VARONIS SYSTEMS INC
Form 10-Q
August 04, 2017

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2017

or

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

For the transition period from __________ to __________

Commission File Number: 001-36324

VARONIS SYSTEMS, INC.

(Exact name of registrant as specified in its charter)

Delaware	**57-1222280**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
1250 Broadway, 29th Floor New York, NY	**10001**
(Address of principal executive offices)	**(Zip Code)**

(877) 292-8767

(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 and 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. x Yes ¨ No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). x Yes ¨ 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.

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

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

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

At August 2, 2017, there were 27,504,378 shares of Common Stock, par value $0.001 per share, outstanding.

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PART 1. FINANCIAL INFORMATION

Item 1. Financial Statements

CONSOLIDATED BALANCE SHEETS

(in thousands, except share and per share data)

	June 30, 2017 (unaudited)	December 31, 2016
Assets		
Current assets:		
Cash and cash equivalents	$53,539	$ 48,315
Short-term investments	68,039	65,493
Trade receivables (net of allowance for doubtful accounts of $420 and $372 at June 30, 2017 and December 31, 2016, respectively)	41,313	53,861
Prepaid expenses and other current assets	7,571	3,650
Total current assets	170,462	171,319
Long-term assets:		
Other assets	818	609
Property and equipment, net	11,160	9,910
Total long-term assets	11,978	10,519
Total assets	$182,440	$ 181,838
Liabilities and stockholders’ equity		
Current liabilities:		
Trade payables	$1,348	$ 1,288
Accrued expenses and other short term liabilities	30,769	28,479
Deferred revenues	57,457	58,478
Total current liabilities	89,574	88,245
Long-term liabilities:		
Deferred revenues	3,889	3,562
Severance pay	1,472	1,664
Other liabilities	5,273	5,628
Total long-term liabilities	10,634	10,854
Stockholders’ equity:		
Share capital		
Common stock of $0.001 par value - Authorized: 200,000,000 shares at June 30, 2017 and December 31, 2016; Issued and outstanding: 27,468,395 shares at June 30, 2017 and 26,821,762 shares at December 31, 2016	27	27

Accumulated other comprehensive income (loss)	2,128	(479)
Additional paid-in capital	204,751	189,335
Accumulated deficit	(124,674)	(106,144)
Total stockholders' equity	82,232	82,739
Total liabilities and stockholders' equity	$ 182,440	$ 181,838

The accompanying notes are an integral part of these consolidated financial statements.

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UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except share and per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Revenues:				
Licenses	$28,420	$21,742	$47,575	$35,586
Maintenance and services	21,754	16,899	42,979	33,525
Total revenues	50,174	38,641	90,554	69,111
Cost of revenues	4,878	3,721	9,550	7,217
Gross profit	45,296	34,920	81,004	61,894
Operating costs and expenses:				
Research and development	11,498	8,905	21,907	17,742
Sales and marketing	32,560	26,840	63,371	51,204
General and administrative	6,582	4,760	12,095	9,322
Total operating expenses	50,640	40,505	97,373	78,268
Operating loss	(5,344)	(5,585)	(16,369)	(16,374)
Financial income (expenses), net	950	(605)	1,419	40
Loss before income taxes	(4,394)	(6,190)	(14,950)	(16,334)
Income taxes	(641)	(303)	(964)	(509)
Net loss	$(5,035)	$(6,493)	$(15,914)	$(16,843)
Net loss per share of common stock, basic and diluted	$(0.18)	$(0.25)	$(0.59)	$(0.64)
Weighted average number of shares used in computing net loss per share of common stock, basic and diluted	27,321,837	26,273,380	27,137,930	26,195,269

The accompanying notes are an integral part of these consolidated financial statements.

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UNAUDITED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

(in thousands)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Net loss	$ (5,035)	$ (6,493)	$ (15,914)	$ (16,843)
Other comprehensive income (loss):				
Unrealized losses on short term investments	(10)	-	(10)	-
Unrealized gains (losses) on derivative instruments	493	(845)	2,617	379
Total other comprehensive income (loss)	483	(845)	2,607	379
Comprehensive loss	$ (4,552)	$ (7,338)	$ (13,307)	$ (16,464)

The accompanying notes are an integral part of these consolidated financial statements.

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UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	Six Months Ended June 30, 2017	Six Months Ended June 30, 2016
Cash flows from operating activities:		
Net loss	$(15,914)	$(16,843)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation	1,284	1,066
Stock-based compensation	9,663	5,997
Capital gain from disposal of fixed assets	(2)	-
Changes in assets and liabilities:		
Trade receivables	12,548	13,943
Prepaid expenses and other current assets	(1,783)	47
Trade payables	60	(538)
Accrued expenses and other short term liabilities	2,769	16
Severance pay	(192)	21
Deferred revenues	(694)	(1,144)
Other long term liabilities	(355)	(224)
Net cash provided by operating activities	7,384	2,341
Cash flows from investing activities:		
Decrease (increase) in short-term investments	(2,556)	4,750
Increase in long-term deposits	(160)	(27)
Increase in restricted cash	(49)	(7)
Proceeds on sales of property and equipment	2	-
Purchase of property and equipment	(2,534)	(1,447)
Net cash provided by (used in) investing activities	(5,297)	3,269
Cash flows from financing activities:		
Proceeds from employee stock plans, net	3,137	1,251
Net cash provided by financing activities	3,137	1,251
Increase in cash and cash equivalents	5,224	6,861
Cash and cash equivalents at beginning of period	48,315	49,241
Cash and cash equivalents at end of period	$53,539	$56,102
Supplemental disclosure of cash flow information:		
Cash paid for income taxes	$140	$96

The accompanying notes are an integral part of these consolidated financial statements.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1:- GENERAL

a. Varonis Systems, Inc. ("VSI" and together with its subsidiaries, collectively, the "Company") was incorporated under the laws of the State of Delaware on November 3, 2004 and commenced operations on January 1, 2005.

VSI has seven wholly-owned subsidiaries: Varonis Systems Ltd. ("VSL") incorporated under the laws of Israel on November 24, 2004; Varonis (UK) Limited ("VSUK") incorporated under the laws of England on March 14, 2007; Varonis Systems (Deutschland) GmbH ("VSG") incorporated under the laws of Germany on July 6, 2011; Varonis France SAS ("VSF") incorporated under the laws of France on February 22, 2012; Varonis Systems Corp. ("VSC") incorporated under the laws of British Columbia, Canada on February 19, 2013; Varonis Systems (Ireland) Limited incorporated under the laws of Ireland on November 11, 2016; and Varonis Systems (Australia) Pty Ltd ("VSA") incorporated under the laws of Victoria, Australia on February 28, 2017.

The Company's software products and services allow enterprises to manage, analyze and secure enterprise data. The Company specializes in creating software that manages and protects enterprise data against insider threats, data breaches and cyberattacks by detecting and alerting on deviations from known behavioral baselines, identifying and mitigating exposures of sensitive data, and automating processes to secure enterprise data. Enterprise data under our scope is typically comprised of sensitive information that is stored in spreadsheets, emails, word processing documents, presentations, audio files, video files, text messages and any other data created by employees. This data often contains an enterprise's financial information, product plans, strategic initiatives, intellectual property and numerous other forms of vital information. Through its products, DatAdvantage (including DatAlert and the Automation Engine), DataPrivilege, IDU Classification Framework, Data Transport Engine and DatAnswers, the software platform allows enterprises to protect sensitive data from insider threats and cyberattacks and realize the value of their enterprise data.

VSI markets and sells products and services mainly in the United States. VSUK, VSG, VSF, VSC and VSA resell the Company's products and services mainly in the UK, Germany, France and rest of Europe, Canada and Australia, respectively. The Company primarily sells its products and services to a global network of distributors and Value Added Resellers (VARs), which sell the products to end user customers.

b. Basis of Presentation:

The accompanying unaudited consolidated interim financial statements have been prepared in accordance with Article 10 of Regulation S-X, "Interim Financial Statements" and the rules and regulations for Form 10-Q of the Securities and

Exchange Commission (the "SEC"). Pursuant to those rules and regulations, the Company has condensed or omitted certain information and footnote disclosure it normally includes in its annual consolidated financial statements prepared in accordance with U.S. generally accepted accounting principles ("GAAP").

In management's opinion, the Company has made all adjustments (consisting only of normal, recurring adjustments, except as otherwise indicated) necessary to fairly present its consolidated financial position, results of operations and cash flows. The Company's interim period operating results do not necessarily indicate the results that may be expected for any other interim period or for the full fiscal year. These financial statements and accompanying notes should be read in conjunction with the 2016 consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for its fiscal year ended December 31, 2016 filed with the SEC on February 9, 2017 (the "2016 Form 10-K"). There have been no changes in the significant accounting policies from those that were disclosed in the audited consolidated financial statements for the fiscal year ended December 31, 2016 included in the 2016 Form 10-K, except as follows:

Effective as of January 1, 2017, the Company adopted Accounting Standards Update 2016-09, "Compensation—Stock Compensation (Topic 718)" ("ASU 2016-09") on a modified, retrospective basis. ASU 2016-09 permits entities to make an accounting policy election related to how forfeitures will impact the recognition of compensation cost for stock-based compensation: to estimate the total number of awards for which the requisite service period will not be rendered or to account for forfeitures as they occur. Upon adoption of ASU 2016-09, the Company elected to change its accounting policy to account for forfeitures as they occur. The change was applied on a modified, retrospective basis with a cumulative-effect adjustment to retained earnings of $2,616 (which increased the accumulated deficit) as of January 1, 2017.

ASU 2016-09 also eliminates the requirement that excess tax benefits be realized as a reduction in current taxes payable before the associated tax benefit can be recognized as an increase in paid in capital. Approximately $7,131 of federal net operating losses and $718 of state net operating losses, neither of which was included in the deferred tax assets recognized in the statement of financial position as of December 31, 2016, have been attributed to tax deduction for stock-based compensation in excess of the related book expense. Under ASU 2016-09, these previously unrecognized deferred tax assets will be recognized on a modified, retrospective basis as of the start of the year in which the ASU 2016-09 is adopted; in this case as of January 1, 2017. The U.S. federal and state net operating losses and credits that were recognized as of January 1, 2017 have been offset by a valuation allowance. As a result, there is no cumulative-effect adjustment to retained earnings as of January 1, 2017.

Additionally, ASU 2016-09 addresses the presentation of excess tax benefits and employee taxes paid on the statement of cash flows. The Company is now required to present excess tax benefits as an operating activity on the statement of cash flows rather than as a financing activity. The Company adopted this change prospectively.

c. Derivative Instruments:

The Company’s primary objective for holding derivative instruments is to reduce its exposure to foreign currency rate changes. The Company reduces its exposure by entering into forward foreign exchange contracts with respect to operating expenses that are forecast to be incurred in currencies other than the U.S. dollar. A majority of the Company’s revenues and a majority of its operating expenditures are transacted in U.S. dollars. However, certain operating expenditures are incurred in or exposed to other currencies, primarily the New Israeli Shekel (“NIS”).

The Company has established forecasted transaction currency risk management programs to protect against fluctuations in fair value and the volatility of future cash flows caused by changes in exchange rates. The Company’s currency risk management program includes forward foreign exchange contracts designated as cash flow hedges. These forward foreign exchange contracts generally mature within 12 months, and, as of June 30, 2017, the Company had entered into such contracts until January 2018. The Company does not enter into derivative financial instruments for trading purposes.

Derivative instruments measured at fair value and their classification on the consolidated balance sheets are presented in the following table (in thousands):

	Assets as of June 30, 2017 (unaudited)		Liabilities as of December 31, 2016	
	Notional Amount	Fair Value	Notional Amount	Fair Value

Foreign exchange forward contract derivatives in cash flow hedging relationships - included in other current assets and accrued expenses and other short term liabilities	$24,780	$2,138	$46,116	$(479)

For the three and six months ended June 30, 2017, the unaudited consolidated statements of operations reflect a gain of approximately $653 and $918, respectively, related to the effective portion of foreign currency forward contracts. For the three and six months ended June 30, 2016, the unaudited consolidated statements of operations reflect a gain of approximately $154 and $82, respectively, related to the effective portion of foreign currency forward contracts. There was no ineffective portion for the three and six months ended June 30, 2017 and 2016.

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d. Cash, Cash Equivalents and Short-Term Investments:

The Company accounts for investments in marketable securities in accordance with ASC No. 320, "Investments—Debt and Equity Securities". The Company considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents. Cash and cash equivalents consist of cash on hand, highly liquid investments in money market funds and various deposit accounts.

The Company considers all high quality investments purchased with original maturities at the date of purchase greater than three months to be short-term investments. Investments are available to be used for current operations, and are, therefore, classified as current assets even though maturities may extend beyond one year. Cash equivalents and short-term investments are classified as available for sale and are, therefore, recorded at fair value on the consolidated balance sheet, with any unrealized gains and losses reported in accumulated other comprehensive income (loss), which is reflected as a separate component of stockholders' equity in the Company's consolidated balance sheets, until realized. The Company uses the specific identification method to compute gains and losses on the investments. The amortized cost of securities is adjusted for amortization of premiums and accretion of discounts to maturity. Such amortization and accretion is included as a component of financial income, net in the consolidated statement of operations. Cash, cash equivalents and short-term investments consist of the following (in thousands):

	As of June 30, 2017 (unaudited)			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Loss	Fair Value
Cash and cash equivalents				
Cash	$40,083	$ -	$ -	$40,083
Money market funds	12,456	-	-	12,456
US Treasury securities	1,000	-	*)	1,000
Total	$53,539	$ -	$ -	$53,539
Short-term investments				
US Treasury securities	$32,946	$ -	$ (10)	$32,936
Term bank deposits	35,103	-	-	35,103
Total	$68,049	$ -	$ (10)	$68,039

*) Represents an amount lower than $ 1.

All the US Treasury securities in short-term investments have a stated effective maturity of less than 12 months as of June 30, 2017.

	As of December 31, 2016			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Loss	Fair Value
Cash and cash equivalents				
Cash	$42,175	$ -	$ -	$42,175
Money market funds	6,140	-	-	6,140
Total	$48,315	$ -	$ -	$48,315
Short-term investments				
Term bank deposits	$65,493	-	-	$65,493
Total	$65,493	$ -	$ -	$65,493

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The gross unrealized loss related to these short-term investments was due primarily to changes in interest rates. The Company reviews its short-term investments on a regular basis to evaluate whether or not any security has experienced an other than temporary decline in fair value. The Company considers factors such as length of time and extent to which the market value has been less than the cost, the financial condition and near-term prospects of the issuer and its intent to sell, or whether it is more likely than not the Company will be required to sell the investment before recovery of the investment's amortized cost basis. If the Company believes that an other than temporary decline exists in one of these securities, the Company writes down these investments to fair value. For debt securities, the portion of the write-down related to credit loss would be recorded to other income (expense), net in the Company's consolidated statements of operations. Any portion not related to credit loss would be recorded to accumulated other comprehensive income (loss), which is reflected as a separate component of stockholders' equity in the Company's condensed consolidated balance sheets. During the six months ended June 30, 2017, the Company did not consider any of its investments to be other-than-temporarily impaired.

e. Recently Issued Accounting Pronouncements:

In May 2014, the FASB issued ASU No. 2014-09, "Revenue from Contracts with Customers", an updated standard on revenue recognition and issued subsequent amendments to the initial guidance in March 2016, April 2016, May 2016 and December 2016 within ASU 2016-08, 2016-10, 2016-12, 2016-20, respectively. The new standards provide enhancements to the quality and consistency of how revenue is reported while also improving comparability in the financial statements of companies reporting using IFRS and US GAAP. The core principle of the new standard is for companies to recognize revenue to depict the transfer of goods or services to customers in amounts that reflect the consideration (that is, payment) to which the company expects to be entitled in exchange for those goods or services. The new standard also will result in enhanced disclosures about revenue, provide guidance for transactions that were not previously addressed comprehensively (for example, service revenue and contract modifications) and improve guidance for multiple-element arrangements. ASU 2014-09 was initially scheduled to be effective for annual and interim reporting periods beginning after December 15, 2016 and may be adopted either on a full retrospective or modified retrospective approach. However, on July 9, 2015, the FASB approved a one year deferral of the effective date of ASU 2014-09. The revised effective date is for annual reporting periods beginning after December 15, 2017 and interim periods thereafter, with an early adoption permitted as of the original effective date. The Company is in the process of evaluating the effect the new revenue recognition standard will have on its consolidated financial statements and related disclosures but has not completed its evaluation and implementation process. The Company intends to complete this process in 2017 and will adopt the new standard on January 1, 2018, using the full retrospective method. Based on its preliminary evaluation to date, the Company believes adoption of the new standard may have a material impact on its consolidated financial statements.

