QUALYS, INC.
Form 10-Q
August 07, 2014
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended June 30, 2014

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

For the transition period from to

Commission file number 001-35662

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

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

1600 Bridge Parkway, Redwood City, California 94065
(Address of principal executive offices, including zip code)

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

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	o	Accelerated filer	x	Non-accelerated filer	o	Smaller reporting company	o

(Do not check if a smaller reporting company)

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

The number of shares of the Registrant's common stock outstanding as of July 31, 2014 was 32,986,683.

Table of Contents

Qualys, Inc.
TABLE OF CONTENTS

Table of Contents

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

	June 30, 2014	December 31, 2013
Assets		
Current assets:		
Cash and cash equivalents	$41,672	$42,369
Short-term investments	67,673	54,827
Accounts receivable, net of allowance of $431 and $389 at June 30, 2014 and December 31, 2013, respectively	28,062	28,581
Prepaid expenses and other current assets	5,502	4,679
Total current assets	142,909	130,456
Long-term investments	34,415	35,608
Property and equipment, net	24,012	23,075
Intangible assets, net	2,198	2,394
Goodwill	317	317
Other noncurrent assets	721	753
Total assets	$204,572	$192,603
Liabilities and Stockholders’ Equity		
Current liabilities:		
Accounts payable	$1,735	$1,930
Accrued liabilities	8,389	9,037
Deferred revenues, current	71,853	67,505
Capital lease obligations, current	270	805
Total current liabilities	82,247	79,277
Deferred revenues, noncurrent	8,781	8,889
Other noncurrent liabilities	1,423	1,320
Total liabilities	92,451	89,486
Commitments and contingencies (Note 5)		
Stockholders’ equity:		
Preferred stock, $0.001 par value; 20,000,000 shares authorized, no shares issued and outstanding at June 30, 2014 and December 31, 2013	—	—
Common stock, $0.001 par value; 1,000,000,000 shares authorized, 32,975,245 and 32,375,299 shares issued and outstanding at June 30, 2014 and December 31, 2013, respectively	33	32
Additional paid-in capital	184,387	176,641
Accumulated other comprehensive loss	(1,097)	(1,088)
Accumulated deficit	(71,202)	(72,468)
Total stockholders’ equity	112,121	103,117
Total liabilities and stockholders’ equity	$204,572	$192,603

See accompanying Notes to Condensed Consolidated Financial Statements

3

Table of Contents

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Revenues	$32,302	$26,291	$62,658	$51,174
Cost of revenues	7,175	5,924	14,021	11,719
Gross profit	25,127	20,367	48,637	39,455
Operating expenses:				
Research and development	6,411	5,291	12,815	10,588
Sales and marketing	11,845	10,160	24,337	20,328
General and administrative	5,081	4,053	9,956	7,949
Total operating expenses	23,337	19,504	47,108	38,865
Income from operations	1,790	863	1,529	590
Other income (expense), net:				
Interest expense	(3)	(12)	(7)	(30)
Interest income	130	81	238	158
Other income (expense), net	(37)	33	(138)	(286)
Total other income (expense), net	90	102	93	(158)
Income before provision for income taxes	1,880	965	1,622	432
Provision for income taxes	174	92	356	162
Net income	$1,706	$873	$1,266	$270
Net income per share:				
Basic	$0.05	$0.03	$0.04	$0.01
Diluted	$0.05	$0.02	$0.03	$0.01
Weighted average shares used in computing net income per share:				
Basic	32,818	31,777	32,668	31,636
Diluted	36,839	35,393	36,966	35,353

See accompanying Notes to Condensed Consolidated Financial Statements

Table of Contents

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Net income	$1,706	$873	$1,266	$270
Change in foreign currency translation loss, net of zero tax	(50)	(51)	(41)	(61)
Available-for-sale investments:				
Change in net unrealized gain on investments, net of zero tax	27	(15)	39	(15)
Less: reclassification adjustment for net realized gain included in net income	(7)	(2)	(7)	(8)
Net change, net of zero tax	20	(17)	32	(23)
Other comprehensive loss	(30)	(68)	(9)	(84)
Comprehensive income	$1,676	$805	$1,257	$186

