability.

If our solutions fail to detect vulnerabilities or incorrectly detect vulnerabilities, our brand and reputation could be harmed, which could have an adverse effect on our business and results of operations.

If our solutions fail to detect vulnerabilities in our customers’ IT infrastructures, or if our solutions fail to identify and respond to new and increasingly complex methods of attacks, our business and reputation may suffer. There is no guarantee that our solutions will detect all vulnerabilities. Additionally, our security and compliance solutions may falsely detect vulnerabilities or threats that do not actually exist. For example, some of our solutions rely on information on attack sources aggregated from third-party data providers who monitor global malicious activity originating from a variety of sources, including anonymous proxies, specific IP addresses, botnets and phishing sites. If the information from these data providers is inaccurate, the potential for false indications of security vulnerabilities increases. These false positives, while typical in the industry, may impair the perceived reliability or usability of our solutions and may therefore adversely impact market acceptance of our solutions and could result in negative publicity,

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loss of customers and sales, increased costs to remedy any incorrect information or problem, or claims by aggrieved parties. Similar issues may be generated by the misuse of our tools to identify and exploit vulnerabilities.

In addition, our solutions do not currently extend to cover mobile devices or personal devices that employees may bring into an organization. As such, our solutions would not identify or address vulnerabilities in mobile devices, such as mobile phones or tablets, or personal devices, and our customers' IT infrastructures may be compromised by attacks that infiltrate their networks through such devices.

An actual or perceived security breach or theft of the sensitive data of one of our customers, regardless of whether the breach is attributable to the failure of our solutions, could adversely affect the market's perception of our security solutions.

Incorrect or improper implementation or use of our solutions could result in customer dissatisfaction and harm our business and reputation.

Our solutions are deployed in a wide variety of IT environments, including large-scale, complex infrastructures. If our customers are unable to implement our solutions successfully, customer perceptions of our platform may be impaired or our reputation and brand may suffer. Our customers have in the past inadvertently misused our solutions, which triggered downtime in their internal infrastructure until the problem was resolved. Any misuse of our solutions could result in customer dissatisfaction, impact the perceived reliability of our solutions, result in negative press coverage, negatively affect our reputation and harm our financial results.

Undetected software errors or flaws in our cloud platform could harm our reputation or decrease market acceptance of our solutions, which would harm our operating results.

Our solutions may contain undetected errors or defects when first introduced or as new versions are released. We have experienced these errors or defects in the past in connection with new solutions and solution upgrades and we expect that these errors or defects will be found from time to time in the future in new or enhanced solutions after commercial release of these solutions. Since our customers use our solutions for security and compliance reasons, any errors, defects, disruptions in service or other performance problems with our solutions may damage our customers' business and could hurt our reputation. If that occurs, we may incur significant costs, the attention of our key personnel could be diverted, our customers may delay or withhold payment to us or elect not to renew, or other significant customer relations problems may arise. We may also be subject to liability claims for damages related to errors or defects in our solutions. A material liability claim or other occurrence that harms our reputation or decreases market acceptance of our solutions may harm our business and operating results.

Our solutions could be used to collect and store personal information of our customers' employees or customers, and therefore privacy and other data handling concerns could result in additional cost and liability to us or inhibit sales of our solutions.

We collect the names and email addresses of our customers in connection with subscriptions to our solutions. Additionally, the data that our solutions collect to help secure and protect the IT infrastructure of our customers may include additional personal or confidential information of our customers' employees and their customers. Personal privacy has become a significant issue in the United States and in many other countries where we offer our solutions. The regulatory framework for privacy issues worldwide is currently evolving and is likely to remain uncertain for the foreseeable future. Many federal, state and foreign government bodies and agencies have adopted or are considering adopting laws and regulations regarding the collection, use, disclosure and retention of personal information. In the United States, these include, for example, rules and regulations promulgated under the authority of the Federal Trade Commission, the Health Insurance Portability and Accountability Act of 1996, the Gramm-Leach-Bliley Act, and state

breach notification laws. Internationally, virtually every jurisdiction in which we operate has established its own data security and privacy legal framework with which we or our customers must comply, including the Data Protection Directive established in the European Union and the Federal Data Protection Act passed in Germany.

These privacy, data protection and information security laws and regulations may result in ever-increasing regulatory and public scrutiny and escalating levels of enforcement and sanctions. Additionally, new laws and regulations relating to privacy and data protection continue to be proposed and enacted. For example, the European Union has adopted the General Data Protection Regulation, or GDPR, to supersede the Data Protection Directive. This regulation, which will take full effect on May 25, 2018, will cause EU data protection requirements to be more

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stringent and provide for greater penalties. Noncompliance with the GDPR can trigger fines of up to €20 million or 4% of global annual revenues, whichever is higher.

The privacy, data protection, and information security laws and regulations we must comply with also are subject to change. For example, in June 2016, United Kingdom voters approved an exit from the European Union, commonly referred to as "Brexit," which could also lead to further legislative and regulatory changes. Additionally, an October 2015 ruling of the Court of Justice of the European Union invalidated the U.S.-EU Safe Harbor Framework as a method of compliance with European restrictions regarding the transfer of personal data outside of the European Economic Area, or EEA. U.S. and EU authorities reached a political agreement in February 2016 regarding a new means for legitimizing personal data transfers from the EEA to the U.S., the EU-U.S. Privacy Shield Framework, and we have joined the EU-U.S. Privacy Shield Framework and a related program, the Swiss-U.S. Privacy Shield Framework. The EU-U.S. Privacy Shield Framework is subject to legal challenge, however, and it or the Swiss-U.S. Privacy Shield Framework may be modified or invalidated. We may be unsuccessful in maintaining legitimate means for our transfer and receipt of personal data from the EEA or Switzerland. We may experience reluctance or refusal by current or prospective European customers to use our products, and we may find it necessary or desirable to make further changes to our handling of personal data of European residents.

In addition to laws and regulations, privacy advocacy and industry groups or other private parties may propose new and different privacy standards that either legally or contractually apply to us. Because the interpretation and application of privacy and data protection laws, regulations, standards and contractual obligations are uncertain, it is possible that they may be interpreted and applied in a manner that is, or perceived to be, inconsistent with our data management practices or the features of our solutions. If so, in addition to the possibility of regulatory investigations and enforcement actions, fines, lawsuits and other claims, other forms of injunctive or operations-limiting relief, and damage to our reputations and loss of goodwill, we could be required to fundamentally change our business activities and practices or modify our solutions and may face limitations in our ability to develop new solutions and features, any of which could have an adverse effect on our business. Any inability to adequately address privacy concerns, even if unfounded, or any actual or perceived inability to comply with applicable privacy or data protection laws, regulations and privacy standards, could result in cost and liability to us, damage our reputation, inhibit sales of subscriptions and harm our business.