In May 2016, the FASB issued ASU 2016-11, "Revenue Recognition: Customer Payments and Incentives", which clarifies the guidance in recognizing costs for consideration given by a vendor to a customer as a component of cost of sales. This ASU is effective for annual and interim periods beginning after December 15, 2017. The Company is currently evaluating the impact of this standard on its consolidated financial statements and related disclosures.

In February 2016, the FASB issued ASU 2016-02, “Leases”, on the recognition, measurement, presentation and disclosure of leases for both parties to a contract (i.e., lessees and lessors). The new standard requires lessees to apply a dual approach, classifying leases as either finance or operating leases based on the principle of whether or not the lease is effectively a financed purchase by the lessee. This classification will determine whether lease expense is recognized based on an effective interest method or on a straight line basis over the term of the lease, respectively. A lessee is also required to record a right-of-use asset and a lease liability for all leases with a term of greater than 12 months regardless of their classification. Leases with a term of 12 months or less will be accounted for in a manner similar to the accounting under existing guidance for operating leases today. The new standard requires lessors to account for leases using an approach that is substantially equivalent to existing guidance for sales-type leases, direct financing leases and operating leases. ASC 842 supersedes the previous leases standard, ASC 840, "Leases". The guidance is effective for the interim and annual periods beginning on or after December 15, 2018, and early adoption is permitted. The Company is currently evaluating whether to early adopt this standard and the potential effect of the guidance on its consolidated financial statements.

In November 2016, the FASB issued ASU 2016-18, “Statement of Cash Flows (Topic 230): Restricted Cash”, which requires companies to include amounts generally described as restricted cash and restricted cash equivalents in cash and cash equivalents when reconciling beginning-of-period and end-of-period total amounts shown on the statement of cash flows. This ASU is effective for annual and interim periods beginning after December 15, 2017 and early adoption is permitted. The Company is currently evaluating whether to early adopt this standard and the potential effect of the guidance on its consolidated financial statements.

In May 2017, the FASB issued ASU 2017-09, *Compensation - Stock Compensation: Scope of Modification Accounting*, which clarifies when changes to the terms or conditions of a share-based payment award must be accounted for as modifications. Under the new guidance, modification accounting is required only if the fair value, the vesting conditions, or the classification of the award changes as a result of the change in terms or conditions. ASU 2017-09 will be applied prospectively to awards modified on or after the adoption date. The standard is effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. Early adoption is permitted. The Company is currently evaluating the impact of adoption of this standard on its consolidated financial statements.

NOTE 2:- FAIR VALUE MEASUREMENTS

The Company evaluates assets and liabilities subject to fair value measurements on a recurring basis to determine the appropriate level to classify them for each reporting period. There have been no transfers between fair value measurements levels during the three months ended June 30, 2017.

The authoritative guidance on fair value measurements establishes a consistent framework for measuring fair value on either a recurring or nonrecurring basis whereby inputs, used in valuation techniques, are assigned a hierarchical level. The following are the hierarchical levels of inputs to measure fair value:

- Level 1: Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets.
- Level 2: Observable inputs that reflect quoted prices for identical assets or liabilities in markets that are not active; quoted prices for similar assets or liabilities in active markets; inputs other than quoted prices that are observable for the assets or liabilities; or inputs that are derived principally from or corroborated by observable market data by correlation or other means.
- Level 3: Unobservable inputs reflecting our own assumptions incorporated in valuation techniques used to determine fair value. These assumptions are required to be consistent with market participant assumptions that are reasonably available.

The following table sets forth the Company’s assets and liabilities that were measured at fair value as of June 30, 2017 and December 31, 2016 by level within the fair value hierarchy (in thousands):

	As of June 30, 2017 (unaudited)				As of December 31, 2016			
	Level I	Level II	Level III	Fair Value	Level I	Level II	Level III	Fair Value
Financial assets:								

Cash equivalents:								
Money market funds	12,456	–	–	12,456	6,140	–	–	6,140
US Treasury securities	1,000	–	–	1,000	–	–	–	–
Short-term investments:								
US Treasury securities	32,936	–	–	32,936	–	–	–	–
Term bank deposits	35,103	–	–	35,103	65,493	–	–	65,493
Other current assets:								
Forward foreign exchange contracts	–	2,138	–	2,138	–	–	–	–
Financial liabilities:								
Forward foreign exchange contracts	–	–	–	–	–	(479)	–	(479)
Total financial assets (liabilities)	$81,495	$2,138	$ –	$83,633	$71,633	$(479)	$ –	$71,154

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NOTE 3:- COMMITMENTS AND CONTINGENT LIABILITIES

a. Liens:

The Company has several liens granted to financial institutions mainly to secure various operating lease agreements in connection with its office space.

b. Lease Commitments:

The Company rents its facilities in all locations under operating leases with lease periods expiring from 2017 - 2026. The lease agreement of VSL includes extension options. VSL leases cars for its employees under operating lease agreements expiring at various dates from 2017 – 2020.

Aggregate minimum rental commitments under non-cancelable leases as of June 30, 2017 for the upcoming years were as follows:

	(unaudited)
2017	$ 2,736
2018	4,872
2019	4,839
2020	3,486
2021	3,495
Thereafter	13,062
	$ 32,490

Total rent expenses for the six months ended June 30, 2017 and the year ended December 31, 2016 were $1,814 and $3,258, respectively. The total minimum rent to be received in the future under the non-cancelable sublease as of June 30, 2017 was $1,121.

For leases that contain predetermined fixed escalations of the minimum rent, the Company recognizes the related rent expense on a straight-line basis from the date of possession of the property to the end of the initial lease term. The Company records any differences between the straight-line rent amounts and amounts payable under the leases as part of deferred rent, in accrued liabilities or long-term liabilities, as appropriate. Cash or lease incentives received upon entering into certain leases (“tenant allowances”) are recognized on a straight-line basis as a reduction to rent from the date of possession of the property through the end of the initial lease term. The Company records the unamortized portion of tenant allowances as a part of deferred rent, in current liabilities or other long-term liabilities, as appropriate.

c. Credit Facility:

On March 31, 2014, the Company entered into a promissory note and related security documents with Bank Leumi USA. The Company may borrow up to $7,000 against certain of its accounts receivable outstanding amount, based on several conditions, at an annual interest rate of the Wall Street Journal Prime Rate less 0.15%. As of June 30, 2017, that rate amounted to 4.10%. This promissory note enables the Company, among other things, to engage in foreign currency hedging transactions with Bank Leumi USA to manage exposure to foreign currency risk without restricted cash requirements. The Company may borrow under the promissory note until August 15, 2017 at which time the principal sum of each such loan, together with accrued and unpaid interest payable, will become due and payable. As of June 30, 2017, the Company had no balance outstanding under the promissory note. As part of the transaction, the Company granted the lender a security interest in its personal property, excluding intellectual property and other intangible assets. The promissory note also contains customary events of default.

NOTE 4:- STOCKHOLDERS' EQUITY

a. On December 30, 2005, the Company's board of directors adopted the Varonis Systems, Inc. 2005 Stock Plan (the "2005 Stock Plan"). As of December 31, 2013, the Company had reserved 4,713,319 shares of common stock available for issuance to employees, directors, officers and consultants of the Company and its subsidiaries. The options generally vest over four years. No awards were granted under the 2005 Stock Plan subsequent to December 31, 2013, and no further awards will be granted under the 2005 Stock Plan.

On November 14, 2013, the Company's board of directors adopted the Varonis Systems, Inc. 2013 Omnibus Equity Incentive Plan (the "2013 Plan") which was subsequently approved by the Company's stockholders. The Company initially reserved 1,904,633 shares of common stock available for issuance under the 2013 Plan to employees, directors, officers and consultants of the Company and its subsidiaries. The number of shares of common stock available for issuance under the 2013 Plan was increased on January 1, 2016 and will be increased on each January 1 thereafter by four percent (4%) of the number of shares of common stock issued and outstanding on each December 31 immediately prior to the date of increase (rounded down to the nearest whole share), but the amount of each increase will be limited to the number of shares of common stock necessary to bring the total number of shares of Common Stock available for grant and issuance under the 2013 Plan to five percent (5%) of the number of shares of common stock issued and outstanding on each December 31. On January 1, 2016 and 2017, the share reserve under the 2013 Plan was automatically increased by 1,042,766 and 1,072,870 shares, respectively. Awards granted under the 2013 Plan generally vest over four years. Any award that is forfeited or canceled before expiration becomes available for future grants under the 2013 Plan.

A summary of employees' stock options activities during the six months ended June 30, 2017 is as follows:

	Six Months Ended June 30, 2017 (unaudited)			
	Number	Weighted average exercise price	Aggregate intrinsic value (in thousands)	Weighted average remaining contractual life (years)
Options outstanding as of January 1, 2017	2,388,348	$ 15.243	$ 30,025	5.861
Granted	-	$ -		
Exercised	(330,351)	$ 10.324		
Forfeited	(72,893)	$ 18.148		
Options outstanding as of June 30, 2017	1,985,104	$ 15.941	$ 42,589	5.035
Options exercisable at the end of the period	1,633,271	$ 14.216	$ 37,856	4.624

The aggregate intrinsic value in the table above represents the total intrinsic value that would have been received by the option holders had all option holders exercised their options on the last date of the exercise period. Total intrinsic value of options exercised for the six months ended June 30, 2017 was $7,500.

b. The options outstanding as of June 30, 2017 (unaudited) have been separated into ranges of exercise price as follows:

Range of exercise price		**Options outstanding as of June 30, 2017**	**Weighted average remaining contractual life (years)**	**Weighted average exercise price**	**Options exercisable as of June 30, 2017**	**Weighted average remaining contractual life (years)**	**Weighted average exercise price of options exercisable**
$1.039 -	$1.576	575,859	1.855	$1.329	575,859	1.855	$1.329
$6.230 -	8.800	70,930	4.266	$7.032	70,930	4.266	$7.032
$12.470-	16.870	297,114	6.172	$13.429	263,780	5.859	$12.995
$19.510-	21.660	475,348	6.602	$21.202	311,878	6.512	$21.200
$22.010-	24.230	269,316	6.335	$22.270	204,808	6.316	$22.305
$29.880		150,887	7.649	$29.880	86,643	7.649	$29.880
$39.860		145,650	5.435	$39.860	119,373	5.435	$39.860
		1,985,104	5.035	$15.941	1,633,271	4.624	$14.216

c. Options issued to consultants:

The Company’s outstanding options granted to consultants for services as of June 30, 2017 (unaudited) were as follows:

	Options for shares of common stock (number)	Exercise price per share	Options exercisable (number)	Exercisable through
February 2013	1,500	$ 12.470	1,500	February 2023
August 2013	4,188	$ 21.140	3,559	August 2023
March 2014	13,100	$ 39.860	10,546	March 2024
May 2014	6,250	$ 22.010	4,580	May 2024
November 2014	8,431	$ 21.660	4,663	November 2024
May 2015	3,500	$ 19.510	1,105	May 2025
February 2016	2,500	$ 16.870	832	February 2026
	39,469		26,785	

d. Restricted stock units:

A summary of restricted stock units for employees, consultants and non-employee directors of the Company for the six months ended June 30, 2017 (unaudited) is as follows:

	Number of shares underlying outstanding restricted stock units	Weighted-average grant date fair value
Unvested balance - January 1, 2017	1,399,127	$ 19.96
Granted	1,011,903	$ 28.93
Vested	(309,675)	$ 20.46
Forfeited	(153,200)	$ 21.40
Unvested balance – June 30, 2017	1,948,155	$ 25.11

e. As of June 30, 2017, there was $4,378 and $43,752 of total unrecognized compensation cost related to unvested employee stock options and unvested restricted stock units, respectively. This cost is expected to be recognized over a period of approximately 1.242 years and 3.083 years for stock options and restricted stock units, respectively.

f. 2015 Employee Stock Purchase Plan

On May 5, 2015, the Company's stockholders approved the Varonis Systems, Inc. 2015 Employee Stock Purchase Plan (the "ESPP"), which the Company's board of directors had adopted on March 19, 2015. The ESPP became effective as of June 30, 2015. The ESPP allows eligible employees to purchase shares of the Company's common stock at a discount through payroll deductions of up to 15% of their eligible compensation, at not less than 85% of the fair market value of the Company's common stock on the first day or last trading day in the offering period, subject to any plan limitations. The Company initially reserved 500,000 shares of common stock for issuance under the ESPP. The number of shares available for issuance under the ESPP was increased on January 1, 2016, and will increase each January 1 thereafter, by an amount equal to the lesser of (i) one percent (1%) of the number of shares of common stock issued and outstanding on each December 31 immediately prior to the date of increase, except that the amount of each such increase will be limited to the number of shares of common stock necessary to bring the total number of shares of common stock available for issuance under the ESPP to two percent (2%) of the number of shares of common stock issued and outstanding on each such December 31, or (ii) 400,000 shares of common stock. On January 1, 2016 and 2017, the share reserve under the ESPP was automatically increased by 21,383 and 158,695 shares, respectively. The ESPP will continue in effect until the earlier of (i) the date when no shares of common stock are available for issuance thereunder or (ii) June 30, 2025; unless terminated prior thereto by the Company's board of directors or compensation committee, each of which has the right to terminate the ESPP at any time.

g. Stock-based compensation expense for employees and consultants:

The Company recognized non-cash stock-based compensation expense in the consolidated statements of operations as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
	(unaudited) (in thousands)		(unaudited) (in thousands)	
Cost of revenues	$ 273	$ 172	$ 500	$ 318
Research and development	1,301	793	2,431	1,458
Sales and marketing	2,362	1,628	4,421	2,803
General and administrative	1,323	780	2,311	1,418
Total	$ 5,259	$ 3,373	$ 9,663	$ 5,997

Since the Company is in a net loss position for all periods presented, basic net loss per share is the same as diluted net loss per share for all the periods as the inclusion of all potential common shares outstanding would have been anti-dilutive. There are 3,972,728 and 4,091,928 potentially dilutive shares from the conversion of outstanding RSUs and stock options that were not included in the calculation of diluted net loss per share as of June 30, 2017 and 2016, respectively.

NOTE 5:- GEOGRAPHIC INFORMATION AND MAJOR CUSTOMER AND PRODUCT DATA

Summary information about geographic areas:

ASC 280, "Segment Reporting," establishes standards for reporting information about operating segments. Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing performance. The Company manages its business on the basis of one reportable segment and derives revenues from licensing of software and sales of professional services, maintenance and technical support (see Note 1 for a brief description of the Company's business). The following is a summary of revenues within geographic areas:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
	(unaudited) (in thousands)		(unaudited) (in thousands)	
Revenues based on customer's location:				
United States	$ 33,135	$ 24,330	$ 57,544	$ 41,845
EMEA (*)	13,879	11,857	27,120	22,354
Rest of World	3,160	2,454	5,890	4,912
Total revenues	$ 50,174	$ 38,641	$ 90,554	$ 69,111

(*) Sales to customers in France accounted for $5,153 of the Company's revenues for the three months ended June 30, 2017 and did not exceed 10% of the Company's revenues for the three months ended June 30, 2016. Sales to customers in France did not exceed 10% of the Company's revenues for the six months ended June 30, 2017 and accounted for $6,922 of the Company's revenues for the six months ended June 30, 2016.

	June 30, 2017	December 31, 2016
	(unaudited) (in thousands)	
Long-lived assets by geographic region:		
United States	$ 7,352	$ 7,664
Israel	2,731	1,827
Other	1,077	419

	$11,160	$ 9,910

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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our consolidated financial statements and related notes appearing elsewhere in this Quarterly Report on Form 10-Q and our Annual Report on Form 10-K for our fiscal year ended December 31, 2016.

Special Note Regarding Forward-Looking Statements

This report contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those discussed in the forward-looking statements. The statements contained in this report that are not purely historical are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the "Securities Act"), and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Forward-looking statements are often identified by the use of words such as, but not limited to, "anticipate," "believe," "can," "continue," "could," "estimate," "expect," "intend," "may," "plan," "project," "seek," "should," "strategy," "t and similar expressions or variations intended to identify forward-looking statements. These statements are based on the beliefs and assumptions of our management based on information currently available to management. Such forward-looking statements are subject to risks, uncertainties and other important factors that could cause actual results and the timing of certain events to differ materially from future results expressed or implied by such forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those identified below and those discussed in the section titled "Risk Factors" included under Part II, Item 1A below. Furthermore, such forward-looking statements speak only as of the date of this report. Except as required by law, we undertake no obligation to update any forward-looking statements to reflect events or circumstances after the date of such statements.

Overview

We provide an innovative software platform that allows enterprises to manage, analyze and secure enterprise data. We specialize in creating software that manages and protects enterprise data against insider threats, data breaches and cyberattacks by detecting and alerting on deviations from known behavioral baselines, identifying and mitigating exposures of sensitive data and automating processes to secure enterprise data. Enterprise data under our scope is typically comprised of sensitive information that is stored in spreadsheets, emails, word processing documents, presentations, audio files, video files, text messages and any other data created by employees. This data often contains an enterprise's financial information, product plans, strategic initiatives, intellectual property and numerous other forms of vital information. Our proprietary technology platform extracts critical metadata, or data about data, from an enterprise's IT infrastructure and uses this contextual information to map functional relationships among employees, data objects, content and usage. IT and business personnel deploy our software for a variety of use cases, including data governance, security, management, archiving and information collaboration.