See accompanying Notes to Condensed Consolidated Financial Statements

Table of Contents

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

	Six Months Ended June 30,	
	2014	2013
Cash flows from operating activities:		
Net income	$1,266	$270
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization expense	5,782	4,493
Bad debt expense	153	68
Loss on disposal of property and equipment	1	9
Stock-based compensation	4,606	2,187
Amortization of premiums on investments	325	115
Excess tax benefits from stock-based compensation	(54)	—
Changes in operating assets and liabilities:		
Accounts receivable	367	1,549
Prepaid expenses and other assets	(787)	429
Accounts payable	(207)	477
Accrued liabilities	(618)	1,170
Deferred revenues	4,240	2,545
Other noncurrent liabilities	101	(442)
Net cash provided by operating activities	15,175	12,870
Cash flows from investing activities:		
Purchases of investments	(76,907)	(75,048)
Sales and maturities of investments	64,960	100,624
Purchases of property and equipment	(6,495)	(6,238)
Release of restricted cash	—	114
Net cash (used in) provided by investing activities	(18,442)	19,452
Cash flows from financing activities:		
Proceeds from exercise of stock options	3,082	2,163
Excess tax benefits from stock-based compensation	54	—
Principal payments under capital lease obligations	(536)	(655)
Net cash provided by financing activities	2,600	1,508
Effect of exchange rate changes on cash and cash equivalents	(30)	(96)
Net (decrease) increase in cash and cash equivalents	(697)	33,734
Cash and cash equivalents at beginning of period	42,369	34,885
Cash and cash equivalents at end of period	$41,672	$68,619
Non-cash investing and financing activities:		
Purchases of property and equipment recorded in accrued liabilities	$—	$2,450
Vesting of early exercised common stock options	$35	$144

See accompanying Notes to Condensed Consolidated Financial Statements

6

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

NOTE 1. The Company and Summary of Significant Accounting Policies

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

Basis of Presentation
The accompanying unaudited condensed consolidated financial statements and condensed footnotes have been prepared by the Company in accordance with accounting principles generally accepted in the United States ("U.S. GAAP") for interim financial information as well as the instructions to Form 10-Q and the rules and regulations of the U.S. Securities and Exchange Commission ("SEC"). Certain information and note disclosures normally included in the financial statements prepared in accordance with U.S. GAAP have been condensed or omitted pursuant to such rules and regulations. The condensed consolidated balance sheet as of December 31, 2013, included herein, was derived from the audited financial statements as of that date but does not include all disclosures, including notes required by U.S. GAAP. In the opinion of management, the accompanying unaudited condensed consolidated financial statements reflect all adjustments, which include only normal recurring adjustments, necessary for the fair presentation of the financial position, results of operations and cash flows for the interim periods. The results of operations for the three and six month periods ended June 30, 2014 is not necessarily indicative of the results of operations expected for the entire year ending December 31, 2014 or for any other future annual or interim period. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2013 filed with the SEC on February 28, 2014.

Certain prior year amounts have been reclassified to conform to the current year presentation. These reclassifications did not change previously reported total assets, liabilities, stockholders' equity, income from operations or net income.

Principles of Consolidation
The accompanying condensed consolidated financial statements include the accounts of the Company and its majority owned subsidiaries. All significant intercompany transactions and balances have been eliminated upon consolidation.

Use of Estimates
The preparation of the condensed consolidated financial statements in conformity with U.S. GAAP requires management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements and the reported results of operations during the reporting period. The Company’s management regularly assesses these estimates, which primarily affect revenue recognition, the valuation of accounts receivable, goodwill and intangible assets, stock-based compensation and the valuation allowances associated with deferred tax assets.

7

Actual results could differ from those estimates and such differences may be material to the accompanying condensed consolidated financial statements.

Concentration of Credit Risk

The Company invests its cash and cash equivalents with major financial institutions. Cash balances with any one institution at times may be in excess of federally insured limits. Cash equivalents are invested in high-quality investment grade financial instruments and are diversified. The Company has not experienced any losses in such accounts and believes it is not exposed to any significant credit risk.

Credit risk with respect to accounts receivable is dispersed due to the large number of customers. In addition, the Company’s credit risk is mitigated by the relatively short collection period. Collateral is not required for accounts receivable. The Company maintains an allowance for potential credit losses based upon the expected collectability of accounts receivable. The Company writes off its receivables when collectability is deemed to be doubtful. As of June 30, 2014 and December 31, 2013, no customer or channel partner accounted for more than 10% of the Company's accounts receivable balance.