Furthermore, the costs of compliance with, and other burdens imposed by, the laws, regulations, and privacy standards that are applicable to the businesses of our customers may limit the use and adoption of, and reduce the overall demand for, our solutions. Privacy concerns, whether valid or not valid, may inhibit market adoption of our solutions particularly in certain industries and foreign countries.

If we are unable to continue the expansion of our sales force, sales of our solutions and the growth of our business would be harmed.

We believe that our growth will depend, to a significant extent, on our success in recruiting and retaining a sufficient number of qualified sales personnel and their ability to obtain new customers, manage our existing customer base and expand the sales of our newer solutions. We plan to continue to expand our sales force and make significant investment in our sales and marketing activities. Our recent hires and planned hires may not become as productive as quickly as we would like, and we may be unable to hire or retain sufficient numbers of qualified individuals in the future in the competitive markets where we do business. Competition for highly skilled personnel is frequently intense, especially in the San Francisco Bay Area, one of the locations in which we have a substantial presence and need for highly skilled personnel and we may not be able to compete for these employees. If we are unable to recruit and retain a sufficient number of productive sales personnel, sales of our solutions and the growth of our business may be harmed. Additionally, if our efforts do not result in increased revenues, our operating results could be negatively impacted due to the upfront operating expenses associated with expanding our sales force.

A significant portion of our customers, channel partners and employees are located outside of the United States, which subjects us to a number of risks associated with conducting international operations, and if we are unable to successfully manage these risks, our business and operating results could be harmed.

We market and sell subscriptions to our solutions throughout the world and have personnel in many parts of the world. In addition, we have sales offices and research and development facilities outside the United States and we conduct, and expect to continue to conduct, a significant amount of our business with organizations that are located outside the United States, particularly in Europe and Asia. Therefore, we are subject to risks associated with having international sales and worldwide operations, including:

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- foreign currency exchange fluctuations;
- trade and foreign exchange restrictions;
- economic or political instability in foreign markets;
- greater difficulty in enforcing contracts, accounts receivable collection and longer collection periods;
- changes in regulatory requirements;
- tax laws (including U.S. taxes on foreign subsidiaries);
- difficulties and costs of staffing and managing foreign operations;
- the uncertainty and limitation of protection for intellectual property rights in some countries;
- costs of compliance with foreign laws and regulations and the risks and costs of non-compliance with such laws and regulations;
- costs of complying with U.S. laws and regulations for foreign operations, including the Foreign Corrupt Practices Act, import and export control laws, tariffs, trade barriers, economic sanctions and other regulatory or contractual limitations on our ability to sell our solutions in certain foreign markets, and the risks and costs of non-compliance;
- heightened risks of unfair or corrupt business practices in certain geographies and of improper or fraudulent sales arrangements that may impact financial results and result in restatements of, and irregularities in, financial statements;
- the potential for political unrest, acts of terrorism, hostilities or war;
- management communication and integration problems resulting from cultural differences and geographic dispersion; and
- multiple and possibly overlapping tax structures.

Our business, including the sales of subscriptions of our solutions, may be subject to foreign governmental regulations, which vary substantially from country to country and change from time to time. Failure to comply with these regulations could adversely affect our business. Further, in many foreign countries it is common for others to engage in business practices that are prohibited by our internal policies and procedures or U.S. regulations applicable to us. Although we have implemented policies and procedures designed to ensure compliance with these laws and policies, there can be no assurance that all of our employees, contractors, channel partners and agents have complied or will comply with these laws and policies. Violations of laws or key control policies by our employees, contractors, channel partners or agents could result in delays in revenue recognition, financial reporting misstatements, fines, penalties or the prohibition of the importation or exportation of our solutions and could have a material adverse effect on our business and results of operations. If we are unable to successfully manage the challenges of international operations, our business and operating results could be adversely affected.

In addition, as of March 31, 2018, approximately 58% of our employees were located outside of the United States, with a significant number of these employees located in Pune, India. Accordingly, we are exposed to changes in laws governing our employee relationships in various U.S. and foreign jurisdictions, including laws and regulations regarding wage and hour requirements, fair labor standards, employee data privacy, unemployment tax rates, workers' compensation rates, citizenship requirements and payroll and other taxes which may have a direct impact on our operating costs. We may continue to expand our international operations and international sales and marketing activities. Expansion in international markets has required, and will continue to require, significant management attention and resources. We may be unable to scale our infrastructure effectively or as quickly as our competitors in these markets and our revenues may not increase to offset any increased costs and operating expenses, which would cause our results to suffer.

Disruptive technologies could gain wide adoption and supplant our cloud security and compliance solutions, thereby weakening our sales and harming our results of operations.

The introduction of products and services embodying new technologies could render our existing solutions obsolete or less attractive to customers. Our business could be harmed if new security and compliance technologies are widely

adopted. We may not be able to successfully anticipate or adapt to changing technology or customer

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requirements on a timely basis, or at all. If we fail to keep up with technological changes or to convince our customers and potential customers of the value of our solutions even in light of new technologies, our business could be harmed and our revenues may decline.

Our business and operations have experienced significant growth, and if we do not appropriately manage any future growth, or are unable to improve our systems and processes, our operating results may be negatively affected.

We have experienced significant growth over the last several years. Our headcount increased from 510 employees at the beginning of 2016 to 934 employees at March 31, 2018. We rely on information technology systems to help manage critical functions such as order processing, revenue recognition and financial forecasts. To manage any future growth effectively we must continue to improve and expand our IT systems, financial infrastructure, and operating and administrative systems and controls, and continue to manage headcount, capital and processes in an efficient manner. We may not be able to successfully implement improvements to these systems and processes in a timely or efficient manner.

Our failure to improve our systems and processes, or their failure to operate in the intended manner, may result in our inability to manage the growth of our business and to accurately forecast our revenues, expenses and earnings, or to prevent certain losses. In addition, as we continue to grow, our productivity and the quality of our solutions may also be adversely affected if we do not integrate and train our new employees quickly and effectively. Any future growth would add complexity to our organization and require effective coordination across our organization. Failure to manage any future growth effectively could result in increased costs, harm our results of operations and lead to investors losing confidence in our internal systems and processes.

Forecasts of market growth may prove to be inaccurate, and even if the markets in which we compete achieve the forecasted growth, there can be no assurance that our business will grow at similar rates, or at all.