We have been a pioneer in developing a software platform that allows enterprises to realize the value of their data in ways that are not resource-intensive and are easy to implement. The revolution in internet search occurred when search engines began to mine internet metadata, such as the links between pages, in addition to page content, thereby making the internet's content more usable and subsequently valuable. Similarly, our software creates advanced searchable data structures and provides real-time intelligence about an enterprise's massive volumes of data, making data more valuable to the organization.

We started operations in 2005 with a vision to make enterprise data more secure, manageable, accessible and actionable. We began offering our flagship product, DatAdvantage, which provides centralized visibility for enterprise data, in 2006. Since then we have continued to invest in innovation and have consistently introduced new products to our customers, including DataPrivilege, which was introduced in 2006, as our self-service web portal for business users. In 2008, we enhanced our DatAdvantage offering with DatAdvantage for UNIX/Linux. In 2009, we introduced the IDU Classification Framework for sensitive data classification and DatAdvantage for SharePoint. We further enhanced our DatAdvantage offering by releasing DatAdvantage for Exchange governance in 2010 which enabled our customers to exercise control over the information being transferred through corporate e-mails. In 2011, we introduced DatAdvantage for Directory Services for increased visibility into Active Directory. In 2012, we released the Data Transport Engine for intelligent data migration and archiving and DatAnywhere for secure hybrid cloud collaboration. In 2014, we introduced DatAnswers, a secure enterprise search solution for enterprise data that delivers highly relevant and secure search results to enterprise employees, greatly improving their productivity. In 2015, we enhanced our DatAdvantage, DataPrivilege and IDU Classification offerings; with DatAdvantage support for the following Microsoft Office 365 data stores: Exchange online, SharePoint online, OneDrive and Active Directory hosted in Azure; with DataPrivilege for SharePoint; and with IDU Classification Framework for UNIX, SharePoint online and OneDrive. In 2016, we enhanced our DatAdvantage offerings with additional Office 365 support; DatAnswers support for SharePoint Online and OneDrive; and introduced a new web UI for DatAlert for comprehensive security management and threat detection. We added additional user behavior analytics driven threat models to DatAlert to significantly enhance our detection of insider threats, including potential disgruntled employees, rogue administrators, hijacked accounts and malware, such as ransomware. We also established a behavioral research laboratory where a dedicated team of security experts and data scientists from Varonis continually introduces new behavior-based threat models to DatAlert. In 2017, we released the Automation Engine to automatically repair and maintain file systems so that organizations are less vulnerable to attacks and security breaches, more compliant and consistently meeting a least privilege model. We enhanced DatAlert with DatAlert Analytics Rewind to allow customers to analyze past user and data activity to identify security breaches that may have occurred in the past and pre-emptively tune out false positives. We have continued to update our web UI for DatAlert and added new threat models to detect suspicious mailbox and Exchange behaviors, password resets and unusual activity from personal devices.

At the core of our technology is our ability to intelligently extract and analyze metadata from an enterprise's vast, distributed data stores. The broad applicability of our technology has resulted in our customers deploying our platform for numerous use cases for security, IT, operations and business personnel. We currently have six product families, and, as of June 30, 2017, approximately 50% of our customers had purchased products in two or more families, one of which was DatAdvantage for all of these customers. We believe our existing customer base serves as a strong source of incremental revenues given our broad platform of products, their growing volumes and complexity of enterprise data and associated security concerns. Our maintenance renewal rate for the six months ended June 30, 2017 and 2016 was over 90%. Our key strategies to maintain our renewal rate include focusing on the quality and reliability of our customer service and support to ensure our customers receive value from our products, providing consistent software upgrades and having sufficient dedicated renewal sales personnel.

We sell substantially all of our products and services to channel partners, including distributors and resellers, which sell to end-user customers, which we refer to in this report as our customers. We believe that our sales model, which combines the leverage of a channel sales model with our highly trained and professional sales force, has and will continue to play a major role in our ability to grow and to successfully deliver our unique value proposition for enterprise data. As of June 30, 2017, we had approximately 5,750 customers, spanning leading firms in the financial services, healthcare, public, industrial, insurance, energy and utilities, media and entertainment, consumer and retail, technology and education sectors. We believe our customer count is a key indicator of our market penetration and the value that our products bring to our customer base. We also believe our existing customers represent significant future revenue opportunities for us. While our products serve customers of all sizes, in all industries and all geographies, our sales and marketing focus is on targeting organizations with 1,000 users or more who can make larger purchases with us over time and have a greater potential lifetime value.

We believe there is a significant long term growth opportunity in both domestic and foreign markets, which could include any organization that uses file shares, intranets and email for collaboration, regardless of region. For the three and six months ended June 30, 2017, approximately 66% and 64%, respectively, of our revenues were derived from the United States, while Europe, the Middle East and Africa accounted for approximately 28% and 30%, respectively, of our revenues and Rest of World ("ROW") accounted for approximately 6% and 6%, respectively, of our revenues. Growth in the US was particularly strong, increasing 36% and 38%, respectively, for the three and six months ended June 30, 2017 as compared to the comparable periods in the prior year. In EMEA, growth for the three and six months ended June 30, 2017 was 17% and 21%, respectively, as compared to the comparable periods in the prior year. We expect both continued sales growth in the United States and international expansion to be key components of our growth strategy, and we will continue to market our products and services in international markets.

We plan to continue to expand our international operations as part of our growth strategy. The expansion of our international operations depends in particular on our ability to hire, integrate and retain local sales and marketing personnel in these international markets, acquire new channel partners and implement an effective marketing strategy. Given the nominal amount of our ROW revenues, our ROW revenue growth rates have fluctuated in the past and may fluctuate in the future based on the timing of deal closures. In addition, the further expansion of our international operations will increase our sales and marketing and general and administrative expenses and will subject us to a variety of risks and challenges, including those related to economic and political conditions in each region, compliance with foreign laws and regulations, and compliance with domestic laws and regulations applicable to our international operations.

We derive revenues from license sales of our products, services, including initial maintenance contracts and professional services, and renewals. Substantially all of our license sales are derived from a platform of products, consisting of DatAdvantage, DataPrivilege, IDU Classification Framework and Data Transport Engine. As of June 30, 2017 and 2016, 93.2% and 92.6% of our customers, respectively, had purchased DatAdvantage; 15.4%, and 16.3% of our customers, respectively, had purchased DataPrivilege; 37.7% and 32.4% of our customers, respectively, had purchased IDU Classification Framework; and 5.8% and 4.9% of our customers, respectively, had purchased Data Transport Engine. As of June 30, 2017 and 2016, 43.2% and 46.5% of our customers, respectively, made standalone purchases of DatAdvantage, and approximately 0.4% and 0.3% of our customers made standalone purchases of DataPrivilege. As of June 30, 2017, our customers made no standalone purchases of IDU Classification Framework or Data Transport Engine. License sales accounted for 56.6% and 56.3% of our total revenues for the three months ended June 30, 2017 and 2016, respectively, and 52.5% and 51.5% of our total revenues for the six months ended June 30, 2017 and 2016, respectively.

We have achieved significant growth and scale in recent periods utilizing our business model. For the three months ended June 30, 2017 and 2016, our revenues were $50.2 million and $38.6 million, respectively, representing year-over-year growth of 30%. For the six months ended June 30, 2017 and 2016, our revenues were $90.6 million and $69.1 million, respectively, representing year-over-year growth of 31%. For the three months ended June 30, 2017 and 2016, we had operating losses of $5.3 million and $5.6 million and net losses of $5.0 million and $6.5 million, respectively. For the six months ended June 30, 2017 and 2016, we had operating losses of $16.4 million and net losses of $15.9 million and $16.8 million, respectively.

Components of Operating Results

Revenues

Our revenues consist of licenses and maintenance and services revenues.

License Revenues. License revenues reflect the revenues recognized from sales of software licenses to new customers and additional licenses to existing customers. Substantially all of our license revenues consist of revenues from perpetual licenses, under which we generally recognize the license fee portion of the arrangement upon delivery, assuming all revenue recognition criteria are satisfied. Customers may also purchase term license agreements, under which we recognize the license fee ratably, on a straight-line basis, over the term of the underlying maintenance contract, which is typically up to one year. We are focused on acquiring new customers and increasing revenues from our existing customers.

Maintenance and Services Revenues. Maintenance and services revenues consist of revenues from maintenance agreements and, to a lesser extent, professional services. Typically, when purchasing a perpetual license, a customer also purchases a one year maintenance contract for which we charge a percentage of the license fee. Customers may renew, and generally have renewed, their maintenance agreements for a fee that is based upon a percentage of the initial license fee paid. Customers with maintenance agreements are entitled to receive support and unspecified upgrades and enhancements when and if they become available during the maintenance period. We have experienced growth in maintenance revenues primarily due to increased license sales to new customers and high annual retention of existing customers. We recognize the revenues associated with maintenance ratably, on a straight-line basis, over the associated maintenance period. We measure the perpetual license maintenance renewal rate for our customers over a 12-month period, based on a dollar renewal rate for contracts expiring during that time period. Our maintenance renewal rate for each of the six months ended June 30, 2017 and 2016 has been over 90%. We also offer professional services focused on both deployment and training our customers to fully leverage the use of our products. We recognize the revenues associated with these professional services on a time and materials basis as we deliver the services, provide the training or when the service term has expired.

The following table sets forth the percentage of our revenues that have been derived from licenses and maintenance and services revenues for the periods presented.

	Six Months Ended June 30,			
	2017		2016	
	(as a percentage of total revenues)			
Revenues:				
Licenses	52.5	%	51.5	%
Maintenance and services	47.5		48.5	
Total revenues	100.0	%	100.0	%

Our products are used by a wide range of enterprises, including Fortune 500 corporations and small and medium-sized businesses. As of June 30, 2017, we had approximately 5,750 customers across a broad array of company sizes and industries located in 75 countries.

Cost of Revenues, Gross Profit and Gross Margin

Our cost of revenues consists of cost of maintenance and services revenues. Cost of maintenance and services revenues consist primarily of salaries (including payroll tax expense related to stock-based compensation), employee benefits (including commissions and bonuses) and stock-based compensation for our maintenance and services employees; travel expenses; and allocated overhead costs for facilities, IT and depreciation of equipment. We recognize expenses related to maintenance and services as they are incurred. We expect that our cost of maintenance and services revenues will increase in absolute dollars as we increase our headcount to support revenue growth.

Gross profit is total revenues less total cost of revenues. Gross margin is gross profit expressed as a percentage of total revenues. Our gross margin has historically fluctuated slightly from period to period as a result of changes in the mix of license and maintenance and services revenues. Due to the seasonality of our business, the first quarter typically results in the lowest gross margin as our first quarter revenues have historically been the lowest for the year and the majority of our expenses are relatively fixed quarter over quarter.

Operating Costs and Expenses

Our operating costs and expenses are classified into three categories: research and development, sales and marketing and general and administrative. For each category, the largest component is personnel costs, which consists of salaries (including payroll tax expense related to stock-based compensation), employee benefits (including commissions and bonuses) and stock-based compensation. Operating costs and expenses also include allocated overhead costs for depreciation of equipment. Allocated costs for facilities primarily consist of rent and office maintenance. Operating costs and expenses are generally recognized as incurred. We expect personnel costs to continue to increase in absolute dollars as we hire new employees to continue to grow our business.

Research and Development. Research and development expenses primarily consist of personnel costs attributable to our research and development personnel, as well as allocated overhead costs. We expense research and development costs as incurred. We expect that our research and development expenses will continue to increase in absolute dollars as we increase our research and development headcount to further strengthen our technology platform and invest in the development of both existing and new products.

Sales and Marketing. Sales and marketing expenses are the largest component of our operating costs and expenses and consist primarily of personnel costs, as well as marketing and business development costs, travel expenses, training and education and allocated overhead costs. We expect that sales and marketing expenses will continue to increase in absolute dollars, as we plan to expand our sales and marketing efforts, both domestically and internationally. We expect sales and marketing expenses to be our largest category of operating costs and expenses as we continue to expand our business worldwide.

*General and Administrativ*e. General and administrative expenses mostly consist of personnel and facility-related costs for our executive, finance, legal, human resources and administrative personnel. Other expenses are comprised of legal, accounting and other consultant fees and other corporate expenses and allocated overhead. We expect that general and administrative expense will increase in absolute dollars as we grow and expand our operations, including higher legal, corporate insurance and accounting expenses, and the additional costs of achieving and maintaining compliance with the Sarbanes-Oxley Act of 2002 (the “Sarbanes-Oxley Act”) and related regulations.

Financial Income (Expenses), Net

Financial income (expenses), net consist primarily of foreign exchange gains or losses and net interest. Foreign exchange gains or losses relate to our business activities in foreign countries with different operational reporting currencies. As a result of our business activities in foreign countries, we expect that foreign exchange gains or losses will continue to occur due to fluctuations in exchange rates in the countries where we do business. The United Kingdom’s decision to exit the European Union (“Brexit”), as well as other member countries public discussions about the possibility of also withdrawing, could also contribute to instability and volatility in the global financial and foreign exchange markets, including volatility in the value of Pounds Sterling, Euros and other currencies. Net interest represents interest income received on our cash, cash equivalents and short-term investments.

Income Taxes

We operate in several tax jurisdictions and are subject to taxes in each country or jurisdiction in which we conduct business. Earnings from our non-U.S. activities are subject to local country income tax and may be subject to U.S. income tax. To date, on a consolidated basis, we have incurred accumulated net losses and have not recorded any U.S. federal tax provisions.

Because of our history of U.S. and Israel net operating losses, we have established a full valuation allowance against potential future benefits for deferred tax assets including loss carryforwards. Our income tax provision could be significantly impacted by estimates surrounding our uncertain tax positions and changes to our valuation allowance in future periods. We reevaluate the judgments surrounding our estimates and make adjustments as appropriate each reporting period.

Our Israeli subsidiary currently qualifies as a “Beneficiary Enterprise” which, upon fulfillment of certain conditions, allows it to qualify for a reduced tax rate based on the beneficiary program guidelines.

In addition, we are subject to the continuous examinations of our income tax returns by different tax authorities. We regularly assess the likelihood of adverse outcomes resulting from these examinations to determine the adequacy of our provision for income taxes.

Results of Operations

Comparison of the Three Months Ended June 30, 2017 and 2016

The following tables are a summary of our consolidated statements of operations for the three months ended June 30, 2017 and 2016 in dollars and as a percentage of our total revenues.

	Three Months Ended June 30, 2017	2016
	(unaudited) (in thousands)	
Statement of Operations Data:		
Revenues:		
Licenses	$ 28,420	$ 21,742
Maintenance and services	21,754	16,899
Total revenues	50,174	38,641
Cost of revenues	4,878	3,721
Gross profit	45,296	34,920
Operating costs and expenses:		
Research and development	11,498	8,905
Sales and marketing	32,560	26,840
General and administrative	6,582	4,760
Total operating expenses	50,640	40,505
Operating loss	(5,344)	(5,585)
Financial income (expenses), net	950	(605)
Loss before income taxes	(4,394)	(6,190)
Income taxes	(641)	(303)
Net loss	$ (5,035)	$ (6,493)

	Three Months Ended June 30, 2017		2016	
	(as a percentage of total revenues)			
Statement of Operations Data:				
Revenues:				
Licenses	56.6	%	56.3	%
Maintenance and services	43.4		43.7	
Total revenues	100.0		100.0	
Cost of revenues	9.7		9.6	
Gross profit	90.3		90.4	

Operating costs and expenses:				
Research and development	22.9		23.1	
Sales and marketing	64.9		69.5	
General and administrative	13.1		12.3	
Total operating expenses	100.9		104.9	
Operating loss	(10.6	)	(14.5	)
Financial income (expenses), net	1.9		(1.5	)
Loss before income taxes	(8.7	)	(16.0	)
Income taxes	(1.3	)	(0.8	)
Net loss	(10.0	)%	(16.8	)%

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Revenues

	Three Months Ended June 30,		
	2017	2016	% Change
	(unaudited) (in thousands)		
Revenues:			
Licenses	$ 28,420	$ 21,742	30.7 %
Maintenance and services	21,754	16,899	28.7 %
Total revenues	$ 50,174	$ 38,641	29.8 %

	Three Months Ended June 30,	
	2017	2016
	(as a percentage of total revenues)	
Revenues:		
Licenses	56.6 %	56.3 %
Maintenance and services	43.4 %	43.7 %
Total revenues	100.0 %	100.0 %

Total revenue growth was achieved due to increased demand for our products and services from existing and new customers, mostly in the domestic market, as well as in international markets. The increase in license revenues was driven by sales to existing customers as well as larger aggregate sales to 254 new customers in the three months ended June 30, 2017 compared to the aggregate sales from 285 new customers in the three months ended June 30, 2016. As of June 30, 2017 and 2016, we had approximately 5,750 and approximately 4,800 customers, respectively. Almost all of our license revenues was attributable to sales of perpetual licenses. The increase in maintenance and services revenues was primarily due to an increase in the sale of maintenance agreements resulting from the growth of our installed customer base. In each of the three months ended June 30, 2017 and 2016, our maintenance renewal rate was over 90%. Of the license and first year maintenance and services revenues recognized in the three months ended June 30, 2017, 55% was attributable to revenues from new customers, and 45% was attributable to revenues from existing customers. Of the license and first year maintenance and services revenues recognized in the three months ended June 30, 2016, 59% was attributable to revenues from new customers, and 41% was attributable to revenues from existing customers. As of June 30, 2017 and 2016, 50% and 46%, respectively, of our customers had purchased two or more product families.