Cash, Cash Equivalents, Short-Term and Long-Term Investments

Cash and cash equivalents include cash held in banks and highly liquid money market funds, commercial paper and corporate bonds, all with original maturities of three months or less when acquired. The Company’s investments consist of fixed-income U.S. government agency securities, corporate bonds, municipal bonds, asset-backed securities, certificates of deposit, and commercial paper. Management determines the appropriate classification of the Company's investments at the time of purchase and reevaluates such designation at each balance sheet date. The Company classifies its investments as either short-term or long-term based on each instrument's underlying contractual maturity date.

Cash equivalents are stated at cost, which approximates fair market value. Short-term and long-term investments are classified as available-for-sale and are carried at fair value. Unrealized gains and losses in fair value are reported in other comprehensive income (loss). When the available-for-sale securities are sold, cost is based on the specific identification method, and the realized gains and losses are included in other income (expense) in the condensed consolidated statements of operations. Short-term and long-term investments are reviewed quarterly for impairment that is deemed to be other-than-temporary. An investment is considered other-than-temporarily impaired when its fair value is below its amortized cost and (1) there is an intent to sell the security, (2) it is “more likely than not” that the security will be sold before recovery of its amortized cost basis or (3) the present value of expected cash flows from the investment is not expected to recover the entire amortized cost basis. Declines in value that are considered to be other-than-temporary and adjustments to amortized cost for the amortization of premiums and the accretion of discounts are recorded in other income (expense). Interest and dividends are recorded in interest income as earned.

Recent Accounting Pronouncements

Under the Jumpstart Our Business Startups Act (the "JOBS Act"), the Company meets the definition of an “emerging growth company.” The Company has irrevocably elected to opt out of the extended transition period for complying with new or revised accounting standards pursuant to Section 107(b) of the JOBS Act. As a result, the Company will comply with new or revised accounting standards on the relevant dates on which adoption of such standards is required from non-emerging growth companies.

In May 2014, the Financial Accounting Standards Board (“FASB”) issued an Accounting Standard Update (“ASU”) amending revenue recognition guidance and requiring more detailed disclosures to enable users of financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. The guidance is effective for annual and interim reporting periods beginning after December 15, 2016, with early adoption prohibited. The Company is currently evaluating the impact this ASU will have on its consolidated financial statements.

NOTE 2. Fair Value of Financial Instruments

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

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

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

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

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

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

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

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

	June 30, 2014			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
	(in thousands)			
Cash and cash equivalents:				
Cash	$28,229	$—	$—	$28,229
Money market funds	2,544	—	—	2,544
Commercial paper	10,898	1	—	10,899
Total	41,671	1	—	41,672
Short-term investments:				
Commercial paper	27,170	9	—	27,179
Corporate bonds	33,547	34	(3)	33,578
Certificate of Deposit	2,509	—	(6)	2,503
U.S. government agencies	4,409	4	—	4,413
Total	67,635	47	(9)	67,673
Long-term investments:				
Asset-backed securities	18,872	18	(1)	18,889
Corporate bonds	15,512	19	(5)	15,526
Total	34,384	37	(6)	34,415
Total	$143,690	$85	$(15)	$143,760

	December 31, 2013			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
	(in thousands)			
Cash and cash equivalents:				
Cash	$27,488	$—	$—	$27,488
Money market funds	183	—	—	183
Commercial paper	14,697	1	—	14,698
Total	42,368	1	—	42,369
Short-term investments:				
Commercial paper	32,784	6	—	32,790
Corporate bonds	16,894	11	—	16,905
Municipal bonds	1,128	—	—	1,128
U.S. government agencies	4,004	—	—	4,004
Total	54,810	17	—	54,827
Long-term investments:				
Asset-backed securities	5,497	4	—	5,501
Corporate bonds	15,256	22	(4)	15,274
U.S. government agencies	14,835	1	(3)	14,833
Total	35,588	27	(7)	35,608
Total	$132,766	$45	$(7)	$132,804

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

The following table sets forth by level within the fair value hierarchy the fair value of the Company's available-for-sale securities measured on a recurring basis:

	June 30, 2014			
	Level 1	Level 2	Level 3	Fair Value
	(in thousands)			
Commercial paper	$—	$38,078	$—	$38,078
Asset-backed securities	—	18,889	—	18,889
Corporate bonds	—	49,104	—	49,104
Certificate of deposit	—	2,503	—	2,503
U.S. government agencies	—	4,413	—	4,413
Total	$—	$112,987	$—	$112,987

	December 31, 2013			
	Level 1	Level 2	Level 3	Fair Value
	(in thousands)			
Commercial paper	$—	$47,488	$—	$47,488
Asset-backed securities	—	5,501	—	5,501
Corporate bonds	—	32,179	—	32,179
Municipal bonds	—	1,128	—	1,128
U.S. government agencies	—	18,837	—	18,837
Total	$—	$105,133	$—	$105,133