Growth forecasts relating to the expected growth in the market for IT security and compliance and other markets are subject to significant uncertainty and are based on assumptions and estimates which may prove to be inaccurate. Even if these markets experience the forecasted growth, we may not grow our business at similar rates, or at all. Our growth is subject to many factors, including our success in implementing our business strategy, which is subject to many risks and uncertainties. Accordingly, forecasts of market growth should not be taken as indicative of our future growth.

We rely on third-party channel partners to generate a substantial amount of our revenues, and if we fail to expand and manage our distribution channels, our revenues could decline and our growth prospects could suffer.

Our success significantly depends upon establishing and maintaining relationships with a variety of channel partners, and we anticipate that we will continue to depend on these partners in order to grow our business. For the three months ended March 31, 2018, we derived approximately 40% of our revenues from sales of subscriptions for our solutions through channel partners, and the percentage of revenues derived from channel partners may increase in future periods. Our agreements with our channel partners are generally non-exclusive and do not prohibit them from working with our competitors or offering competing solutions, and many of our channel partners have more established relationships with our competitors. If our channel partners choose to place greater emphasis on products of their own or those offered by our competitors, do not effectively market and sell our solutions, or fail to meet the needs of our customers, then our ability to grow our business and sell our solutions may be adversely affected. In addition, the loss of one or more of our larger channel partners, who may cease marketing our solutions with limited or no notice, and our possible inability to replace them, could adversely affect our sales. Moreover, our ability to expand our distribution channels depends in part on our ability to educate our channel partners about our solutions, which can be complex. Our failure to recruit additional channel partners, or any reduction or delay in their sales of our solutions or conflicts between channel sales and our direct sales and marketing activities may harm our results of

operations. Even if we are successful, these relationships may not result in greater customer usage of our solutions or increased revenues.

In addition, the financial health of our channel partners and our continuing relationships with them are important to our success. Some of these channel partners may be unable to withstand adverse changes in economic conditions, which could result in insolvency and/or the inability of such distributors to obtain credit to finance purchases of our products and services. In addition, weakness in the end-user market could negatively affect the cash flows of our

channel partners who could, in turn, delay paying their obligations to us, which would increase our credit risk exposure. Our business could be harmed if the financial condition of some of these channel partners substantially weakened and we were unable to timely secure replacement channel partners.

Our solutions contain third-party open source software components, and our failure to comply with the terms of the underlying open source software licenses could restrict our ability to sell our solutions.

Our solutions contain software licensed to us by third-parties under so-called "open source" licenses, including the GNU General Public License, the GNU Lesser General Public License, the BSD License, the Apache License and others. From time to time, there have been claims against companies that distribute or use open source software in their products and services, asserting that such open source software infringes the claimants' intellectual property rights. We could be subject to suits by parties claiming that what we believe to be licensed open source software infringes their intellectual property rights. Use and distribution of open source software may entail greater risks than use of third-party commercial software, as open source licensors generally do not provide warranties or other contractual protections regarding infringement claims or the quality of the code. In addition, certain open source licenses require that source code for software programs that are subject to the license be made available to the public and that any modifications or derivative works to such open source software continue to be licensed under the same terms. If we combine our proprietary software with open source software in certain ways, we could, in some circumstances, be required to release the source code of our proprietary software to the public. Disclosing the source code of our proprietary software could make it easier for cyber attackers and other third parties to discover vulnerabilities in or to defeat the protections of our solutions, which could result in our solutions failing to provide our customers with the security they expect from our services. This could harm our business and reputation. Disclosing our proprietary source code also could allow our competitors to create similar products with lower development effort and time and ultimately could result in a loss of sales for us. Any of these events could have a material adverse effect on our business, operating results and financial condition.

Although we monitor our use of open source software in an effort both to comply with the terms of the applicable open source licenses and to avoid subjecting our solutions to conditions we do not intend, the terms of many open source licenses have not been interpreted by U.S. courts, and there is a risk that these licenses could be construed in a way that could impose unanticipated conditions or restrictions on our ability to commercialize our solutions. In this event, we could be required to seek licenses from third parties to continue offering our solutions, to make our proprietary code generally available in source code form, to re-engineer our solutions or to discontinue the sale of our solutions if re-engineering could not be accomplished on a timely basis, any of which could adversely affect our business, operating results and financial condition.

We rely on software-as-a-service vendors to operate certain functions of our business and any failure of such vendors to provide services to us could adversely impact our business and operations.

We rely on third-party software-as-a-service vendors to operate certain critical functions of our business, including financial management and human resource management. If these services become unavailable due to extended outages or interruptions or because they are no longer available on commercially reasonable terms or prices, our expenses could increase, our ability to manage our finances could be interrupted and our processes for managing sales of our solutions and supporting our customers could be impaired until equivalent services, if available, are identified, obtained and integrated, all of which could harm our business.

We use third-party software and data that may be difficult to replace or cause errors or failures of our solutions that could lead to lost customers or harm to our reputation and our operating results.

We license third-party software as well as security and compliance data from various third parties to deliver our solutions. In the future, this software or data may not be available to us on commercially reasonable terms, or at all. Any loss of the right to use any of this software or data could result in delays in the provisioning of our solutions until equivalent technology or data is either developed by us, or, if available, is identified, obtained and integrated, which could harm our business. In addition, any errors or defects in or failures of this third-party software or data could result in errors or defects in our solutions or cause our solutions to fail, which could harm our business and be costly to correct. Many of these providers attempt to impose limitations on their liability for such errors, defects or failures, and if enforceable, we may have additional liability to our customers or third-party providers that could harm our reputation and increase our operating costs.

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We will need to maintain our relationships with third-party software and data providers, and to obtain software and data from such providers that do not contain any errors or defects. Any failure to do so could adversely impact our ability to deliver effective solutions to our customers and could harm our operating results.

Delays or interruptions in the manufacturing and delivery of our physical scanner appliances by our sole source manufacturer may harm our business.

Upon customer request, we provide physical or virtual scanner appliances on a subscription basis as an additional capability to the customer's subscription for use during their subscription term. Our physical scanner appliances are built by a single manufacturer. Our reliance on a sole manufacturer involves several risks, including a potential inability to obtain an adequate supply of physical scanner appliances and limited control over pricing, quality and timely deployment of such scanner appliances. In addition, replacing this manufacturer may be difficult and could result in an inability or delay in deploying our solutions to customers that request physical scanner appliances as part of their subscriptions.