Cost of Revenues and Gross Margin

Three Months Ended
June 30,

	2017	2016	% Change
	(unaudited)		
	(in thousands)		
Cost of revenues	$ 4,878	$ 3,721	31.1 %

	Three Months Ended	
	June 30,	
	2017	2016
	(as a percentage of total revenues)	
Total gross margin	90.3 %	90.4 %

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The increase in cost of revenues was primarily related to an increase of $1.1 million in salaries and benefits and stock based compensation expense due to increased headcount for support personnel to support our increased revenues and high renewal rate.

Operating Costs and Expenses

	Three Months Ended June 30,		
	2017	2016	% Change
	(unaudited) (in thousands)		
Operating costs and expenses:			
Research and development	$ 11,498	$ 8,905	29.1 %
Sales and marketing	32,560	26,840	21.3 %
General and administrative	6,582	4,760	38.3 %
Total operating expenses	$ 50,640	$ 40,505	25.0 %

	Three Months Ended June 30,	
	2017	2016
	(as a percentage of total revenues)	
Operating costs and expenses:		
Research and development	22.9 %	23.1 %
Sales and marketing	64.9 %	69.5 %
General and administrative	13.1 %	12.3 %
Total operating expenses	100.9 %	104.9 %

The increase in research and development expenses was primarily related to an increase of $2.1 million in salaries and stock based compensation expense resulting from increased headcount as part of our focus on enhancing and developing our existing and new products and a $0.4 million increase in facilities and allocated overhead costs.

The increase in sales and marketing expenses was primarily related to a $4.1 million increase in salaries and benefits and stock based compensation expense due to increased headcount to expand our sales force and commissions on increased customer orders. Of the remainder, $0.6 million of the increase was related to additional marketing related expenses and a $0.6 million increase in facilities and allocated overhead costs.

The increase in general and administrative expenses was primarily related to an increase of $1.4 million in salaries and benefits and stock based compensation expense due to increased headcount to support the overall growth of our business and a $0.4 million increase in other expenses predominately relating to IT.

Financial Income (Expenses), Net

	Three Months Ended June 30,		
	2017	2016	% Change
	(unaudited) (in thousands)		
Financial income (expenses), net	$ 950	$ (605)	257.0 %

Financial income (expenses), net for the three months ended June 30, 2017 was primarily due to foreign currency gains compared to foreign currency losses for the three months ended June 30, 2016.

Income Taxes

	Three Months Ended June 30,		
	2017	2016	% Change
	(unaudited)		
	(in thousands)		
Income taxes	$ (641)	$ (303)	111.6 %

Income taxes for the three months ended June 30, 2017 and 2016 were comprised primarily of foreign income taxes.

Comparison of the Six Months Ended June 30, 2017 and 2016

The following tables are a summary of our consolidated statements of operations for the six months ended June 30, 2017 and 2016 in dollars and as a percentage of our total revenues.

	Six Months Ended June 30,	
	2017	2016
	(unaudited)	
	(in thousands)	
Statement of Operations Data:		
Revenues:		
Licenses	$47,575	$35,586
Maintenance and services	42,979	33,525
Total revenues	90,554	69,111
Cost of revenues	9,550	7,217
Gross profit	81,004	61,894
Operating costs and expenses:		
Research and development	21,907	17,742
Sales and marketing	63,371	51,204
General and administrative	12,095	9,322
Total operating expenses	97,373	78,268
Operating loss	(16,369)	(16,374)
Financial income, net	1,419	40
Loss before income taxes, net	(14,950)	(16,334)
Income taxes	(964)	(509)
Net loss	$(15,914)	$(16,843)

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	Six Months Ended June 30, 2017	2016
	(as a percentage of total revenues)	
Statement of Operations Data:		
Revenues:		
Licenses	52.5 %	51.5 %
Maintenance and services	47.5	48.5
Total revenues	100.0	100.0
Cost of revenues	10.5	10.4
Gross profit	89.5	89.6
Operating costs and expenses:		
Research and development	24.2	25.7
Sales and marketing	70.0	74.1
General and administrative	13.4	13.5
Total operating expenses	107.6	113.3
Operating loss	(18.1)	(23.7)
Financial income, net	1.6	0.1
Loss before income taxes, net	(16.5)	(23.6)
Income taxes	(1.1)	(0.7)
Net loss	(17.6)%	(24.3)%

Revenues

	Six Months Ended June 30, 2017	2016	% Change
	(unaudited) (in thousands)		
Revenues:			
Licenses	$47,575	$35,586	33.7 %
Maintenance and services	42,979	33,525	28.2 %
Total revenues	$90,554	$69,111	31.0 %

	Six Months Ended June 30, 2017	2016
	(as a percentage of total revenues)	
Revenues:		
Licenses	52.5 %	51.5 %

Maintenance and services	47.5 %	48.5 %
Total revenues	100.0 %	100.0 %

Total revenue growth was achieved due to increased demand for our products and services from existing and new customers, mostly in domestic markets, as well as in the international market. The increase in license revenues was driven by sales to existing customers as well as larger aggregate sales to 441 new customers in the six months ended June 30, 2017 compared to the aggregate sales from 508 new customers in the six months ended June 30, 2016. As of June 30, 2017 and 2016, we had approximately 5,750 and approximately 4,800 customers, respectively. Substantially all of our license revenues was attributable to sales of perpetual licenses. The increase in maintenance and services revenues was primarily due to an increase in the sale of maintenance agreements resulting from the growth of our installed customer base. In each of the six months ended June 30, 2017 and 2016, our maintenance renewal rate was over 90%. Of the license and first year maintenance and services revenues recognized in the six months ended June 30, 2017, 54% was attributable to revenues from new customers, and 46% was attributable to revenues from existing customers. Of the license and first year maintenance and services revenues recognized in the six months ended June 30, 2016, 61% was attributable to revenues from new customers, and 39% was attributable to revenues from existing customers. As of June 30, 2017 and 2016, 50% and 46% of our customers, respectively, had purchased two or more products.

Cost of Revenues and Gross Margin

	Six Months Ended June 30,		
	2017	2016	% Change
	(unaudited) (in thousands)		
Cost of revenues	$ 9,550	$ 7,217	32.3 %

	Six Months Ended June 30,	
	2017	2016
	(as a percentage of total revenues)	
Total gross margin	89.5 %	89.6 %

The increase in cost of revenues was primarily related to an increase of $2.1 million in salaries and benefits and stock based compensation expense due to increased headcount for support personnel to support our increased revenues and high renewal rate.

Operating Costs and Expenses

	Six Months Ended June 30,		
	2017	2016	% Change
	(unaudited) (in thousands)		
Operating costs and expenses:			
Research and development	$21,907	$17,742	23.5 %
Sales and marketing	63,371	51,204	23.8 %
General and administrative	12,095	9,322	29.7 %
Total operating expenses	$97,373	$78,268	24.4 %

	Six Months Ended June 30,	
	2017	2016
	(as a percentage of total revenues)	
Operating costs and expenses:		

Research and development	24.2 %	25.7 %
Sales and marketing	70.0 %	74.1 %
General and administrative	13.4 %	13.5 %
Total operating expenses	107.6 %	113.3 %

The increase in research and development expenses was primarily related to an increase of $3.7 million in salaries and stock based compensation expense resulting from increased headcount as part of our focus on enhancing and developing our existing and new products and a $0.5 million increase in facilities and allocated overhead costs.

The increase in sales and marketing expenses was primarily related to a $9.7 million increase in salaries and benefits and stock based compensation expense due to increased headcount to expand our sales force and commissions on increased customer orders. Of the remainder, $0.9 million of the increase was related to facilities and allocated overhead costs and $0.7 million of additional marketing related expenses.

The increase in general and administrative expenses was primarily related to an increase of $2.1 million in salaries and benefits and stock based compensation expense due to increased headcount to support the overall growth of our business and an increase of $0.7 million of other expenses predominately relating to IT.

Financial Income, Net

	Six Months Ended June 30,		
	2017	2016	% Change
	(unaudited) (in thousands)		
Financial income, net	$ 1,419	$ 40	3447.5 %

Financial income, net for each of the six months ended June 30, 2017 and 2016 was primarily due to foreign currency gains.

Income Taxes

	Six Months Ended June 30,		
	2017	2016	% Change
	(unaudited) (in thousands)		
Income taxes	$ (964)	$ (509)	(89.4)%

Income taxes for the six months ended June 30, 2017 and 2016 were comprised primarily of foreign income taxes.

Liquidity and Capital Resources

The following table shows our cash flows from operating activities, investing activities and financing activities for the stated periods:

	Six Months Ended June 30,	
	2017	2016
	(unaudited) (in thousands)	
Net cash provided by operating activities	$7,384	$2,341
Net cash provided by (used in) investing activities	(5,297)	3,269
Net cash provided by financing activities	3,137	1,251
Increase in cash and cash equivalents	$5,224	$6,861

On June 30, 2017, our cash and cash equivalents and short-term investments of $121.6 million were held for working capital purposes and were invested primarily in short-term investments. We intend to increase our investment in capital expenditures in 2017, consistent with the growth in our business and operations. We believe that our existing cash and cash equivalents, short-term investments and cash flow from operations will be sufficient to fund our operations and capital expenditures for at least the next 12 months. Our future capital requirements will depend on many factors, including our rate of revenue growth, the expansion of our sales and marketing activities, the timing and extent of spending to support product development efforts and expansion into new geographic locations, the timing of introductions of new software products and enhancements to existing software products, the continuing market acceptance of our software offerings and our use of cash to pay for acquisitions, if any.

Operating Activities

Net cash provided by operating activities is driven by sales of our products less costs and expenses, primarily payroll and related expenses, and adjusted for certain non-cash items, mainly depreciation and stock-based compensation, and changes in operating assets and liabilities. Changes in operating assets and liabilities are driven mainly by collection of accounts receivable from the sales of our software products and services and deferred revenues which represent unearned amounts billed to our channel partners, related to these sales.

For the six months ended June 30, 2017, cash inflows from our operating activities were $7.4 million. We have observed two seasonal patterns that impact our net cash provided by operating activities. First, a majority of our sales are made during the last four weeks of the quarter. Second, the highest dollar amount of sales of our products and services occurs in the fourth quarter. Consequently, we end the fourth quarter with our highest accounts receivable balance of any quarter which in turn generates the greatest amount of collections in the following quarter. This pattern was observed for the six months ended June 30, 2017, and the resulting decrease in account receivable provided a $12.5 million source of cash. Our days' sales outstanding ("DSO") for the three and six months ended June 30, 2017 was 71 and 69 days, respectively. For the six months ended June 30, 2017, the $2.8 million increase in accrued expenses and a $0.1 million increase in accounts payable provided an additional source of operating cash. This was partially offset by our net loss excluding non-cash charges of $5.0 million. Our net loss was primarily driven by increased headcount of our sales and research and development personnel. Additional sources of cash outflows included a $1.8 million increase in prepaid expenses, a $0.7 million decrease in deferred revenues and a $0.5 million decrease in severance and other long term liabilities.

For the six months ended June 30, 2016, cash inflows from our operating activities were $2.3 million. For the six months ended June 30, 2016, sources of cash inflows were from changes in our working capital, including a $13.9 million decrease in accounts receivable reflecting the seasonal pattern discussed above. Our DSO for the three and six months ended June 30, 2016, was 76 and 78 days, respectively. This was partially offset by our net loss of $9.8 million, which excludes non-cash charges. Our net loss was primarily driven by increased headcount of our sales force. Additional sources of cash outflows included a $1.1 million decrease in deferred revenues, a $0.5 million decrease in accounts payable and a $0.2 million decrease in other long term liabilities.

Investing Activities

Our investing activities consist primarily of capital expenditures to purchase property and equipment, maturities and purchases of short-term investments and changes in our restricted cash. In the future, we expect to continue to incur capital expenditures to support our expanding operations.

During the six months ended June 30, 2017, net cash used in investing activities of $5.3 million was primarily attributable to a $2.6 million increase in short-term investments, a $0.2 million increase in long-term deposits and $2.5 million in capital expenditures to support our growth during the period including hardware, software, office equipment and leasehold improvements mainly in connection with new office space.

During the six months ended June 30, 2016, net cash provided by investing activities of $3.3 million was primarily attributable to a $4.7 million decrease in deposits, partially offset by $1.4 million in capital expenditures to support our growth during the period including hardware, software, office equipment and leasehold improvements mainly in connection with new office space.

Financing Activities

For the six months ended June 30, 2017 and 2016, net cash provided by financing activities of $3.1 million and $1.3 million, respectively, was attributable to net proceeds from employee stock plans.

Promissory Note

On March 31, 2014, we entered into a promissory note and related security documents with Bank Leumi USA. We may borrow up to $7.0 million against certain of our accounts receivable outstanding amount, based on several conditions, at an annual interest rate of the Wall Street Journal Prime Rate less 0.15%. As of June 30, 2017, that rate amounted to 4.10%. This promissory note enables us, among other things, to engage in foreign currency hedging transactions with Bank Leumi USA to manage our exposure to foreign currency risk without restricted cash requirements. We may borrow under the promissory note until August 15, 2017 at which time the principal sum of each such loan, together with accrued and unpaid interest payable, will become due and payable. As of June 30, 2017, we had no balance outstanding under the promissory note. As part of the transaction, we granted the lender a security interest in our personal property, excluding intellectual property and other intangible assets. The promissory note also contains customary events of default.

Contractual Payment Obligations

Our principal commitments primarily consist of obligations under leases for office space and motor vehicles. Aggregate minimum rental commitments under non-cancelable leases as of June 30, 2017 for the upcoming years were as follows:

	Payments Due by Period						
	2017	2018	2019	2020	2021	Thereafter	Total
	(in thousands)						
Operating lease obligations	$2,736	$4,872	$4,839	$3,486	$3,495	$13,062	$32,490

We have obligations related to unrecognized tax benefit liabilities totaling $2.2 million and for severance pay, which have been excluded from the table above as we do not believe it is practicable to make reliable estimates of the periods in which payments for these obligations will be made.

Off-Balance Sheet Arrangements

As of June 30, 2017, we did not have any off-balance sheet arrangements.

Critical Accounting Policies and Estimates

We prepare our consolidated financial statements in accordance with generally accepted accounting principles in the United States. The preparation of consolidated financial statements also requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, costs and expenses and related disclosures. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances. Actual results could differ significantly from the estimates made by our management. To the extent that there are differences between our estimates and actual results, our future financial statement presentation, financial condition, results of operations and cash flows will be affected. We believe that the accounting policies discussed below are critical to understanding our historical and future performance, as these policies relate to the more significant areas involving management’s judgments and estimates. Critical accounting policies and estimates are those that we consider the most important to the portrayal of our financial condition and results of operations because they require our most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of the matters that are inherently uncertain.

Recently Issued Accounting Pronouncements

In May 2014, the FASB issued ASU No. 2014-09, "Revenue from Contracts with Customers", an updated standard on revenue recognition and issued subsequent amendments to the initial guidance in March 2016, April 2016, May 2016 and December 2016 within ASU 2016-08, 2016-10, 2016-12 and 2016-20, respectively. The new standards provide enhancements to the quality and consistency of how revenue is reported while also improving comparability in the financial statements of companies reporting using IFRS and US GAAP. The core principle of the new standard is for companies to recognize revenue to depict the transfer of goods or services to customers in amounts that reflect the consideration (that is, payment) to which the company expects to be entitled in exchange for those goods or services. The new standard also will result in enhanced disclosures about revenue, provide guidance for transactions that were not previously addressed comprehensively (for example, service revenue and contract modifications) and improve guidance for multiple-element arrangements. ASU 2014-09 was initially scheduled to be effective for annual and interim reporting periods beginning after December 15, 2016 and may be adopted either on a full retrospective or modified retrospective approach. However, on July 9, 2015, the FASB approved a one year deferral of the effective date of ASU 2014-09. The revised effective date is for annual reporting periods beginning after December 15, 2017 and interim periods thereafter, with an early adoption permitted as of the original effective date. We are in the process of evaluating the effect the new revenue recognition standard will have on our consolidated financial statements and related disclosures but have not completed our evaluation and implementation process. We intend to complete this process in 2017 and will adopt the new standard on January 1, 2018, using the full retrospective method. Based on our preliminary evaluation to date, we believe adoption of the new standard may have a material impact on our consolidated financial statements.