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

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

	June 30, 2014		
	Mature within One Year	After One Year through Two Years	Fair Value
	(in thousands)		
Commercial paper	$38,078	$—	$38,078
Corporate bonds	33,578	15,526	49,104
Certificate of deposit	2,503	—	2,503
U.S. government agencies	4,413	—	4,413
Asset-backed securities	13,371	5,518	18,889
Total	$91,943	$21,044	$112,987

	December 31, 2013		
	Mature within One Year	After One Year through Two Years	Fair Value
	(in thousands)		
Commercial paper	$47,488	$—	$47,488
Municipal bonds	1,128	—	1,128
Corporate bonds	16,905	15,274	32,179
U.S. government agencies	8,719	10,118	18,837
Asset-backed securities	1,500	4,001	5,501
Total	$75,740	$29,393	$105,133

Derivative Financial Instruments

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

At June 30, 2014, the Company had two outstanding forward contracts with notional amounts of 4.6 million Euros and 2.3 million British Pounds, both of which expired on July 31, 2014. At December 31, 2013, the Company had two outstanding forward contracts with notional amounts of 6.3 million Euros and 2.0 million British Pounds, which expired on January 31, 2014. These forward contracts were entered into at the end of each month, and thus the fair value of these contracts was $0 at June 30, 2014 and December 31, 2013. In the three months ended June 30, 2014 and 2013, the Company recorded a gain of $23,000 and a loss of $0.1 million from these contracts, respectively, which was partially offset by minimal foreign currency transaction gains and losses during these periods. In the six months ended June 30, 2014, the Company recorded a loss of $0.2 million from these contracts, partially offsetting other foreign currency transaction gains of $0.1 million. In the six months ended June 30, 2013, the Company recorded a loss of $0.2 million from these contracts, in addition to other foreign currency transaction losses of $0.2 million. These derivatives did not meet the criteria to be designated as hedges. These instruments were valued using Level 2 inputs.

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

NOTE 3. Property and Equipment, Net

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

	June 30, 2014	December 31, 2013
	(in thousands)	
Computer equipment	$31,689	$27,464
Computer software	9,313	9,277
Furniture, fixtures and equipment	2,416	2,031
Scanner appliances	18,323	17,055
Leasehold improvements	2,235	2,100
Total property and equipment	63,976	57,927
Less: accumulated depreciation and amortization	(39,964)	(34,852)
Property and equipment, net	$24,012	$23,075

Assets held under capital lease included in computer software at June 30, 2014 and December 31, 2013 totaled approximately $3.1 million. The related accumulated depreciation at June 30, 2014 and December 31, 2013 totaled $1.4 million and $1.2 million, respectively. The capital lease obligations are secured by the related software.

Physical scanner appliances and other computer equipment that are or will be subject to subscriptions by customers have a net carrying value of $5.6 million and $4.7 million at June 30, 2014 and December 31, 2013, respectively, including assets that have not been placed in service of $0.9 million and $0.6 million, respectively. Other fixed assets not placed in service at June 30, 2014 and December 31, 2013, included in computer equipment and leasehold improvements, relate to new information technology systems and tenant improvements of approximately $2.3 million and $1.6 million, respectively. Depreciation and amortization expense relating to property and equipment, including capitalized leases, was $2.9 million and $2.3 million for three months ended June 30, 2014 and 2013, respectively and $5.6 million and $4.3 million for the six months ended June 30, 2014 and 2013, respectively.

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

NOTE 4. Goodwill and Intangible Assets, Net

Intangible assets consist primarily of existing technology, patent license and non-competition agreements acquired in business combinations. Acquired intangibles are amortized on a straight-line basis over the respective estimated useful lives of the assets.

The carrying values of intangible assets are as follows (in thousands):

			June 30, 2014		December 31, 2013	
	Estimated Lives	Cost	Accumulated Amortization	Net Book Value	Accumulated Amortization	Net Book Value
Existing technology	7 years	$1,910	$(1,046)	$864	$(909)	$1,001
Patent license	14 years	1,388	(372)	1,016	(323)	1,065
Non-competition agreements and other	3 years	171	(148)	23	(138)	33
Total intangibles subject to amortization		$3,469	$(1,566)	1,903	$(1,370)	2,099
Intangible assets not subject to amortization				295		295
Total intangible assets, net				$2,198		$2,394

Intangibles amortization expense was $0.1 million for the three months ended June 30, 2014 and 2013 and $0.2 million for the six months ended June 30, 2014 and 2013.