Furthermore, our manufacturer's ability to timely manufacture and ship our physical scanner appliances depends on a variety of factors, such as the availability of hardware components, supply shortages or contractual restrictions. In the event of an interruption from this manufacturer, we may not be able to develop alternate or secondary sources in a timely manner. If we are unable to purchase physical scanner appliances in quantities sufficient to meet our requirements on a timely basis, we may not be able to effectively deploy our solutions to new customers that request physical scanner appliances, which could harm our business.

We are exposed to fluctuations in currency exchange rates, which could negatively affect our financial condition and results of operations.

Our reporting currency is the U.S. dollar and we generate a majority of our revenues in U.S. dollars. However, for the three months ended March 31, 2018, we incurred approximately 18% of our expenses outside of the United States in foreign currencies, primarily Euros, British Pounds, and Indian Rupee, principally with respect to salaries and related personnel expenses associated with our European and Indian operations. Additionally, for the three months ended March 31, 2018, approximately 18% of our revenues were generated in foreign currencies. Accordingly, changes in exchange rates may have a material adverse effect on our business, operating results and financial condition. The exchange rate between the U.S. dollar and foreign currencies has fluctuated substantially in recent years and may continue to fluctuate substantially in the future. We expect that a majority of our revenues will continue to be generated in U.S. dollars for the foreseeable future and that a significant portion of our expenses, including personnel costs, as well as capital and operating expenditures, will continue to be denominated in Euro, British Pound and Indian Rupee. The results of our operations may be adversely affected by foreign exchange fluctuations.

We use forward foreign exchange contracts to mitigate the effect of changes in foreign exchange rates on certain cash and accounts receivable balances denominated in certain foreign currencies. However, we may not be able to purchase derivative instruments that are adequate to insulate ourselves from foreign currency exchange risks. Additionally, our hedging activities may contribute to increased losses as a result of volatility in foreign currency markets.

Failure to protect our proprietary technology and intellectual property rights could substantially harm our business and operating results.

The success of our business depends in part on our ability to protect and enforce our trade secrets, trademarks, copyrights, patents and other intellectual property rights. We attempt to protect our intellectual property under copyright, trade secret, patent and trademark laws, and through a combination of confidentiality procedures, contractual provisions and other methods, all of which offer only limited protection.

We primarily rely on our unpatented proprietary technology and trade secrets. Despite our efforts to protect our proprietary technology and trade secrets, unauthorized parties may attempt to misappropriate, reverse engineer or otherwise obtain and use them. The contractual provisions that we enter into with employees, consultants, partners, vendors and customers may not prevent unauthorized use or disclosure of our proprietary technology or intellectual property rights and may not provide an adequate remedy in the event of unauthorized use or disclosure of our proprietary technology or intellectual property rights. Moreover, policing unauthorized use of our technologies, solutions and intellectual property is difficult, expensive and time-consuming, particularly in foreign countries where the laws may not be as protective of intellectual property rights as those in the United States and where mechanisms

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for enforcement of intellectual property rights may be weak. We may be unable to determine the extent of any unauthorized use or infringement of our solutions, technologies or intellectual property rights.

As of March 31, 2018, we have twelve issued patents and several pending U.S. patent applications, and we may file additional patent applications in the future. Additionally, we have an exclusive license to four third-party patents. The process of obtaining patent protection is expensive and time-consuming, and we may not be able to prosecute all necessary or desirable patent applications at a reasonable cost or in a timely manner, if at all. We may choose not to seek patent protection for certain innovations and may choose not to pursue patent protection in certain jurisdictions.

Furthermore, it is possible that our patent applications may not result in granted patents, that the scope of our issued patents will be limited or not provide the coverage originally sought, that our issued patents will not provide us with any competitive advantages, or that our patents and other intellectual property rights may be challenged by others or invalidated through administrative processes or litigation. In addition, issuance of a patent does not guarantee that we have an absolute right to practice the patented invention. As a result, we may not be able to obtain adequate patent protection or to enforce our issued patents effectively.

From time to time, legal action by us may be necessary to enforce our patents and other intellectual property rights, to protect our trade secrets, to determine the validity and scope of the intellectual property rights of others or to defend against claims of infringement or invalidity. Such litigation could result in substantial costs and diversion of resources and could negatively affect our business, operating results and financial condition. If we are unable to protect our intellectual property rights, we may find ourselves at a competitive disadvantage to others who need not incur the additional expense, time and effort required to create the innovative solutions that have enabled us to be successful to date.

Assertions by third parties of infringement or other violations by us of their intellectual property rights could result in significant costs and harm our business and operating results.

Patent and other intellectual property disputes are common in our industry. Some companies, including some of our competitors, own large numbers of patents, copyrights and trademarks, which they may use to assert claims against us. Third parties may in the future assert claims of infringement, misappropriation or other violations of intellectual property rights against us. They may also assert such claims against our customers or channel partners whom we typically indemnify against claims that our solutions infringe, misappropriate or otherwise violate the intellectual property rights of third parties. As the numbers of products and competitors in our market increase and overlaps occur, claims of infringement, misappropriation and other violations of intellectual property rights may increase. Any claim of infringement, misappropriation or other violation of intellectual property rights by a third party, even those without merit, could cause us to incur substantial costs defending against the claim and could distract our management from our business.

The patent portfolios of our most significant competitors are larger than ours. This disparity may increase the risk that they may sue us for patent infringement and may limit our ability to counterclaim for patent infringement or settle through patent cross-licenses. In addition, future assertions of patent rights by third parties, and any resulting litigation, may involve patent holding companies or other adverse patent owners who have no relevant product revenues and against whom our own patents may therefore provide little or no deterrence or protection. There can be no assurance that we will not be found to infringe or otherwise violate any third-party intellectual property rights or to have done so in the past.

An adverse outcome of a dispute may require us to:

- pay substantial damages, including treble damages, if we are found to have willfully infringed a third party’s patents or copyrights;

- cease making, licensing or using solutions that are alleged to infringe or misappropriate the intellectual property of others;
- expend additional development resources to attempt to redesign our solutions or otherwise develop non-infringing technology, which may not be successful;
- enter into potentially unfavorable royalty or license agreements in order to obtain the right to use necessary technologies or intellectual property rights; and

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- indemnify our partners and other third parties.

In addition, royalty or licensing agreements, if required or desirable, may be unavailable on terms acceptable to us, or at all, and may require significant royalty payments and other expenditures. Some licenses may also be non-exclusive, and therefore our competitors may have access to the same technology licensed to us. Any of the foregoing events could seriously harm our business, financial condition and results of operations.

If we are required to collect sales and use or other taxes on the solutions we sell, we may be subject to liability for past sales and our future sales may decrease.