In May 2016, the FASB issued ASU 2016-11, “Revenue Recognition: Customer Payments and Incentives”, which clarifies the guidance in recognizing costs for consideration given by a vendor to a customer as a component of cost of sales. This ASU is effective for annual and interim periods beginning after December 15, 2017. We are currently evaluating the impact of this standard on our consolidated financial statements and related disclosures.

In February 2016, the FASB issued ASU 2016-02, “Leases”, on the recognition, measurement, presentation and disclosure of leases for both parties to a contract (i.e., lessees and lessors). The new standard requires lessees to apply a dual approach, classifying leases as either finance or operating leases based on the principle of whether or not the lease is effectively a financed purchase by the lessee. This classification will determine whether lease expense is recognized based on an effective interest method or on a straight line basis over the term of the lease, respectively. A lessee is also required to record a right-of-use asset and a lease liability for all leases with a term of greater than 12 months regardless of their classification. Leases with a term of 12 months or less will be accounted for in a manner similar to the accounting under existing guidance for operating leases today. The new standard requires lessors to account for leases using an approach that is substantially equivalent to existing guidance for sales-type leases, direct financing leases and operating leases. ASC 842 supersedes the previous leases standard, ASC 840, "Leases". The guidance is effective for the interim and annual periods beginning on or after December 15, 2018, and early adoption is permitted. We are currently evaluating whether to early adopt this standard and the potential effect of the guidance on our consolidated financial statements.

In November 2016, the FASB issued ASU 2016-18, “Statement of Cash Flows (Topic 230): Restricted Cash”, which requires companies to include amounts generally described as restricted cash and restricted cash equivalents in cash and cash equivalents when reconciling beginning-of-period and end-of-period total amounts shown on the statement of cash flows. This ASU is effective for annual and interim periods beginning after December 15, 2017 and early adoption is permitted. We are currently evaluating whether to early adopt this standard and the potential effect of the guidance on our consolidated financial statements.

In May 2017, the FASB issued ASU 2017-09, *Compensation - Stock Compensation: Scope of Modification Accounting*, which clarifies when changes to the terms or conditions of a share-based payment award must be accounted for as modifications. Under the new guidance, modification accounting is required only if the fair value, the vesting conditions, or the classification of the award changes as a result of the change in terms or conditions. ASU 2017-09 will be applied prospectively to awards modified on or after the adoption date. The standard is effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. Early adoption is permitted. We are currently evaluating the impact of adoption of this standard on our consolidated financial statements.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Market risk represents the risk of loss that may impact our financial position due to adverse changes in financial market prices and rates. Our market risk exposure is primarily a result of fluctuations in interest rates and foreign currency exchange rates. We do not hold or issue financial instruments for trading purposes.

Market Risk

We are exposed to certain financial risks, including fluctuations in foreign currency exchange rates and interest rates. We manage our exposure to these market risks through internally established policies and procedures. Our policies do not allow speculation in derivative instruments for profit or execution of derivative instrument contracts for which there are no underlying exposures. We do not use financial instruments for trading purposes, and we are not a party to any leveraged derivatives. We monitor our underlying market risk exposures on an ongoing basis and, where appropriate, may use hedging strategies to mitigate these risks.

Foreign Currency Exchange Risk

Approximately 30% of our revenues for the three months ended June 30, 2017 were earned in non-U.S. dollar denominated currencies, mainly in the Euro and Pound Sterling. Our expenses are generally denominated in the currencies in which our operations are located, primarily the U.S. dollar and NIS, and to a lesser extent the Euro, Pound Sterling and Canadian dollar. Our NIS-denominated expenses consist primarily of personnel and overhead costs from our operations in Israel. Our consolidated results of operations and cash flow are, therefore, subject to fluctuations due to changes in foreign currency exchange rates and may be adversely affected in the future due to changes in foreign exchange rates. The effect of a hypothetical 10% change in foreign currency exchange rates applicable to our business would not have a material impact on our historical consolidated financial statements.

For purposes of our consolidated financial statements, local currency assets and liabilities are translated at the rate of exchange to the U.S. dollar on the balance sheet date and local currency revenues and expenses are translated at the exchange rate at the date of the transaction or the average exchange rate dollar during the reporting period to the United States.

To date, we have used derivative financial instruments, specifically foreign currency forward contracts, to manage exposure to foreign currency risks, by hedging a portion of our forecasted expenses denominated in NIS expected to occur within 12 months. As of June 30, 2017, we had entered into foreign currency forward contracts until January 2018. The effect of exchange rate changes on these contracts is expected to offset the effect of exchange rate changes on the underlying hedged item. We do not use derivative financial instruments for speculative or trading purposes.

Interest Rate Risk

We had cash and cash equivalents and short-term investments of $121.6 million as of June 30, 2017. We hold our cash and cash equivalents and short-term investments for working capital purposes. Our cash and cash equivalents are held in cash deposits, money market funds and US Treasury securities. Due to the short-term nature of these instruments, we believe that we do not have any material exposure to changes in the fair value of our investment portfolio as a result of changes in interest rates. Declines in interest rates, however, would reduce our future interest income.

As of June 30, 2017, we had no outstanding obligations under our promissory note. To the extent we enter into other long-term debt arrangements in the future, we would be subject to fluctuations in interest rates which could have a material impact on our future financial condition and results of operation.

Inflation

We do not believe that inflation had a material effect on our business, financial condition or results of operations in the last three fiscal years. If our costs were to become subject to significant inflationary pressures, we may not be able to fully offset such higher costs through price increases. Our inability or failure to do so could harm our business, financial condition and results of operations.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act) as of the end of the period covered by this report. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures as of the end of the period covered by this report were effective at a reasonable assurance level in ensuring that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. We believe that a control system, no matter how well designed and operated, cannot provide absolute assurance that the objectives of the control system are met, and no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a company have been detected.

Changes in Internal Control over Financial Reporting

There was no change in our internal control over financial reporting that occurred during the three months ended June 30, 2017 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

We are not currently a party to any material litigation.

Item 1A. Risk Factors

Investing in our common stock involves a high degree of risk. You should carefully consider the following risks and all other information contained herein, including our consolidated financial statements and the related notes thereto, before investing in our common stock. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties that we are unaware of, or that we currently believe are not material, also may become important factors that affect us. If any of the following risks materialize, our business, financial condition and results of operations could be materially harmed. In that case, the trading price of our common stock could decline, and you may lose some or all of your investment.

Risks Related to Our Business and Industry

The market for software that analyzes, secures, manages and migrates enterprise data is new and unproven and may not grow.

We believe our future success depends in large part on the growth of the market for software that enables enterprises to analyze, secure, manage and migrate their data. In order for us to market and sell our products, we must successfully demonstrate to enterprise IT and business personnel the potential value of their data and persuade them to devote a portion of their budgets to the single integrated platform that we offer to manage, protect and extract value from this resource. We cannot provide any assurance that enterprises will recognize the need for our products or, if they do, that they will decide that they need a solution that offers the range of functionalities that we offer. Software solutions focused on enterprise data may not yet be viewed as a necessity, and accordingly, our sales effort is and will continue to be focused in large part on explaining the need for, and value offered by, our solution. We can provide no assurance that the market for our solution will continue to grow at its current rate or at all. The failure of the market to develop would materially adversely impact our results of operations.

Our quarterly results of operations have fluctuated and may fluctuate significantly due to variability in our revenues which could adversely impact our stock price.

Our revenues and other results of operations have fluctuated from quarter to quarter in the past and could continue to fluctuate in the future. As a result, comparing our revenues and results of operations on a period-to-period basis may not be meaningful, and you should not rely on any particular past quarter or other period results. Our revenues depend in part on the conversion of enterprises that have installed an evaluation license for our software into paying customers. In this regard, most of our sales are typically made during the last three weeks of every quarter. We may fail to meet market expectations for that quarter if we are unable to close the number of transactions that we expect during this short period and closings are deferred to a subsequent quarter. In addition, our sales cycle from initial contact to delivery of and payment for the software license generally becomes longer and less predictable with respect to large transactions and often involves multiple meetings or consultations at a substantial cost and time commitment to us. Although we try to minimize the potential impact of large transactions on our quarterly results of operations, the closing of a large transaction in a particular quarter may raise our revenues in that quarter and thereby make it more difficult for us to meet market expectations in subsequent quarters, and our failure to close a large transaction in a particular quarter may adversely impact our revenues in that quarter. In addition, we base our current and future expense levels on our revenue forecasts and operating plans, and our expenses are relatively fixed in the short term. Accordingly, we would likely not be able to reduce our costs sufficiently to compensate for an unexpected shortfall in revenues and even a relatively small decrease in revenues could disproportionately and adversely affect our financial results for that quarter.

The variability and unpredictability of these and other factors, many of which are outside of our control, could result in our failing to meet or exceed financial expectations for a given period. If our revenues or results of operations fall below the expectations of investors or any securities analysts that cover our stock, the price of our common stock could decline substantially

A failure to hire and integrate additional sales and marketing personnel or maintain their productivity could adversely affect our results of operations and growth prospects.

Our business requires intensive sales and marketing activities. Our sales and marketing personnel are essential to attracting new customers and expanding sales to existing customers, both of which are key to our future growth. We face a number of challenges in successfully expanding our sales force. We must locate and hire a significant number of qualified individuals, and competition for such individuals is intense. In addition, as we expand into new markets with which we have less familiarity, we will need to recruit individuals who are multilingual or who have skills particular to a certain geography, and it may be difficult to find candidates with those qualifications. We may be unable to achieve our hiring or integration goals due to a number of factors, including, but not limited to, the number of individuals we hire, challenges in finding individuals with the correct background due to increased competition for such hires and increased attrition rates among new hires and existing personnel. Furthermore, based on our past experience, it often can take up to 12 months before a new sales force member is trained and operating at a level that meets our expectations. We invest significant time and resources in training new members of our sales force, and we may be unable to achieve our target performance levels with new sales personnel as rapidly as we have done in the past due to larger numbers of hires or lack of experience training sales personnel to operate in new jurisdictions. Our failure to hire a sufficient number of qualified individuals, to integrate new sales force members within the time periods we have achieved historically or to keep our attrition rates at levels comparable to others in our industry may materially impact our projected growth rate.

Failure to attract, recruit and retain highly qualified engineers could adversely affect our results of operations and growth prospects.

Our future success and growth depends, in part, on our ability to continue to recruit and retain highly skilled personnel, particularly engineers. Any of our employees may terminate their employment at any time and competition for highly skilled engineering personnel is frequently intense, especially in Israel, where we have a substantial presence and need for qualified engineers. Moreover, to the extent we hire personnel from other companies, we may be subject to allegations that they have been improperly solicited or may have divulged proprietary or other confidential information to us. If we are unable to attract or retain qualified engineers, our ability to innovate, introduce new products and compete would be adversely impacted, and our financial condition and results of operations may suffer.

If we fail to manage our rapid growth effectively, our business and results of operations will be adversely affected.

We have experienced rapid growth in a relatively short period of time. Our revenues grew from $53.4 million in 2012 to $164.5 million in 2016. Our number of employees and independent contractors increased from 399 as of December 31, 2012 to 1,171 as of June 30, 2017. During this period, we also established and expanded our operations in a number of countries outside the United States. We intend to continue to grow our business and plan to continue to hire new employees, particularly in our sales and marketing and research and development groups. If we cannot adequately train these new employees, including our sales force, software engineers and customer support staff, our sales may not grow at the rates we project or our customers may lose confidence in the knowledge and capability of our employees. In addition, we are expanding our current operations, and we intend to make investments to continue our expansion efforts. We must successfully manage our growth to achieve our objectives. Although our business has experienced significant growth in the past, we cannot provide any assurance that our business will continue to grow at the same rate, or at all.

Our ability to effectively manage any significant growth of our business will depend on a number of factors, including our ability to do the following:

- effectively recruit, integrate, train and motivate a large number of new employees, including our sales force and engineers, while retaining existing employees, maintaining the beneficial aspects of our corporate culture and effectively executing our business plan;
- satisfy existing customers and attract new customers;
- effectively manage existing channel partnerships and expand to new ones;

- successfully introduce new products and enhancements;
- improve our key business applications and processes to support our business needs;
- enhance information and communication systems to ensure that our employees and offices around the world are well-coordinated and can effectively communicate with each other and our growing customer base;
- enhance our internal controls to ensure timely and accurate reporting of all of our operations and financial results;
- protect and further develop our strategic assets, including our intellectual property rights; and
- make sound business decisions in light of the scrutiny associated with operating as a public company.

These activities will require significant investments and allocation of valuable management and employee resources, and our growth will continue to place significant demands on our management and our operational and financial infrastructure. There are no guarantees we will be able to grow our business in an efficient or timely manner, or at all. Moreover, if we do not effectively manage the growth of our business and operations, the quality of our software could suffer, which could negatively affect our brand, results of operations and overall business.

Our failure to continually enhance and improve our technology could adversely affect sales of our products.

The market is characterized by the exponential growth in enterprise data, rapid technological advances, changes in customer requirements, including customer requirements driven by changes to legal, regulatory and self-regulatory compliance mandates, frequent new product introductions and enhancements and evolving industry standards in computer hardware and software technology. As a result, we must continually change and improve our products in response to changes in operating systems, application software, computer and communications hardware, networking software, data center architectures, programming tools and computer language technology. Moreover, the technology in our products is especially complex because it needs to effectively identify and respond to a user’s data retention, security and governance needs, while minimizing the impact on database and file system performance. Our products must also successfully interoperate with products from other vendors.

We cannot guarantee that we will be able to anticipate future market needs and opportunities or be able to extend our technological expertise and develop new products or expand the functionality of our current products in a timely manner or at all. Even if we are able to anticipate, develop and introduce new products and expand the functionality of our current products, there can be no assurance that enhancements or new products will achieve widespread market acceptance.

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

- failure to accurately predict market demand in terms of product functionality and to supply products that meet this demand in a timely fashion;

- inability to interoperate effectively with the database technologies and file systems of prospective customers;
- defects, errors or failures;
- negative publicity or customer complaints about performance or effectiveness; and
- poor business conditions, causing customers to delay IT purchases.

If we fail to anticipate market requirements or stay abreast of technological changes, we may be unable to successfully introduce new products, expand the functionality of our current products or convince our customers and potential customers of the value of our solutions in light of new technologies. Accordingly, our business, results of operations and financial condition could be materially and adversely affected.

We are dependent on the continued services and performance of our co-founder, Yakov Faitelson, the loss of whom could adversely affect our business.

Our future performance depends in large part on the continued services and continuing contributions of our co-founder, our Chief Executive Officer and President, Yakov Faitelson, to successfully manage our company, to execute on our business plan and to identify and pursue new opportunities and product innovations. The loss of services of Mr. Faitelson could significantly delay or prevent the achievement of our development and strategic objectives and adversely affect our business.

Due to our rapid growth, we have a limited operating history at our current scale, which makes it difficult to evaluate and predict our future prospects and may increase the risk that we will not be successful.

We have been growing rapidly in recent periods and, as a result, have a relatively short history operating our business at its current scale. For example, we have significantly increased the number of our employees and have expanded our operations and product offerings. This limits our ability to forecast our future operating results and subjects us to a number of uncertainties, including our ability to plan for and model future growth. We have encountered and will continue to encounter risks and uncertainties frequently experienced by growing companies in new markets that may not develop as expected. Because we depend in part on the market's acceptance of our products, it is difficult to evaluate trends that may affect our business. If our assumptions regarding these trends and uncertainties, which we use to plan our business, are incorrect or change in reaction to changes in our markets, or if we do not address these risks successfully, our operating and financial results could differ materially from our expectations and our business could suffer. Moreover, although we have experienced significant growth historically, we may not continue to grow as quickly in the future.

Our future success will depend in large part on our ability to, among other things:

- maintain and expand our business, including our customer base and operations, to support our growth, both domestically and internationally;
- hire, integrate, train and retain skilled talent, including members of our sales force and software engineers;
- develop new products and services and bring products and services in beta to market;
- renew maintenance and support agreements with, and sell additional products to, existing customers;
- increase market awareness of our products and enhance our brand; and
- maintain compliance with applicable governmental regulations and other legal obligations, including those related to intellectual property, international sales and taxation.