As of June 30, 2014, the Company expects amortization expense in future periods to be as follows (in thousands):

Remainder of 2014	$196
2015	386
2016	373
2017	282
2018	100
2019 and thereafter	566
Total expected future amortization expense	$1,903

Goodwill, which is not subject to amortization, totaled $0.3 million as of June 30, 2014 and December 31, 2013.

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

NOTE 5. Commitments and Contingencies
Leases
The Company leases certain computer equipment and its corporate office and data center facilities under noncancelable operating leases for varying periods through 2018.

In 2011, the Company entered into a $3.1 million financing arrangement for computer software, accounted for as a capital lease, with minimum quarterly payments scheduled through 2014. The capital lease obligation has an interest rate of 1.8% and is secured by the related computer software. In connection with this transaction, the Company also has minimum obligations for related maintenance and support, which were amended in June 2013. Minimum obligations were $0.3 million at December 31, 2013 and were recorded in current liabilities in the accompanying condensed consolidated balance sheets at December 31, 2013. There were no remaining obligations as of June 30, 2104.

The following are the minimum annual lease payments due under these leases at June 30, 2014:

	Operating Leases	Capital Leases
	(in thousands)	
Remainder of 2014	$2,111	$271
2015	2,864	—
2016	1,923	—
2017	1,610	—
2018	207	—
Total minimum lease payments	$8,715	271
Less amount representing interest		(1)
Present value of minimum payments		270
Less current portion		(270)
Capital lease obligations, noncurrent		$—

Rent expense was $1.5 million and $1.4 million for the three months ended June 30, 2014 and 2013, respectively, and $3.0 million and $2.7 million for the six months ended June 30, 2014 and 2013, respectively. Although certain of the operating lease agreements provide for escalating rent payments over the terms of the leases, rent expense under these agreements is recognized on a straight-line basis. As of June 30, 2014 and December 31, 2013, the Company has accrued $0.6 million of deferred rent related to these agreements, which is reflected in other noncurrent liabilities in the accompanying condensed consolidated balance sheets.

Table of Contents

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

Sales and Other Taxes

The Company’s software-as-a-service solutions are subject to sales and other taxes in certain jurisdictions where the Company does business. The Company bills sales and other taxes to customers and remits these amounts to the respective government authorities. For those jurisdictions where the Company has not yet billed sales tax to its customers and believes it is probable it may have exposure and can reasonably estimate such exposure, it has recorded a liability of $0.5 million at June 30, 2014 and December 31, 2013, which is recorded within accrued liabilities in the condensed consolidated balance sheets. However, taxing jurisdictions have differing rules and regulations, which are subject to varying interpretations that may change over time. Other than the liability that the Company has accrued in its condensed consolidated balance sheets, the Company has been unable to assess the probability, or estimate the amount, of its sales tax exposure, if any. There are no pending reviews at June 30, 2014 of which the outcome is expected to result in sales and other taxes due in excess of accrued liabilities. Management does not anticipate that its sales tax exposure, if any, would have a material adverse effect on the financial position, results of operations or cash flows of the Company.

Indemnifications

The Company from time to time enters into certain types of contracts that contingently require it to indemnify various parties against claims from third parties. These contracts primarily relate to (i) the Company's by-laws, under which it must indemnify directors and executive officers, and may indemnify other officers and employees, for liabilities arising out of their relationship, (ii) contracts under which the Company must indemnify directors and certain officers for liabilities arising out of their relationship, and (iii) contracts under which the Company may be required to indemnify customers or resellers from certain liabilities arising from potential infringement of intellectual property rights, as well as potential damages caused by limited product defects. To date, the Company has not incurred and has not recorded any liability in connection with such indemnifications.

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

Contingencies

From time to time, the Company may have certain contingent liabilities that arise in the ordinary course of its business activities. The Company accrues a liability for such matters when it is probable a loss has been incurred and such loss can be reasonably estimated. At June 30, 2014, the Company has not recorded any material liabilities in accordance with accounting for contingencies.