Taxing jurisdictions, including state and local entities, have differing rules and regulations governing sales and use or other taxes, and these rules and regulations are subject to varying interpretations that may change over time. In particular, the applicability of sales taxes to our subscription services in various jurisdictions is unclear. It is possible that we could face sales tax audits and that our liability for these taxes could exceed our estimates as tax authorities could still assert that we are obligated to collect additional amounts as taxes from our customers and remit those taxes to those authorities. We could also be subject to audits with respect to state and international jurisdictions for which we have not accrued tax liabilities. A successful assertion that we should be collecting additional sales or other taxes on our services in jurisdictions where we have not historically done so and do not accrue for sales taxes could result in substantial tax liabilities for past sales, discourage customers from purchasing our solutions or otherwise harm our business and operating results.

We depend on the continued services and performance of our senior management and other key employees, the loss of any of whom could adversely affect our business, operating results and financial condition.

Our future performance depends on the continued services and continuing contributions of our senior management, particularly Philippe F. Courtot, our Chairman, President and Chief Executive Officer, and other key employees, to execute on our business plan and to identify and pursue new opportunities and product innovations. We do not maintain key-man insurance for Mr. Courtot or for any other member of our senior management team. From time to time, there may be changes in our senior management team resulting from the termination or departure of executives. Our senior management and key employees are generally employed on an at-will basis, which means that they could terminate their employment with us at any time. The loss of the services of our senior management, particularly Mr. Courtot, or other key employees for any reason could significantly delay or prevent the achievement of our development and strategic objectives and harm our business, financial condition and results of operations.

If we are unable to hire, retain and motivate qualified personnel, our business may suffer.

Our future success depends, in part, on our ability to continue to attract and retain highly skilled personnel. The loss of the services of any of our key personnel, the inability to attract or retain qualified personnel or delays in hiring required personnel, particularly in engineering and sales, may seriously harm our business, financial condition and results of operations. Any of our employees may terminate their employment at any time. Competition for highly skilled personnel is frequently intense, especially in the San Francisco Bay Area, one of the locations in which we have a substantial presence and need for highly skilled personnel and we may not be able to compete for these employees.

We are required under accounting principles generally accepted in the United States (“U.S. GAAP”) to recognize compensation expense in our operating results for employee stock-based compensation under our equity grant programs, which may negatively impact our operating results and may increase the pressure to limit stock-based compensation that we might otherwise offer to current or potential employees, thereby potentially harming our ability

to attract or retain highly skilled personnel. In addition, to the extent we hire personnel from competitors, we may be subject to allegations that they have been improperly solicited or divulged proprietary or other confidential information, which could result in a diversion of management's time and our resources.

Changes in laws or regulations related to the Internet may diminish the demand for our solutions and could have a negative impact on our business.

We deliver our solutions through the Internet. Federal, state or foreign government bodies or agencies have in the past adopted, and may in the future adopt, laws or regulations affecting data privacy and the use of the Internet. In addition, government agencies or private organizations may begin to impose taxes, fees or other charges for

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accessing the Internet or on commerce conducted via the Internet. These laws or charges could limit the viability of Internet-based solutions such as ours and reduce the demand for our solutions.

A portion of our revenues are generated by sales to government entities, which are subject to a number of challenges and risks.

Government entities have historically been particularly concerned about adopting cloud-based solutions for their operations, including security solutions, and increasing sales of subscriptions for our solutions to government entities may be more challenging than selling to commercial organizations. Selling to government entities can be highly competitive, expensive and time-consuming, often requiring significant upfront time and expense without any assurance that we will win a sale. We have invested in the creation of a cloud offering certified under the Federal Information Security Management Act, or FISMA, for government usage but we cannot be sure that we will continue to sustain or renew this certification, that the government will continue to mandate such certification or that other government agencies or entities will use this cloud offering. Government demand and payment for our solutions may be impacted by public sector budgetary cycles and funding authorizations, with funding reductions or delays adversely affecting public sector demand for our solutions. Government entities may have contractual or other legal rights to terminate contracts with our channel partners for convenience or due to a default, and any such termination may adversely impact our future results of operations. Governments routinely investigate and audit government contractors' administrative processes, and any unfavorable audit could result in the government refusing to continue buying our solutions, a reduction of revenues or fines or civil or criminal liability if the audit uncovers improper or illegal activities. Any such penalties could adversely impact our results of operations in a material way.

Governmental export or import controls could subject us to liability if we violate them or limit our ability to compete in foreign markets.

Our solutions are subject to U.S. export controls, specifically, the Export Administration Regulations and economic sanctions enforced by the Office of Foreign Assets Control. We incorporate encryption technology into certain of our solutions. These encryption solutions and the underlying technology may be exported only with the required export authorizations, including by license, a license exception or other appropriate government authorizations. U.S. export controls may require submission of an encryption registration, product classification and/or annual or semi-annual reports. Governmental regulation of encryption technology and regulation of imports or exports of encryption products, or our failure to obtain required import or export authorization for our solutions, when applicable, could harm our international sales and adversely affect our revenues. Compliance with applicable regulatory requirements regarding the export of our solutions, including with respect to new releases of our solutions, may create delays in the introduction of our solutions in international markets, prevent our customers with international operations from deploying our solutions throughout their globally-distributed systems or, in some cases, prevent the export of our solutions to some countries altogether. In addition, various countries regulate the import of our appliance-based solutions and have enacted laws that could limit our ability to distribute solutions or could limit our customers' ability to implement our solutions in those countries. Any new export or import restrictions, new legislation or shifting approaches in the enforcement or scope of existing regulations, or in the countries, persons or technologies targeted by such regulations, could result in decreased use of our solutions by existing customers with international operations, declining adoption of our solutions by new customers with international operations and decreased revenues. If we fail to comply with export and import regulations, we may be fined or other penalties could be imposed, including a denial of certain export privileges.

Our success in acquiring and integrating other businesses, products or technologies could impact our financial position.

In order to remain competitive, we have in the past and may in the future seek to acquire additional businesses, products, services or technologies. For example, we acquired 1Mobility on April 1, 2018. The environment for acquisitions in our industry is very competitive and acquisition candidate purchase prices may exceed what we would prefer to pay. Moreover, achieving the anticipated benefits of future acquisitions will depend in part upon whether we can integrate acquired operations, products and technology in a timely and cost-effective manner, and even if we achieve benefits from acquisitions, such acquisitions may still be viewed negatively by customers, financial markets or investors. The acquisition and integration process is complex, expensive and time-consuming, and may cause an interruption of, or loss of momentum in, product development and sales activities and operations of both companies and we may incur substantial cost and expense, as well as divert the attention of management. We may issue equity securities which could dilute current stockholders' ownership, incur debt, assume contingent or other liabilities and expend cash in acquisitions, which could negatively impact our financial position, stockholder equity

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and stock price. We may not find suitable acquisition candidates, and acquisitions we complete may be unsuccessful. If we consummate a transaction, we may be unable to integrate and manage acquired products and businesses effectively or retain key personnel. If we are unable to effectively execute acquisitions, our business, financial condition and operating results could be adversely affected.