If we fail to address the risks and difficulties that we face, including those associated with the challenges listed above as well as those described elsewhere in this "Risk Factors" section, our business will be adversely affected, and our results of operations will suffer.

If we are unable to attract new customers and expand sales to existing customers, both domestically and internationally, our growth could be slower than we expect and our business may be harmed.

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 the effectiveness of our sales and marketing efforts, both domestically and internationally, and our ability to attract new customers. If we fail to attract new customers and maintain and expand those customer relationships, our revenues will grow more slowly than expected, and our business will be harmed.

Our future growth also depends upon expanding sales of our products to existing customers and their organizations. If our customers do not purchase additional licenses or capabilities, our revenues may grow more slowly than expected, may not grow at all or may decline. Additionally, increasing incremental sales to our current customer base requires increasingly sophisticated and costly sales efforts that are targeted at senior management. There can be no assurance that our efforts would result in increased sales to existing customers ("upsells") and additional revenues. If our efforts to upsell to our customers are not successful, our business would suffer. Moreover, while substantially all of our software is currently licensed and sold under perpetual license agreements, we also enter into term license agreements with our customers. Due to the differences in revenue recognition principles, applied to perpetual versus term license sales, shifts in the mix of term and subscription licenses could produce significant variation in the revenues we recognize in a given period.

We may face increased competition in our market.

While there are some companies which offer certain features similar to those embedded in our solutions, as well as others with whom we compete in certain tactical use cases, we believe that we do not currently compete with a company that offers the same breadth of functionalities that we offer in a single integrated solution. Nevertheless, we do compete against a select group of software vendors, such as Veritas Technologies LLC and Quest Software, that provide standalone solutions, similar to those found in our comprehensive software suite, in the specific markets in which we operate. We also face direct competition with respect to certain of our products, specifically DatAnywhere, Data Transport Engine, DatAnswers and DatAdvantage for Directory Services. As we augment our functionality with insider threat detection and user behavior analytics, we may face increased perceived and real competition with other security technologies. In the future, as customer requirements evolve and new technologies are introduced, we may experience increased competition if established or emerging companies develop solutions that address the enterprise data market. Furthermore, because we operate in a relatively new and evolving area, we anticipate that competition will increase based on customer demand for these types of products.

In particular, if a more established company were to target our market, we may face significant competition. They may have competitive advantages, such as greater name recognition, larger sales, marketing, research and acquisition resources, access to larger customer bases and channel partners, a longer operating history and lower labor and development costs, which may enable them to respond more quickly to new or emerging technologies and changes in customer requirements or devote greater resources to the development, promotion and sale of their products than we do. Increased competition could result in us failing to attract customers or maintain licenses at the same rate. It could also lead to price cuts, alternative pricing structures or the introduction of products available for free or a nominal price, reduced gross margins, longer sales cycles and loss of market share.

In addition, our current or prospective channel partners may establish cooperative relationships with any future competitors. These relationships may allow future competitors to rapidly gain significant market share. These developments could also limit our ability to obtain revenues from existing and new customers.

Our ability to compete successfully in our market will also depend on a number of factors, including ease and speed of product deployment and use, the quality and reliability of our customer service and support, total cost of ownership, return on investment and brand recognition. Any failure by us to successfully address current or future competition in any one of these or other areas may reduce the demand for our products and adversely affect our business, results of operations and financial condition.

We have a history of losses, and we may not be profitable in the future.

We have incurred net losses in each year since our inception, including a net loss of $15.9 million for the six months ended June 30, 2017 and net losses of $17.7 million and $21.3 million for the years ended December 31, 2016 and 2015, respectively. Because the market for our software is rapidly evolving and has not yet reached widespread adoption, it is difficult for us to predict our future results of operations. We expect our operating expenses to increase over the next several years as we hire additional personnel, particularly in sales and marketing and research and development groups, expand and improve the effectiveness of our distribution channels, and continue to develop features and applications for our software.

Prolonged economic uncertainties or downturns could materially adversely affect our business.

Our business depends on our current and prospective customers' ability and willingness to invest money in information technology services, which in turn is dependent upon their overall economic health. Negative conditions in the general economy both in the United States and abroad, including conditions resulting from financial and credit market fluctuations and terrorist attacks on the United States, Europe, Asia Pacific or elsewhere, could cause a decrease in corporate spending on enterprise software in general.

Continuing uncertainty in the global economy, particularly in EMEA, which accounted for approximately one-third of our revenues in 2016 and for the six months ended June 30, 2017, and where we have experienced inconsistent growth rates over the last few years, makes it extremely difficult for our customers and us to forecast and plan future business activities accurately. This could cause our customers to reevaluate decisions to purchase our product or to delay their purchasing decisions, which could lengthen our sales cycles.

We have a significant number of customers in the financial services, healthcare, public sector and industrial industries. A substantial downturn in any of these industries, or a reduction in public sector spending, may cause enterprises to react to worsening conditions by reducing their capital expenditures in general or by specifically reducing their spending on information technology. Customers may delay or cancel information technology projects, choose to focus on in-house development efforts or seek to lower their costs by renegotiating maintenance and support agreements. To the extent purchases of licenses for our software are perceived by customers and potential customers to be discretionary, our revenues may be disproportionately affected by delays or reductions in general information technology spending. In addition, the increased pace of consolidation in certain industries may result in reduced overall spending on our software. If the economic conditions of the general economy or industries in which we operate worsen from present levels, our business, results of operations and financial condition could be adversely affected.

If we are unable to maintain successful relationships with our channel partners, our business could be adversely affected.

We rely on channel partners, such as distribution partners and resellers, to sell licenses and support and maintenance agreements for our software. In 2016 and for the six months ended June 30, 2017, our channel partners fulfilled substantially all of our sales, and we expect that sales to channel partners will continue to account for substantially all of our revenues for the foreseeable future. Our ability to achieve revenue growth in the future will depend in part on our success in maintaining successful relationships with our channel partners.

Our agreements with our channel partners are generally non-exclusive, meaning our channel partners may offer customers the products of several different companies. If our channel partners do not effectively market and sell our software, choose to use greater efforts to market and sell their own products or those of others, or fail to meet the needs of our customers, our ability to grow our business, sell our software and maintain our reputation may be adversely affected. Our contracts with our channel partners generally allow them to terminate their agreements for any reason upon 30 days’ notice. A termination of the agreement has no effect on orders already placed. The loss of a substantial number of our channel partners, our possible inability to replace them, or the failure to recruit additional channel partners could materially and adversely affect our results of operations. If we are unable to maintain our relationships with these channel partners, our business, results of operations, financial condition or cash flows could be adversely affected.

If our technical support or professional services are not satisfactory to our customers, they may not renew their maintenance and support agreements or buy future products, which could adversely affect our future results of operations.

Our business relies on our customers' satisfaction with the technical support and professional services we provide to support our products. While substantially all of our software is sold under perpetual license agreements, all of our maintenance and support agreements are sold on a term basis. Our customers typically purchase one year of software maintenance and support as part of their initial purchase of our products, with an option to renew their maintenance agreements. In order for us to maintain and improve our results of operations, it is important that our existing customers renew their maintenance and support agreements when the contract term expires. For example, our maintenance renewal rate for each of the years ended December 31, 2015 and 2016 and for the six months ended June 30, 2017 was over 90%.

If we fail to provide technical support services that are responsive, satisfy our customers' expectations and resolve issues that they encounter with our products and services, then they may elect not to purchase or renew annual maintenance and support contracts and they may choose not to purchase additional products and services from us. Accordingly, our failure to provide satisfactory technical support or professional services could lead our customers not to renew their agreements with us or renew on terms less favorable to us, and therefore have a material and adverse effect on our business and results of operations.

Because we derive substantially all of our revenues and cash flows from sales of licenses for a single platform of products, failure of the products in the platform to satisfy customers or to achieve increased market acceptance would adversely affect our business.

In 2016 and for the six months ended June 30, 2017, we generated substantially all of our revenues from sales of licenses for four of our current product families, DatAdvantage, DataPrivilege, IDU Classification Framework and Data Transport Engine. We expect to continue to derive a majority of our revenues from license sales relating to this platform in the future. As such, market acceptance of this platform of products is critical to our continued success. Demand for licenses for our platform of products is affected by a number of factors, some of which are outside of our control, including continued market acceptance of our software by referenceable accounts for existing and new use cases, technological change and growth or contraction in our market. We expect the proliferation of unstructured data to lead to an increase in the data analysis demands, and data security and retention concerns, of our customers, and our software, including the software underlying our platform of products, may not be able to scale and perform to meet those demands. If we are unable to continue to meet customer demands or to achieve more widespread market acceptance of our software, our business, operations, financial results and growth prospects will be materially and adversely affected.

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

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

As of July 31, 2017, we had 43 issued patents in the United States and 39 pending U.S. patent applications. We also had 13 patents issued and 61 applications pending for examination in non-U.S. jurisdictions, and 15 pending PCT, patent applications, all of which are counterparts of our U.S. patent applications. We may file additional patent applications in the future. 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 all the way through to the successful issuance of a patent. 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 issue as granted patents, that the scope of our issued patents will be insufficient or not have the coverage originally sought, that our issued patents will not provide us with any competitive advantages, and that our patents and other intellectual property rights may be challenged by others or invalidated through administrative process or litigation. In addition, issuance of a patent does not guarantee that we have an absolute right to practice the patented invention. Our policy is to require our employees (and our consultants and service providers that develop intellectual property included in our products) to execute written agreements in which they assign to us their rights in potential inventions and other intellectual property created within the scope of their employment (or, with respect to consultants and service providers, their engagement to develop such intellectual property), but we cannot assure you that we have adequately protected our rights in every such agreement or that we have executed an agreement with every such party. Finally, in order to benefit from patent and other intellectual property protection, we must monitor, detect and pursue infringement claims in certain circumstances in relevant jurisdictions, all of which is costly and time-consuming. As a result, we may not be able to obtain adequate protection or to enforce our issued patents or other intellectual property effectively.

In addition to patented technology, we rely on our unpatented proprietary technology and trade secrets. Despite our efforts to protect our proprietary technologies and our intellectual property rights, unauthorized parties, including our employees, consultants, service providers or customers, may attempt to copy aspects of our products or obtain and use our trade secrets or other confidential information. We generally enter into confidentiality agreements with our employees, consultants, service providers, vendors, channel partners and customers, and generally limit access to and distribution of our proprietary information and proprietary technology through certain procedural safeguards. These agreements may not effectively prevent unauthorized use or disclosure of our intellectual property or technology and may not provide an adequate remedy in the event of unauthorized use or disclosure of our intellectual property or technology. We cannot assure you that the steps taken by us will prevent misappropriation of our trade secrets or technology or infringement of our intellectual property. In addition, the laws of some foreign countries where we operate do not protect our proprietary rights to as great an extent as the laws of the United States, and many foreign countries do not enforce these laws as diligently as government agencies and private parties in the United States.

Moreover, industries in which we operate, such as data security, data retention and data governance are characterized by the existence of a large number of relevant patents and frequent claims and related litigation regarding patent and other intellectual property rights. From time to time, third parties have asserted and may assert their patent, copyright, trademark and other intellectual property rights against us, our channel partners or our customers. Successful claims of infringement or misappropriation by a third party could prevent us from distributing certain products or performing certain services or could require us to pay substantial damages (including, for example, treble damages if we are found to have willfully infringed patents and increased statutory damages if we are found to have willfully infringed copyrights), royalties or other fees. Such claims also could require us to cease making, licensing or using solutions that are alleged to infringe or misappropriate the intellectual property of others or to expend additional development resources to attempt to redesign our products or services or otherwise to develop non-infringing technology. Even if third parties may offer a license to their technology, the terms of any offered license may not be acceptable, and the failure to obtain a license or the costs associated with any license could cause our business, results of operations or financial condition to be materially and adversely affected. In some cases, we indemnify our channel partners and customers against claims that our products infringe the intellectual property of third parties. Defending against claims of infringement or being deemed to be infringing the intellectual property rights of others could impair our ability to innovate, develop, distribute and sell our current and planned products and services. If we are unable to protect our intellectual property rights and ensure that we are not violating the intellectual property rights of others, we may find ourselves at a competitive disadvantage to others who need not incur the additional expense, time and effort required to create the innovative products that have enabled us to be successful to date.

Interruptions or performance problems, including associated with our website or support website or any caused by cyber-attacks, may adversely affect our business.

Our continued growth depends in part on the ability of our existing and potential customers to quickly access our website and support website. Access to our support website is also imperative to our daily operations and interaction with customers, as it allows customers to download our software, fixes and patches, as well as open and respond to support tickets and register license keys for evaluation or production purposes. We have experienced, and may in the future experience, website disruptions, outages and other performance problems due to a variety of factors, including technical failures, cyber-attacks, natural disasters, infrastructure changes, human or software errors, capacity constraints due to an overwhelming number of users accessing our website simultaneously and denial of service or fraud. In some instances, we may not be able to identify the cause or causes of these website performance problems within an acceptable period of time. It may become increasingly difficult to maintain and improve the performance of our websites, especially during peak usage times and as our software becomes more complex and our user traffic increases. If our websites are unavailable or if our users are unable to download our software, patches or fixes within a reasonable amount of time or at all, we may suffer reputational harm and our business would be negatively affected.

Real or perceived errors, failures or bugs in our software could adversely affect our growth prospects.

Because our software uses complex technology, undetected errors, failures or bugs may occur. Our software is often installed and used in a variety of computing environments with different operating system management software, and equipment and networking configurations, which may cause errors or failures of our software or other aspects of the computing environment into which it is deployed. In addition, deployment of our software into computing environments may expose undetected errors, compatibility issues, failures or bugs in our software. Despite testing by us, errors, failures or bugs may not be found in our software until it is released to our customers. Moreover, our customers could incorrectly implement or inadvertently misuse our software, which could result in customer dissatisfaction and adversely impact the perceived utility of our products as well as our brand. Any of these real or perceived errors, compatibility issues, failures or bugs in our software could result in negative publicity, reputational harm, loss of or delay in market acceptance of our software, loss of competitive position or claims by customers for losses sustained by them. In such an event, we may be required, or may choose, for customer relations or other reasons, to expend additional resources in order to help correct the problem.

If our software is perceived as not being secure, customers may reduce the use of or stop using our software, and we may incur significant liabilities.

Our software involves the transmission of data between data stores, and between data stores and desktop and mobile computers, and may in the future involve the storage of data. Any security breaches with respect to such data could result in the loss of this information, litigation, indemnity obligations and other liabilities. While we have taken steps to protect the confidential information that we have access to, including confidential information we may obtain through our customer support services or customer usage of our products, we have no direct control over the substance of the content. Therefore, if customers use our software for the transmission of personally identifiable information and our security measures are breached as a result of third-party action, employee error, malfeasance or otherwise, our reputation could be damaged, our business may suffer and we could incur significant liability. Because techniques used to obtain unauthorized access or sabotage systems change frequently and generally are not identified until they are launched against a target, we may be unable to anticipate these techniques or to implement adequate preventative measures. While we maintain insurance coverage for some of the above events, the potential liabilities associated with these events could exceed the insurance coverage we maintain. Any or all of these issues could tarnish our reputation, negatively impact our ability to attract new customers or sell additional products to our existing customers, cause existing customers to elect not to renew their maintenance and support agreements or subject us to third-party lawsuits, regulatory fines or other action or liability, thereby adversely affecting our results of operations.

We are subject to federal, state and industry privacy and data security regulations, which could result in additional costs and liabilities to us or inhibit sales of our software.

Although our current software products do not transmit our customers' data to us, we collect and utilize demographic and other information, including personally identifiable information, from and about users (such as customers, potential customers and others) as they interact with us over the internet and otherwise provide us with information whether via our website or blog or through email or other means. Users may provide personal information to us in many contexts, including through our direct telephonic support service, blog alert sign-up, product purchase, survey registration, or when accessing our online support portals or using other community or social networking features. Because we may collect and utilize this information, we are subject to laws and regulations regarding the collection, use and disclosure of personal information. In the United States, these include rules and regulations promulgated under the authority of the Federal Trade Commission, the Health Insurance Portability and Accountability Act of 1996, 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 General Data Protection Regulation adopted in the European Union and which will become enforceable on May 25, 2018.

Further, the regulatory framework for privacy issues worldwide is rapidly 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. In addition, privacy advocates and industry groups may propose new and different self-regulatory standards that either legally or contractually apply to us. Because the interpretation and application of privacy and data protection laws are still uncertain, it is possible that these laws may be interpreted and applied in a manner that is inconsistent with our existing data management practices or the features of our software. If so, in addition to the possibility of fines, lawsuits and other claims, we could be required to fundamentally change our business activities and practices or modify our software, which could have an adverse effect on our business. Any inability to adequately address privacy concerns, even if unfounded, or comply with applicable privacy or data protection laws, regulations and policies, could result in additional cost and liability to us, damage our reputation, inhibit sales and adversely affect our business.