Our financial results are based in part on our estimates or judgments relating to our critical accounting policies. These estimates or judgments may prove to be incorrect, which could harm our operating results and result in a decline in our stock price.

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported in the condensed consolidated financial statements and accompanying notes. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, as provided in the section titled “Item 2 - Management’s Discussion and Analysis of Financial Condition and Results of Operations,” the results of which form the basis for making judgments about the carrying values of assets, liabilities, equity, revenues and expenses that are not readily apparent from other sources. Our operating results may be adversely affected if our assumptions change or if actual circumstances differ from those in our assumptions, which could cause our operating results to fall below the expectations of securities analysts and investors, resulting in a decline in our stock price. Significant assumptions and estimates used in preparing our condensed consolidated financial statements include those related to revenue recognition, accounting for income taxes, stock-based compensation, and fair value measurement.

Changes in financial accounting standards may cause adverse and unexpected revenue fluctuations and impact our reported results of operations.

We prepare our financial statements in accordance with U.S. GAAP. These principles are subject to interpretation by the SEC and various bodies formed to interpret and create appropriate accounting principles. A change in these accounting standards or practices could harm our operating results and could have a significant effect on our reporting of transactions and reported results and may even retroactively affect previously reported transactions. New accounting pronouncements and varying interpretations of accounting pronouncements have occurred and may occur in the future. Changes to existing rules or the questioning of current practices may harm our operating results or require that we make significant changes to our systems, processes and controls or the way we conduct our business.

We have historically expensed commissions associated with sales of our solutions immediately upon receipt of a subscription order from a customer and generally recognize the revenues associated with such sale over the term of the agreement. Accordingly, our historical operating income in any period may not be indicative of our financial health and future performance. With the adoption of Accounting Standards Codification ("ASC") 606 Revenue from Contracts with Customers effective January 1, 2018, we commenced capitalizing of our commissions but elected to use the practical expedient in ASC 606 and expense commissions related to contracts with a renewal contract term of one year or less. As a result of the adoption of ASC 606, our future operating results may vary from period to period as our commission expense will not be directly comparable to historical periods.

Through December 2017, we expensed commissions paid to our sales personnel in the quarter in which the related order is received. In contrast, we have generally recognized the revenues associated with a sale of our solutions ratably over the term of the subscription, which is typically one year. Accordingly, our historical results may have fluctuated based on timing of commission expenses as compared to revenue recognized. With the adoption of ASC 606, our operating results will also fluctuate and not be comparable to historical periods, and will continue to fluctuate as we will generally capitalize commissions except for renewal sales that are one year or less. In addition, amortization of expense from previously capitalized contracts is expected to increase over time as our opening capitalized commission asset balance upon adoption of ASC 606 only included open contracts as of December 31, 2017. Accordingly, we

expect our commission expense to grow in future periods following the initial adoption of ASC 606. Without the adoption of ASC 606, commission expenses would have been $0.5 million higher in our first quarter of 2018.

We recognize revenues from subscriptions over the term of the relevant service period, and therefore any decreases or increases in bookings are not immediately reflected in our operating results.

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We recognize revenues from subscriptions over the term of the relevant service period, which is typically one year. As a result, most of our reported revenues in each quarter are derived from the recognition of deferred revenues relating to subscriptions entered into during previous quarters. Consequently, a shortfall in demand for our solutions in any period may not significantly reduce our revenues for that period, but could negatively affect revenues in future periods. Accordingly, the effect of significant downturns in bookings may not be fully reflected in our results of operations until future periods. We may be unable to adjust our costs and expenses to compensate for such a potential shortfall in revenues. Our subscription model also makes it difficult for us to rapidly increase our revenues through additional bookings in any period, as revenues are recognized ratably over the subscription period.

Changes in our provision for income taxes or adverse outcomes resulting from examination of our income tax returns could adversely affect our operating results. We could be subject to additional taxes.

We are subject to income taxes in the United States and various foreign jurisdictions, and our domestic and international tax liabilities are subject to the allocation of expenses in differing jurisdictions. Our tax rate is affected by changes in the mix of earnings and losses in countries with differing statutory tax rates, certain non-deductible expenses arising from the requirement to expense stock options, excess tax benefits from stock-based compensation, and the valuation of deferred tax assets and liabilities, including our ability to utilize our federal and state net operating losses, which were $54.4 million as of December 31, 2017. As a result of the Tax Cuts and Jobs Act (the "2017 Tax Act"), which was enacted by the U.S. federal government on December 22, 2017, our federal tax rate decreased in 2018. Accordingly, our operating results have fluctuated and may not be comparable to historical periods and may continue to fluctuate in the future. Increases in our effective tax rate could harm our operating results.

Additionally, significant judgment is required in evaluating our tax positions and our worldwide provision for taxes. During the ordinary course of business, there are many activities and transactions for which the ultimate tax determination is uncertain. In addition, our tax obligations and effective tax rates could be adversely affected by changes in the relevant tax, accounting and other laws, regulations, principles and interpretations, including those relating to income tax nexus, by recognizing tax losses or lower than anticipated earnings in jurisdictions where we have lower statutory rates and higher than anticipated earnings in jurisdictions where we have higher statutory rates, by changes in foreign currency exchange rates, or by changes in the valuation of our deferred tax assets and liabilities. We may be audited in various jurisdictions, and such jurisdictions may assess additional taxes, sales taxes and value-added taxes against us. Although we believe our tax estimates are reasonable, the final determination of any tax audits or litigation could be materially different from our historical tax provisions and accruals, which could have a material adverse effect on our operating results or cash flows in the period or periods for which a determination is made.

Uncertainties in the interpretation and application of the 2017 Tax Act could materially affect our tax obligations and effective tax rate.

The 2017 Tax Act significantly affected U.S. tax law by changing how the U.S. imposes income tax on multinational corporations. On December 22, 2017, Staff Accounting Bulletin No. 118 ("SAB 118") was issued to address the application of U.S. GAAP in situations when a registrant does not have the necessary information available, prepared, or analyzed (including computations) in reasonable detail to complete the accounting for certain income tax effects of the 2017 Tax Act. In accordance with SAB 118, the effects of the 2017 Tax Act may be adjusted within a one-year measurement period from the enactment date of the 2017 Tax Act for items that were previously reported as provisional estimates, or where a provisional estimate could not be made. We will continue to assess forthcoming guidance and accounting interpretations on the effects of the 2017 Tax Act and expect to complete our analysis within the measurement period in accordance with the SEC guidance. Final resolution of provisional amounts relating to the effects of the 2017 Tax Act may impact our effective tax rate, and may have an adverse effect on our business, financial condition, results of operations, or cash flows.

Our business is subject to the risks of earthquakes, fire, power outages, floods and other catastrophic events, and to interruption by man-made problems such as terrorism.

A significant natural disaster, such as an earthquake, fire or a flood, or a significant power outage could have a material adverse impact on our business, operating results and financial condition. Our corporate headquarters and a significant portion of our operations are located in the San Francisco Bay Area, a region known for seismic activity. In addition, natural disasters could affect our business partners' ability to perform services for us on a timely basis. In the event we or our business partners are hindered by any of the events discussed above, our ability to provide our solutions to customers could be delayed, resulting in our missing financial targets, such as revenues

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and net income, for a particular quarter. Further, if a natural disaster occurs in a region from which we derive a significant portion of our revenues, customers in that region may delay or forego subscriptions of our solutions, which may materially and adversely impact our results of operations for a particular period. In addition, acts of terrorism could cause disruptions in our business or the business of our business partners, customers or the economy as a whole. All of the aforementioned risks may be exacerbated if the disaster recovery plans for us and our suppliers prove to be inadequate. To the extent that any of the above results in delays of customer subscriptions or commercialization of our solutions, our business, financial condition and results of operations could be adversely affected.

If we fail to maintain an effective system of internal control over financial reporting, our ability to produce timely and accurate financial statements or comply with applicable regulations could be impaired.

As a public company, we are subject to the reporting requirements of the Securities Exchange Act of 1934, or the Exchange Act, the Sarbanes-Oxley Act, and the rules and regulations of the NASDAQ Stock Market. To comply with the requirements of being a public company, we may need to undertake various actions, such as implementing additional internal controls and procedures and hiring additional accounting or internal audit staff.

Our internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with U.S. GAAP. Our current controls and any new controls that we develop may become inadequate because of changes in conditions in our business. Any failure to maintain effective controls, or any difficulties encountered in their improvement, could harm our operating results or cause us to fail to meet our reporting obligations. Any failure to maintain effective internal control over financial reporting also could adversely affect the results of periodic management evaluations regarding the effectiveness of our internal control over financial reporting that we are required to include in our periodic reports we file with the SEC under Section 404 of the Sarbanes-Oxley Act. While we were able to assert in our Annual Report on Form 10-K that our internal control over financial reporting was effective as of December 31, 2017, we cannot predict the outcome of our testing in future periods. If we are unable to assert in any future reporting period that our internal control over financial reporting is effective (or if our independent registered public accounting firm is unable to express an opinion on the effectiveness of our internal controls), investors may lose confidence in our operating results and our stock price could decline. In addition, if we are unable to continue to meet these requirements, we may not be able to remain listed on the NASDAQ Stock Market.

Market volatility may affect our stock price and the value of an investment in our common stock and could subject us to litigation.

The trading price of our common stock has been, and may continue to be, subject to significant fluctuations in response to a number of factors, most of which we cannot predict or control, including:

- announcements of new solutions, services or technologies, commercial relationships, acquisitions or other events by us or our competitors;
- fluctuations in stock market prices and trading volumes of securities of similar companies;
- general market conditions and overall fluctuations in U.S. equity markets;
- variations in our operating results, or the operating results of our competitors;
- changes in our financial guidance or securities analysts’ estimates of our financial performance;
- changes in accounting principles;
- sales of large blocks of our common stock, including sales by our executive officers, directors and significant stockholders;
- additions or departures of any of our key personnel;
- announcements related to litigation;
- changing legal or regulatory developments in the United States and other countries; and
- discussion of us or our stock price by the financial press and in online investor communities.

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In addition, the stock market in general, and the stocks of technology companies such as ours in particular, have experienced substantial price and volume volatility that is often seemingly unrelated to the operating performance of particular companies. These broad market fluctuations may cause the trading price of our common stock to decline. In the past, securities class action litigation has often been brought against a company after a period of volatility in the trading price of its common stock. We may become involved in this type of litigation in the future. Any securities litigation claims brought against us could result in substantial expenses and the diversion of our management's attention from our business.

Our actual operating results may differ significantly from our guidance.

From time to time, we have released, and may continue to release, guidance in our quarterly earnings conference calls, quarterly earnings releases, or otherwise, regarding our future performance that represents our management's estimates as of the date of release. This guidance, which includes forward-looking statements, has been and will be based on projections prepared by our management. These projections are not prepared with a view toward compliance with published guidelines of the American Institute of Certified Public Accountants, and neither our registered public accountants nor any other independent expert or outside party compiles or examines the projections. Accordingly, no such person expresses any opinion or any other form of assurance with respect to the projections.

Projections are based upon a number of assumptions and estimates that, while presented with numerical specificity, are inherently subject to significant business, economic and competitive uncertainties and contingencies, many of which are beyond our control and are based upon specific assumptions with respect to future business decisions, some of which will change. We intend to state possible outcomes as high and low ranges which are intended to provide a sensitivity analysis as variables are changed but are not intended to imply that actual results could not fall outside of the suggested ranges. The principal reason that we release guidance is to provide a basis for our management to discuss our business outlook with analysts and investors. We do not accept any responsibility for any projections or reports published by any such third parties.

Guidance is necessarily speculative in nature, and it can be expected that some or all of the assumptions underlying the guidance furnished by us will not materialize or will vary significantly from actual results. Accordingly, our guidance is only an estimate of what management believes is realizable as of the date of release. Actual results may vary from our guidance and the variations may be material. In light of the foregoing, investors are urged not to rely upon our guidance in making an investment decision regarding our common stock.

Any failure to successfully implement our operating strategy or the occurrence of any of the events or circumstances set forth in this "Risk Factors" section in this Quarterly Report on Form 10-Q could result in our actual operating results being different from our guidance, and the differences may be adverse and material.

Concentration of ownership among our existing executive officers, directors and holders of 10% or more of our outstanding common stock may prevent new investors from influencing significant corporate decisions.