Our long-term growth depends, in part, on being able to continue to expand internationally on a profitable basis, which subjects us to risks associated with conducting international operations.

Historically, we have generated a majority of our revenues from customers in the United States. For the year ended December 31, 2016, and six months ended June 30, 2017, approximately 61% and 64%, respectively, of our total revenues were derived from sales in the United States. Nevertheless, we have operations across the globe, and we plan to continue to expand our international operations as part of our long-term growth strategy. The further expansion of our international operations will subject us to a variety of risks and challenges, including:

- sales and customer service challenges associated with operating in different countries;
- increased management travel, infrastructure and legal compliance costs associated with having multiple international operations;
- difficulties in receiving payments from different geographies, including difficulties associated with currency fluctuations, payment cycles, transfer of funds or collecting accounts receivable, especially in emerging markets;
- variations in economic or political conditions between each country or region;
- economic uncertainty around the world and adverse effects arising from economic interdependencies across countries and regions;
- uncertainty around how Brexit will impact the United Kingdom's access to the European Union Single Market, the related regulatory environment, the global economy and the resulting impact on our business;
- compliance with foreign laws and regulations and the risks and costs of non-compliance with such laws and regulations;
- compliance with laws and regulations for foreign operations, including the U.S. Foreign Corrupt Practices Act of 1977, or the FCPA, the U.K. Bribery Act of 2010, import and export control laws, tariffs, trade barriers, economic sanctions and other regulatory or contractual limitations on our ability to sell our software 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 financial statements and irregularities in financial statements;
- reduced protection for intellectual property rights in certain countries and practical difficulties and costs of enforcing rights abroad;
- compliance with the laws of numerous foreign taxing jurisdictions and overlapping of different tax regimes; and
- uncertainty around a potential reverse or renegotiation of international trade agreements and partnerships under the administration of U.S. President Donald J. Trump.

Any of these risks could adversely affect our international operations, reduce our revenues from outside the United States or increase our operating costs, adversely affecting our business, results of operations and financial condition and growth prospects. There can be no assurance that all of our employees, independent contractors and channel partners will comply with the formal policies we have and will implement, or applicable laws and regulations. Violations of laws or key control policies by our employees, independent contractors and channel partners could result in delays in revenue recognition, financial reporting misstatements, fines, penalties or the prohibition of the importation or exportation of our software and services and could have a material adverse effect on our business and results of operations.

If currency exchange rates fluctuate substantially in the future, our results of operations, which are reported in U.S. dollars, could be adversely affected.

Our functional and reporting currency is the U.S. dollar, and we generate a majority of our revenues and incur a majority of our expenses in U.S. dollars. Revenues and expenses are also incurred in other currencies, primarily Euros, Pounds Sterling, Canadian dollars and NIS. Accordingly, changes in exchange rates may have a material adverse effect on our business, results of operations and financial condition. The exchange rates between the U.S. dollar and foreign currencies have fluctuated substantially in recent years and may continue to fluctuate substantially in the future. Furthermore, a strengthening of the U.S. dollar could increase the cost in local currency of our software and our maintenance renewals to customers outside the United States, which could adversely affect our business, results of operations, financial condition and cash flows. For example, the U.S. election in 2016, subsequent actions of the Trump administration and the Brexit referendum have caused significant volatility in global stock markets and currency exchange rate fluctuations. Volatility in exchange rates is currently expected to continue in the short term as the United Kingdom negotiates its exit from the European Union which is scheduled to occur by the end of March 2019. Brexit and the withdrawal of the United Kingdom from the European Union, as well as other member countries public discussions about the possibility of withdrawing from the European Union, may also create global economic uncertainty, which may impact, among other things, the demand for our products.

We incur expenses for employee compensation and other operating expenses at our non-U.S. locations in local currencies. The weakening of the U.S. dollar against such currencies would cause the U.S. dollar equivalent of such expenses to increase which could have a negative impact on our reported results of operations. We use forward foreign exchange contracts to hedge or mitigate the effect of changes in foreign exchange rates on our operating expenses denominated in certain foreign currencies. However, this strategy might not eliminate our exposure to foreign exchange rate fluctuations and involves costs and risks of its own, such as cash expenditures, ongoing management time and expertise, external costs to implement the strategy and potential accounting implications. Additionally, our hedging activities may contribute to increased losses as a result of volatility in foreign currency markets.

Our use of open source software could negatively affect our ability to sell our software and subject us to possible litigation.

We use open source software and expect to continue to use open source software in the future. Some open source software licenses require users who distribute open source software as part of their own software product to publicly disclose all or part of the source code to such software product or to make available any derivative works of the open source code on unfavorable terms or at no cost. We may face ownership claims of third parties over, or seeking to enforce the license terms applicable to, such open source software, including by demanding the release of the open source software, derivative works or our proprietary source code that was developed using such software. These claims could also result in litigation, require us to purchase a costly license or require us to devote additional research and development resources to change our software, any of which would have a negative effect on our business and results of operations. In addition, if the license terms for the open source code change, we may be forced to re-engineer our software or incur additional costs. Finally, we cannot assure you that we have incorporated open source software into our own software in a manner that conforms with our current policies and procedures.

Our business is highly dependent upon our brand recognition and reputation, and the failure to maintain or enhance our brand recognition or reputation may adversely affect our business.

We believe that enhancing the “Varonis” brand identity and maintaining our reputation in the information technology industry is critical to our relationships with our customers and to our ability to attract new customers. Our brand recognition and reputation is dependent upon:

- our ability to continue to offer high-quality, innovative and error- and bug-free products;
- our ability to maintain customer satisfaction with our products;
- our ability to be responsive to customer concerns and provide high quality customer support, training and professional services;
- our marketing efforts;
- any misuse or perceived misuse of our products;

- positive or negative publicity;
- interruptions, delays or attacks on our website; and
- litigation or regulatory-related developments.

We may not be able to successfully promote our brand or maintain our reputation. In addition, independent industry analysts often provide reviews of our products, as well as other products available in the market, and perception of our product in the marketplace may be significantly influenced by these reviews. If these reviews are negative, or less positive than reviews about other products available in the market, our brand may be adversely affected. Furthermore, negative publicity relating to events or activities attributed to us, our employees, our channel partners or others associated with any of these parties, may tarnish our reputation and reduce the value of our brand. Damage to our reputation and loss of brand equity may reduce demand for our products and have an adverse effect on our business, results of operations and financial condition. Any attempts to rebuild our reputation and restore the value of our brand may be costly and time consuming, and such efforts may not ultimately be successful.

Moreover, it may be difficult to enhance our brand and maintain our reputation in connection with sales to channel partners. Promoting our brand requires us to make significant expenditures, and we anticipate that the expenditures will increase as our market becomes more competitive, as we expand into new markets and geographies and as more sales are generated to our channel partners. To the extent that these activities yield increased revenues, these revenues may not offset the increased expenses we incur. If we do not successfully enhance our brand and maintain our reputation, our business may not grow, we may have reduced pricing power relative to competitors with stronger brands, and we could lose customers, all of which would adversely affect our business, operations and financial results.

Our success depends in part on maintaining and increasing our sales to customers in the public sector.

We derive a portion of our revenues from contracts with federal, state, local and foreign governments and government-owned or -controlled entities (such as public health care bodies, educational institutions and utilities), which we refer to as the public sector herein. We believe that the success and growth of our business will continue to depend on our successful procurement of public sector contracts. Selling to public sector entities can be highly competitive, expensive and time consuming, often requiring significant upfront time and expense without any assurance that our efforts will produce any sales. Factors that could impede our ability to maintain or increase the amount of revenues derived from public sector contracts include:

- changes in public sector fiscal or contracting policies;
- decreases in available public sector funding;
- changes in public sector programs or applicable requirements;
- the adoption of new laws or regulations or changes to existing laws or regulations;
- potential delays or changes in the public sector appropriations or other funding authorization processes;
- the requirement of contractual terms that are unfavorable to us, such as most-favored-nation pricing provisions; and
- delays in the payment of our invoices by public sector payment offices.

Furthermore, we must comply with laws and regulations relating to public sector contracting, which affect how we and our channel partners do business in both the United States and abroad. These laws and regulations may impose added costs on our business, and failure to comply with these or other applicable regulations and requirements, including non-compliance in the past, could lead to claims for damages from our channel partners, penalties, termination of contracts, and temporary suspension or permanent debarment from public sector contracting.

The occurrence of any of the foregoing could cause public sector customers to delay or refrain from purchasing licenses of our software in the future or otherwise have an adverse effect on our business, operations and financial results.

We are subject to governmental export and import controls that could subject us to liability or impair our ability to compete in international markets.

We incorporate encryption technology into certain of our products and these products are subject to U.S. export control. We are also subject to Israeli export controls on encryption technology since our product development initiatives are primarily conducted by our wholly-owned Israeli subsidiary. We have obtained the required licenses to export our products outside of the United States. In addition, the current encryption means used in our products are listed in the "free means encryption items" published by the Israeli Ministry of Defense, which means we are exempt from obtaining an encryption control license. If the applicable U.S. or Israeli legal requirements regarding the export of encryption technology were to change or if we change the encryption means in our products, we may need to apply for new licenses in the United States and may no longer be able to rely on our licensing exception in Israel. There can be no assurance that we will be able to obtain the required licenses under these circumstances. Furthermore, various other countries regulate the import of certain encryption technology, including import permitting and licensing requirements, and have enacted laws that could limit our ability to distribute our products or could limit our customers' ability to implement our products in those countries.

We are also subject to U.S. and Israeli export control and economic sanctions laws, which prohibit the shipment of certain products to embargoed or sanctioned countries, governments and persons. Our products could be exported to these sanctioned targets by our channel partners despite the contractual undertakings they have given us and any such export could have negative consequences, including government investigations, penalties and reputational harm. Moreover, the Trump Administration may create further uncertainty regarding export or import regulations, economic sanctions or related legislation. It remains unclear what specifically President Trump would or would not do with respect to the initiatives he has raised and what support he would have to implement any such potential changes. Any change in export or import regulations, economic sanctions or related legislation, shift in the enforcement or scope of existing regulations, or change in the countries, governments, persons or technologies targeted by such regulations, could result in decreased use of our products by, or in our decreased ability to export or sell our products to, existing or potential customers with international operations. Any decreased use of our products or limitation on our ability to export or sell our products would likely adversely affect our business, financial condition and results of operations.

False detection of security breaches or false identification of malicious sources could adversely affect our business.

Our cyber-security products may falsely detect threats that do not actually exist. For example, our DatAlert solution may enrich metadata collected by our products with information from external sources and third-party data providers. If the information from these data providers is inaccurate, the potential for false positives increases. These false positives, while typical in the industry, may affect the perceived reliability of our products and solutions and may therefore adversely impact market acceptance of our products. If our products and solutions restrict access to important systems, files or applications based on falsely identifying legitimate use as an attack or otherwise unauthorized, then our customers' businesses could be adversely affected. Any such false identification of use and subsequent restriction could result in negative publicity, loss of customers and sales, increased costs to remedy any problem and costly litigation.

Our business in countries with a history of corruption and transactions with foreign governments increase the risks associated with our international activities.

As we operate and sell internationally, we are subject to the FCPA and other laws that prohibit improper payments or offers of payments to foreign governments and their officials and political parties for the purpose of obtaining or retaining business. We have operations, deal with and make sales to governmental customers in countries known to experience corruption, particularly certain emerging countries in Eastern Europe, South and Central America, East Asia, Africa and the Middle East. Our activities in these countries create the risk of unauthorized payments or offers of payments by one of our employees, consultants, channel partners or sales agents that could be in violation of various anti-corruption laws, even though these parties may not be under our control. While we have implemented safeguards to prevent these practices by our employees, consultants, channel partners and sales agents, our existing safeguards and any future improvements may prove to be less than effective, and our employees, consultants, channel partners or sales agents may engage in conduct for which we might be held responsible. Violations of the FCPA or other anti-corruption laws may result in severe criminal or civil sanctions, including suspension or debarment from government contracting, and we may be subject to other liabilities, which could negatively affect our business, operating results and financial condition.

Our ability to use our net operating loss carryforwards and other tax attributes may be limited if we undergo an "ownership change."

Our ability to utilize our net operating loss carryforwards ("NOLs") and other tax attributes could be limited if we undergo an "ownership change" within the meaning of Section 382 of the Internal Revenue Code of 1986, as amended (the "Code"). An ownership change is generally defined as a greater than 50 percentage point increase in equity ownership by 5% stockholders in any three-year period. If an ownership change occurred as a result of the sale of future equity issuances, we may not be able to fully realize the benefits of these NOLs. Also, the cash tax benefit from our NOLs is dependent upon our ability to generate sufficient taxable income. Accordingly, we may be unable to earn enough taxable income in order to fully utilize our current NOLs.

Changes in our provision for income taxes or adverse outcomes resulting from examination of our income tax returns could adversely affect our results.

We are subject to income taxation in the United States, Israel and numerous other jurisdictions. Determining our provision for income taxes requires significant management judgment. In addition, our provision for income taxes could be adversely affected by many factors, including, among other things, changes to our operating structure, changes in the amounts of earnings in jurisdictions with different statutory tax rates, changes in the valuation of deferred tax assets and liabilities and changes in tax laws. We are subject to ongoing tax examinations in various jurisdictions. Tax authorities may disagree with our intercompany charges, cross-jurisdictional transfer pricing or other matters and assess additional taxes. While we regularly evaluate the likely outcomes of these examinations to determine the adequacy of our provision for income taxes, there can be no assurance that the outcomes of such examinations will not have a material impact on our results of operations and cash flows. In addition, we may be audited in various jurisdictions, and such jurisdictions may assess additional taxes against us. For example, we are currently subject to a tax audit in Israel. 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 results of operations or cash flows in the period or periods for which a determination is made.

Significant judgment is required to determine the recognition and measurement attributes prescribed in Accounting Standards Codification, ("ASC 740-10-25"). In addition, ASC 740-10-25 applies to all income tax positions, including the potential recovery of previously paid taxes, which if settled unfavorably could adversely impact our provision for income taxes. Further, as a result of certain of our ongoing employment and capital investment actions and commitments, our income in certain countries is subject to reduced tax rates. Our failure to meet these commitments could adversely impact our provision for income taxes. In addition, we are subject to the continuous examination of our income tax returns by the U.S. Internal Revenue Service and other tax authorities. We regularly assess the likelihood of adverse outcomes resulting from these examinations to determine the adequacy of our provision for income taxes. There can be no assurance that the outcomes from these continuous examinations will not have an adverse effect on our results of operations.

The enactment of legislation changing the United States taxation of international business activities or the adoption of other tax reform policies could materially impact our financial position and results of operations.

Changes to U.S. tax laws, including changes that may be enacted in the future, could impact the tax treatment of our foreign earnings. In particular, a number of proposals for broad reform of the corporate tax system in the United States are under evaluation by various legislative and administrative bodies. Due to the expansion of our international business activities, any changes in the U.S. taxation of such activities may increase our worldwide effective tax rate and adversely affect our financial position and results of operations.

We conduct our operations in a number of jurisdictions worldwide and report our taxable income based on our business operations in those jurisdictions. Our intercompany relationships are subject to transfer pricing regulations administered by taxing authorities in various jurisdictions. The relevant taxing authorities may disagree with our determinations as to the income and expenses attributable to specific jurisdictions. If such a disagreement were to occur, and our position were not sustained, we could be required to pay additional taxes, interest and penalties, which could result in one-time tax charges, higher effective tax rates, reduced cash flows and lower overall profitability of our operations.

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

A change in accounting standards or practices could harm our operating results and may even affect our reporting of transactions completed before the change is effective. New accounting pronouncements, such as Accounting Standards Update 2014-09 related to revenue recognition, 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 the way we conduct our business. Additionally, the adoption of new or revised accounting principles may require that we make significant changes to our systems process and controls.

We may require additional capital to support our business growth, and this capital might not be available on acceptable terms, or at all.

We continue to make investments to support our business growth and may require additional funds to respond to business challenges, including the need to develop new features or enhance our software, improve our operating infrastructure or acquire complementary businesses and technologies. Accordingly, we may need to engage in equity or debt financing to secure additional funds. If we raise additional funds through future issuances of equity or convertible debt securities, our existing stockholders could suffer significant dilution, and any new equity securities we issue could have rights, preferences and privileges superior to those of holders of our common stock. Any debt financing that we may secure in the future could involve restrictive covenants relating to our capital raising activities and other financial and operational matters, which may make it more difficult for us to obtain additional capital and to pursue business opportunities, including potential acquisitions. We may not be able to obtain additional financing on terms favorable to us, if at all. If we are unable to obtain adequate financing on terms satisfactory to us when we require it, our ability to continue to support our business growth and to respond to business challenges could be significantly impaired, and our business may be adversely affected.