As of April 19, 2018, our executive officers, directors and holders of 10% or more of our outstanding common stock beneficially owned, in the aggregate, approximately 29% of our outstanding common stock. As a result, such persons, acting together, have significant ability to control our management and affairs and substantially all matters submitted to our stockholders for approval, including the election and removal of directors and approval of any significant transaction. This concentration of ownership may have the effect of delaying, deferring or preventing a change in control, impeding a merger, consolidation, takeover or other business combination involving us, or discouraging a potential acquirer from making a tender offer or otherwise attempting to obtain control of our business, even if such a transaction would benefit other stockholders.

Future sales of shares by existing stockholders could cause our stock price to decline.

The market price of shares of our common stock could decline as a result of substantial sales of our common stock, particularly sales by our directors, executive officers, employees and significant stockholders, a large number of shares of our common stock becoming available for sale, or the perception in the market that holders of a large number of shares intend to sell their shares. As of March 31, 2018, we had approximately 39.0 million shares of our common stock outstanding. Certain holders of shares of our common stock have rights, subject to some conditions, to require us to file registration statements covering their shares or to include these shares in registration statements that we may file for ourselves or other stockholders.

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In addition, as of March 31, 2018, there were approximately 1.3 million restricted stock units and options to purchase approximately 4.2 million shares of our common stock outstanding. If such options are exercised and restricted stock units are released, these additional shares will become available for sale. As of March 31, 2018, we had an aggregate of 4.2 million shares of our common stock reserved for future issuance under our 2012 Equity Incentive Plan, which can be freely sold in the public market upon issuance. If a large number of these shares are sold in the public market, the sales could reduce the trading price of our common stock.

We cannot guarantee that our recently announced stock repurchase program will be fully consummated or that it will enhance stockholder value, and any stock repurchases we make could affect the price of our common stock.

In February 2018, we announced a $100.0 million stock repurchase program. Although our board of directors authorized this stock repurchase program, we are not obligated to repurchase any specific dollar amount or to acquire any specific number of shares. The stock repurchase program could affect the price of our common stock, increase volatility and diminish our cash reserves. In addition, it may be suspended or terminated at any time, which may result in a decrease in the price of our common stock. In the three months ended March 31, 2018, we repurchased 21,288 shares of our common stock for an aggregate purchase price of approximately $1.5 million.

We do not intend to pay dividends on our common stock and therefore any returns will be limited to the value of our stock.

We have never declared or paid any cash dividend on our common stock. We currently anticipate that we will retain future earnings for the development, operation and expansion of our business and do not anticipate declaring or paying any cash dividends for the foreseeable future. Any return to stockholders will therefore be limited to the value of their stock.

Anti-takeover provisions in our charter documents and under Delaware law could make an acquisition of us, which may be beneficial to our stockholders, more difficult and may prevent attempts by our stockholders to replace or remove our current management.

Our amended and restated certificate of incorporation and amended and restated bylaws contain provisions that may delay or prevent an acquisition of us or a change in our management. These provisions include:

- authorizing “blank check” preferred stock, which could be issued by the board without stockholder approval and may contain voting, liquidation, dividend and other rights superior to our common stock, which would increase the number of outstanding shares and could thwart a takeover attempt;
- a classified board of directors whose members can only be dismissed for cause;
- the prohibition on actions by written consent of our stockholders;
- the limitation on who may call a special meeting of stockholders;
- the establishment of advance notice requirements for nominations for election to our board of directors or for proposing matters that can be acted upon at stockholder meetings; and
- the requirement of at least two-thirds of the outstanding capital stock to amend any of the foregoing second through fifth provisions.

In addition, because we are incorporated in Delaware, we are governed by the provisions of Section 203 of the Delaware General Corporation Law, which limits the ability of stockholders owning in excess of 15% of our outstanding voting stock to merge or combine with us. Although we believe these provisions collectively provide for an opportunity to obtain greater value for stockholders by requiring potential acquirers to negotiate with our board of directors, they would apply even if an offer rejected by our board were considered beneficial by some stockholders. In addition, these provisions may frustrate or prevent any attempts by our stockholders to replace or remove our current

management by making it more difficult for stockholders to replace members of our board of directors, which is responsible for appointing the members of our management.

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Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

On February 5, 2018, our Board of Directors authorized a $100.0 million share repurchase program, which was announced on February 12, 2018. Our stock repurchase authorization does not have an expiration date. Our stock repurchases may be effected from time to time through open market purchases or pursuant to a Rule 10b5-1 plan. All share repurchases were made using cash resources. As of March 31, 2018, approximately $98.5 million remained available for share repurchases pursuant to our share repurchase program.

A summary of our repurchases of common stock during the first quarter of 2018 is as follows:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plan or Program	Approximate Dollar Value of Shares that May Yet Be Purchased under the Plan or Program
January 1, 2018 - January 31, 2018	—	$ —	—	$—
February 1, 2018 - February 28, 2018	21,288	$ 69.56	21,288	$98,519,173
March 1, 2018 - March 31, 2018	—	$ —	—	$98,519,173
Total	21,288		21,288	

Item 3. Defaults upon Senior Securities

None.

Item 4. Mine Safety Disclosures

None.

Item 5. Other Information

None.

Item 6. Exhibits

Exhibit Number	Description
31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of The Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of The Sarbanes-Oxley Act of 2002.
32.1^	Certification of Chief Executive Officer pursuant to Rule 13a-14(b) or Rule 15d-14(b) of the Securities Exchange Act of 1934 and 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of The Sarbanes-Oxley Act of 2002.
32.2^	Certification of Chief Financial Officer pursuant to Rule 13a-14(b) or Rule 15d-14(b) of the Securities Exchange Act of 1934 and 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of The Sarbanes-Oxley Act of 2002.
101 INS	XBRL Instance Document
101 SCH	XBRL Taxonomy Extension Schema Document
101 CAL	XBRL Taxonomy Extension Calculation Linkbase Document.
101 DEF	XBRL Taxonomy Extension Definition Linkbase Document.
101 LAB	XBRL Taxonomy Extension Labels Linkbase Document.
101 PRE	XBRL Taxonomy Extension Presentation Linkbase Document.

^ Exhibits 32.1 and 32.2 are being furnished and shall not be deemed to be “filed” for purposes of Section 18 of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), or otherwise subject to the liability of that section, nor shall such exhibits be deemed to be incorporated by reference in any registration statement or other document filed under the Securities Act of 1933, as amended, or the Exchange Act, except as otherwise specifically stated in such filing.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of Foster City, State of California on May 8, 2018.

QUALYS, INC.
By: /s/ PHILIPPE F. COURTOT
Name: Philippe F. Courtot
Title: Chairman, President and Chief Executive Officer
(principal executive officer)

By: /s/ MELISSA B. FISHER
Name: Melissa B. Fisher
Title: Chief Financial Officer
(principal financial and accounting officer)