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

A significant natural disaster, such as a fire, flood or an earthquake, or a significant power outage could have a material adverse impact on our business, results of operations and financial condition. In the event our customers' information technology systems or our channel partners' selling or distribution abilities are hindered by any of these events, we may miss financial targets, such as revenues and sales targets, for a particular quarter. Further, if a natural disaster occurs in a region from which we derive a significant portion of our revenue, customers in that region may delay or forego purchases of our products, 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 channel partners, customers or the economy as a whole. Given our typical concentration of sales at each quarter end, any disruption in the business of our channel partners or customers that impacts sales at the end of our quarter could have a significant adverse impact on our quarterly results. All of the aforementioned risks may be augmented if the disaster recovery plans for us and our channel partners prove to be inadequate. To the extent that any of the above results in delays or cancellations of customer orders, or the delay in the manufacture, deployment or shipment of our products, our business, financial condition and results of operations would be adversely affected.

Risks Related to our Operations in Israel

Conditions in Israel may limit our ability to develop and sell our products, which could result in a decrease of our revenues.

Our principal research and development facility, which also houses a portion of our support and general and administrative teams, is located in Israel. Since the establishment of the State of Israel in 1948, a number of armed conflicts have taken place between Israel and its neighboring countries, as well as incidents of terror activities and other hostilities, and a number of state and non-state actors have publicly committed to its destruction. Political, economic and security conditions in Israel could directly affect our operations. We could be adversely affected by hostilities involving Israel, including acts of terrorism or any other hostilities involving or threatening Israel, the interruption or curtailment of trade between Israel and its trading partners, a significant increase in inflation or a significant downturn in the economic or financial condition of Israel. Any on-going or future armed conflicts, terrorist activities, tension along the Israeli borders or with other countries in the region, including Iran, or political instability in the region could disrupt international trading activities in Israel and may materially and negatively affect our business and could harm our results of operations.

Certain countries, as well as certain companies and organizations, continue to participate in a boycott of Israeli companies, companies with large Israeli operations and others doing business with Israel and Israeli companies. The boycott, restrictive laws, policies or practices directed towards Israel, Israeli businesses or Israeli citizens could, individually or in the aggregate, have a material adverse effect on our business in the future.

Some of our officers and employees in Israel are obligated to perform routine military reserve duty in the Israel Defense Forces, depending on their age and position in the armed forces. Furthermore, they have been and may in the future be called to active reserve duty at any time under emergency circumstances for extended periods of time. Our operations could be disrupted by the absence, for a significant period, of one or more of our officers or key employees due to military service, and any significant disruption in our operations could harm our business.

The tax benefits that are available to our Israeli subsidiary require it to continue to meet various conditions and may be terminated or reduced in the future, which could increase its taxes.

Our Israeli subsidiary benefits from a status of a “Beneficiary Enterprise” under the Israeli Law for the Encouragement of Capital Investments, 5719-1959, or the Investment Law. Based on an evaluation of the relevant factors under the Investment Law, including the level of foreign (i.e., non-Israeli) investment in our company, we have determined that the effective tax rate to be paid by our Israeli subsidiary as a “Beneficiary Enterprise” has historically been approximately 10%. If our Israeli subsidiary does not meet the requirements for maintaining this status, for example, if the Israeli subsidiary materially changes the nature of its business or, if the level of foreign investment in our company decreases, it may no longer be eligible to enjoy this reduced tax rate. As a result, our Israeli subsidiary would be subject to Israeli corporate tax at the standard rate, which, as of January 1, 2017, was set at 24%. Even if our Israeli subsidiary continues to meet the relevant requirements, the tax benefits that the status of “Beneficiary Enterprise” provides may not be continued in the future at their current levels or at all. If these tax benefits were reduced or eliminated, the amount of taxes that our Israeli subsidiary would pay would likely increase, as all of our Israeli operations would consequently be subject to corporate tax at the standard rate, which could adversely affect our results of operations. Additionally, if our Israeli subsidiary increases its activities outside of Israel, for example, through acquisitions, these activities may not be eligible for inclusion in Israeli tax benefit programs. The tax benefits derived from the status of “Beneficiary Enterprise” is dependent upon the ability to generate sufficient taxable income. Accordingly, our Israeli subsidiary may be unable to earn enough taxable income in order to fully utilize its tax benefits.

Risks Related to the Ownership of our Common Stock

Our stock price has been and will likely continue to be volatile.

The market price for our common stock has been, and is likely to continue to be, volatile for the foreseeable future. For example, since shares of our common stock were sold in our initial public offering ("IPO") in March 2014 at a price of $22.00 per share, our common stock's price on The Nasdaq Global Select Market has ranged from $13.25 to $56.80 through August 2, 2017. On August 2, 2017, the closing price of our common stock was $37.40. The market price of our common stock may fluctuate significantly in response to a number of factors, many of which we cannot predict or control, including the factors listed below and other factors described in this "Risk Factors" section:

- actual or anticipated fluctuations in our results or those of our competitors;
- the financial projections we may provide to the public, any changes in these projections or our failure to meet these projections;

- failure of securities analysts to initiate or maintain coverage of our company, changes in financial estimates by any securities analysts who follow our company, or our failure to meet these estimates or the expectations of investors;
- ratings changes by any securities analysts who follow our company;
- announcements of new products, services or technologies, commercial relationships, acquisitions or other events by us or our competitors;
- changes in operating performance and stock market valuations of other technology companies generally, or those in our industry in particular;
- price and volume fluctuations in in certain categories of companies or the overall stock market, including as a result of trends in the global economy;
- 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;
- lawsuits threatened or filed against us;
- short sales, hedging and other derivative transactions involving our capital stock;
- general economic conditions in the United States and abroad;
- changing legal or regulatory developments in the United States and other countries; and
- other events or factors, including those resulting from war, incidents of terrorism or responses to these events.

In addition, the stock markets have experienced extreme price and volume fluctuations that have affected and continue to affect the market prices of equity securities of many technology companies. Stock prices of many technology companies have fluctuated in a manner unrelated or disproportionate to the operating performance of those companies. In the past, stockholders have instituted securities class action litigation following periods of market volatility. If we were to become involved in securities litigation, it could subject us to substantial costs, divert resources and the attention of management from our business and adversely affect our business, results of operations, financial condition and cash flows.

If securities or industry analysts do not publish research or reports about our business, or publish negative reports about our business, our stock price and trading volume could decline.

The trading market for our common stock depends in part on the research and reports that securities or industry analysts publish about us or our business, our market and our competitors. We do not have any control over these analysts or their expectations regarding our performance on a quarterly or annual basis. If one or more of the analysts who cover us downgrade our stock or change their opinion of our stock, our stock price would likely decline. If we fail to meet one or more of these analysts' published expectations regarding our performance on a quarterly basis, our stock price or trading volume could decline. If one or more of these analysts cease coverage of our company or fail to regularly publish reports on us, we could lose visibility in the financial markets, which could cause our stock price or trading volume to decline.

Substantial future sales of shares of our common stock could cause the market price of our common stock to decline.

Sales of a substantial number of shares of our common stock into the public market, or the perception that these sales might occur, could depress the market price of our common stock and could impair our ability to raise capital through the sale of additional equity securities. We are unable to predict the effect that such sales may have on the prevailing market price of our common stock.

As of June 30, 2017, we had options and restricted stock units (“RSUs”) outstanding that, if fully exercised, would result in the issuance of approximately 4.0 million shares of our common stock. All of the shares of our common stock issuable upon exercise of options and vesting of RSUs have been registered for public resale under the Securities Act. Accordingly, these shares will be able to be freely sold in the public market upon issuance as permitted by any applicable vesting requirements.

The requirements of being a public company may strain our resources, divert management’s attention and affect our ability to attract and retain executive management and qualified board members.

As a public company, we are subject to the reporting requirements of the Exchange Act, the Sarbanes-Oxley Act, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, the listing requirements of The Nasdaq Global Select Market and other applicable securities rules and regulations. Compliance with these rules and regulations have increased our legal and financial compliance costs, make some activities more difficult, time-consuming or costly and increase demand on our systems and resources.

The Exchange Act requires, among other things, that we file annual, quarterly and current reports with respect to our business and results of operations. The Sarbanes-Oxley Act requires, among other things, that we maintain effective disclosure controls and procedures and internal control over financial reporting. In order to maintain and, if required, improve our disclosure controls and procedures and internal control over financial reporting to meet this standard, significant resources and management oversight is required. As a result, management’s attention may be diverted from other business concerns, which could adversely affect our business and results of operations. We may need to hire more employees in the future or engage outside consultants, which will increase our costs and expenses. In addition, changing laws, regulations and standards relating to corporate governance and public disclosure are creating uncertainty for public companies, increasing legal and financial compliance costs and making some activities more time consuming. These laws, regulations and standards are subject to varying interpretations, in many cases due to their lack of specificity, and, as a result, their application in practice may evolve over time as new guidance is provided by regulatory and governing bodies. This could result in continuing uncertainty regarding compliance matters and higher costs necessitated by ongoing revisions to disclosure and governance practices.

Being a public company, these new rules and regulations have made it more expensive for us to obtain director and officer liability insurance, and in the future we may be required to accept reduced coverage or incur substantially higher costs to obtain coverage. These factors could also make it more difficult for us to attract and retain qualified members of our board of directors, particularly to serve on our audit and compensation committees, and qualified executive officers.

As a result of disclosure of information in our filings with the SEC, our business and financial condition have become more visible, which we believe may result in threatened or actual litigation, including by competitors and other third parties. If such claims are successful, our business and results of operations could be adversely affected, and even if the claims do not result in litigation or are resolved in our favor, these claims, and the time and resources necessary to resolve them, could divert the resources of our management and adversely affect our business and results of operations.

We are an "emerging growth company" under the JOBS Act and take advantage of certain exemptions from reporting requirements, which may make our common stock less attractive to investors.

We are an "emerging growth company" as defined in the Jumpstart Our Business Startups Act of 2012 (the "JOBS Act"), and we have taken advantage of certain exemptions from various reporting requirements that are applicable to "emerging growth companies," including, but not limited to, not being required to comply with the auditor attestation requirements of Section 404 of the Sarbanes-Oxley Act, reduced disclosure obligations regarding executive compensation in our periodic reports and proxy statements, and exemptions from the requirements of holding a nonbinding advisory vote on executive compensation and stockholder approval of any golden parachute payments not previously approved.

We will remain an "emerging growth company" until December 31, 2017, when we will be deemed to be a "large accelerated filer" as defined in the Exchange Act and, as a result, cease to be an "emerging growth company."

Investors may find our common stock less attractive because we currently rely on these exemptions. If some investors find our common stock less attractive as a result, there may be a less active trading market for our common stock and our stock price may be more volatile.

We are obligated to develop and maintain proper and effective internal controls over financial reporting. These internal controls may not be determined to be effective, which may adversely affect investor confidence in our company and, as a result, the value of our common stock.

We are required, pursuant to Section 404 of the Sarbanes–Oxley Act, to furnish a report by management on, among other things, the effectiveness of our internal control over financial reporting on an annual basis. This assessment includes disclosure of any material weaknesses identified by our management in our internal control over financial reporting. During the evaluation and testing process, if we identify one or more material weaknesses in our internal control over financial reporting, we will be unable to assert that our internal controls are effective.

We are required to disclose changes made in our internal control and procedures on a quarterly basis. Our independent registered public accounting firm will be required to formally attest to the effectiveness of our internal control over financial reporting pursuant to Section 404 as of December 31, 2017 when we are no longer an “emerging growth company.” At such time, our independent registered public accounting firm may issue a report that is adverse in the event it is not satisfied with the level at which our controls are documented, designed or operating. Our remediation efforts may not enable us to avoid a material weakness in the future.

If we are unable to assert 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, we could lose investor confidence in the accuracy and completeness of our financial reports, which would cause the price of our common stock to decline, and we may be subject to investigation or sanctions by the SEC.

Future sales and issuances of our capital stock or rights to purchase capital stock could result in additional dilution of the percentage ownership of our stockholders and could cause our stock price to decline.

Future sales and issuances of our capital stock or rights to purchase our capital stock could result in substantial dilution to our existing stockholders. We may sell common stock, convertible securities and other equity securities in one or more transactions at prices and in a manner as we may determine from time to time. If we sell any such securities in subsequent transactions, investors may be materially diluted. New investors in such subsequent transactions could gain rights, preferences and privileges senior to those of holders of our common stock.

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

We have never declared or paid cash dividends on our common stock. We currently anticipate that we will retain any future earnings and do not expect to pay any dividends in the foreseeable future. Any determination to pay dividends in the future will be at the discretion of our board of directors and will be dependent on a number of factors, including our financial condition, results of operations, capital requirements, general business conditions and other factors that our board of directors may deem relevant. In addition, the loan agreement for our credit facility contains a prohibition on the payment of cash dividends. Until such time that we pay a dividend, investors must rely on sales of their common stock after price appreciation, which may never occur, as the only way to realize any future gains on their investments.

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.

Provisions in our amended and restated certificate of incorporation and amended and restated bylaws 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 75% 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.

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

Sales of Unregistered Securities

None.

Use of Proceeds from Public Offerings of Common Stock

On March 5, 2014, we closed our IPO of 5,520,000 million shares of common stock, including 5,300,436 shares of common stock sold by us (inclusive of 500,436 shares of common stock from the full exercise of the overallotment option of shares granted to the underwriters) and 219,564 shares of common stock sold by the selling stockholder at a price to the public of $22.00 per share. The offer and sale of all of the shares in the IPO were registered under the Securities Act pursuant to a registration statement on Form S-1 (Registration No. 333-191840), which was declared effective by the SEC on February 27, 2014. The offering commenced on February 28, 2014, closed on March 5, 2014 and did not terminate before all of the shares in the IPO that were registered in the registration statement were sold. Morgan Stanley & Co. LLC, Barclays Capital Inc., Jefferies LLC, RBC Capital Markets, LLC and Needham & Company, LLC acted as the underwriters. The aggregate offering price for shares sold in the offering was approximately $121.4 million. We did not receive any proceeds from the sale of shares by the selling stockholder. We raised approximately $106.1 million in net proceeds from the offering, after deducting underwriter discounts and commissions of approximately $8.2 million and other offering expenses of approximately $2.4 million.

No payments were made by us to directors, officers or persons owning ten percent or more of our common stock or to their associates, or to our affiliates, other than payments in the ordinary course of business to our officers for salaries and bonuses and to our non-employee directors as compensation for serving on our board of directors and the various committees thereof. There has been no material change in the planned use of proceeds from our IPO as described in our final prospectus filed with the SEC pursuant to Rule 424(b) under the Securities Act on March 3, 2014. Pending the uses described, we have invested the net proceeds in short-term securities such as certificates of deposit, money market funds and U.S. treasury securities.

Item 6. Exhibits

Exhibit Number	**Description of the Document**
3.1(1)	Amended and Restated Certificate of Incorporation
3.2(2)	Amended and Restated Bylaws
4.1(3)	Third Amended and Restated Investors' Rights Agreement, dated as of February 24, 2011, by and among the Company and certain holders of the Company's capital stock named therein
31.1	Rule 13a-14(a) Certification of Chief Executive Officer and President of the Company in accordance with Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Rule 13a-14(a) Certification of Chief Financial Officer of the Company in accordance with Section 302 of the Sarbanes-Oxley Act of 2002
32.1*	Section 1350 Certification of Chief Executive Officer and President of the Company in accordance with Section 906 of the Sarbanes-Oxley Act of 2002
32.2*	Section 1350 Certification of Chief Financial Officer of the Company in accordance with Section 906 of the Sarbanes-Oxley Act of 2002
101	The following materials from the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2017, formatted in XBRL (eXtensible Business Reporting Language): (i) the Consolidated Balance Sheets, (ii) the Unaudited Consolidated Statements of Operations, (iii) the Unaudited Consolidated Statements of Comprehensive Loss, (iv) the Unaudited Consolidated Statements of Cash Flows and (v) related notes to these consolidated financial statements, tagged as blocks of text and in detail

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(*) Document has been furnished, is not deemed filed and is not to be incorporated by reference into any of the Company's filings under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, irrespective of any general incorporation language contained in any such filing.

(1) Filed as Exhibit 3.1 to the Company's Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on May 8, 2014 (File No. 001-35324) (the "Company's First Quarter 2014 Form 10-Q") and incorporated herein by reference.

(2) Filed as Exhibit 3.2 to the Company's First Quarter 2014 Form 10-Q and incorporated herein by reference.

(3) Filed as Exhibit 3.2 to the Company’s Registration Statement on Form S-1 (File 333-191840) with the SEC on October 22, 2013 and incorporated herein by reference.

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.

	VARONIS SYSTEMS, INC.
August 4, 2017	By: /s/ Yakov Faitelson Yakov Faitelson Chief Executive Officer and President
August 4, 2017	By: /s/ Guy Melamed Guy Melamed Chief Financial Officer (Principal Financial Officer and Principal Accounting Officer)

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