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

NOTE 6. Stock-based Compensation

Stock Options
2012 Equity Incentive Plan

Under the 2012 Equity Incentive Plan (the "2012 Plan"), the Company is authorized to grant to eligible participants incentive stock options (“ISOs”), nonstatutory stock options (“NSOs”), stock appreciation rights ("SARs"), restricted stock awards ("RSAs"), restricted stock units ("RSUs"), performance units and performance shares equivalent to up to 4,668,764 shares of common stock. Options may be granted with an exercise price that is at least equal to the fair market value of the Company's stock at the date of grant and are exercisable when vested. As of June 30, 2014, 1,791,713 shares were available for grant under the 2012 Plan.

2000 Equity Incentive Plan

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

Employee Stock-based Compensation

Employee stock-based compensation is included in the condensed consolidated statements of operations as follows:

	Three Months Ended June 30,		Six months ended June 30,	
	2014	2013	2014	2013
	(in thousands)			
Cost of revenues	$158	$101	$307	$194
Research and development	510	226	945	434
Sales and marketing	705	158	1,278	441
General and administrative	992	457	1,765	792
Total employee stock-based compensation	$2,365	$942	$4,295	$1,861

Compensation cost is recognized on a straight-line basis over the service period. Forfeitures are estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

As of June 30, 2014, the Company had $19.7 million of total unrecognized employee compensation cost related to nonvested awards that it expects to recognize over a weighted-average period of 2.5 years.

The fair value of each option granted to employees is estimated on the date of grant using the Black-Scholes option-pricing model based on the following assumptions:

	Three Months Ended June 30,		Six months ended June 30,	
	2014	2013	2014	2013
Expected term (in years)	5.3 to 5.9	5.4 to 6.1	5.3 to 5.9	5.4 to 6.1

Volatility	49% to 50%	52%	49% to 52%	52% to 53%
Risk-free interest rate	1.65% to 1.67%	0.7% to 1.1%	1.52% to 1.67%	0.7% to 1.1%
Dividend yield	—	—	—	—

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

The expected term of the options is based on evaluations of historical and expected future employee exercise behavior. The risk-free interest rate is based on the U.S. Treasury rates at the date of grant with maturity dates approximately equal to the expected term at the grant date. Volatility is based on historical volatility of several public entities that are similar to the Company, as the Company does not have sufficient historical transactions in its own shares on which to base expected volatility. The Company has not historically issued any dividends and does not expect to in the future.

Non-Employee Stock-based Compensation

The Company records compensation representing the fair value of stock options granted to non-employees. Stock-based non-employee compensation was $0.1 million and $0.3 million for the three months ended June 30, 2014 and 2013, respectively and $0.3 million for the six months ended June 30, 2014 and 2013. Non-employee stock-based compensation is recognized over the vesting periods of the options. The value of options granted to non-employees is remeasured as they vest over a performance period.

Stock Option Plan Activity

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

	Outstanding Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (Years)	Aggregate Intrinsic Value
				(in thousands)
Balance as of December 31, 2013	7,039,093	$7.17	6.5	$112,312
Granted	1,399,400	23.65		
Exercised	(598,670)	5.10		
Canceled	(529,268)	16.81		
Balance as of June 30, 2014	7,310,555	9.80	6.4	116,943
Vested and expected to vest - June 30, 2014	6,802,381	9.18	6.3	112,981
Exercisable - June, 2014	4,870,019	4.70	5.3	102,123

Restricted Stock

The terms and conditions of RSAs, including vesting criteria and timing are set by the board of directors. The cost of RSAs is determined using the fair value of the Company’s common stock on the date of the grant. Compensation cost is recognized on a straight-line basis over the requisite service period of each grant adjusted for estimated forfeitures. Recipients of RSAs generally have voting and dividend rights without regard to vesting. The Company has the right to repurchase shares that do not vest.

During the three months ended June 30, 2014 and 2013, the Company granted 1,401 and 1,900 shares of restricted stock, respectively, which vested immediately and had no further restrictions or service period, and resulted in compensation expense of $27,000 and $20,000 for the three months ended June 30, 2014 and 2013, respectively. The Company did not issue restricted stock during the first quarters of 2014 or 2013.

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

NOTE 7. Accumulated Other Comprehensive Income (Loss)

The following table presents the components of accumulated other comprehensive income (loss):

	June 30, 2014	December 31, 2013
	(in thousands)	
Foreign currency translation gain (loss), net of zero tax	$(1,167)	$(1,126)
Net unrealized gain on investments, net of zero tax	70	38
Total	$(1,097)	$(1,088)

NOTE 8. Other Income (Expense), Net

Other income (expense), net consists of the following:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
	(in thousands)			
Foreign exchange gains (losses)	$(9)	$(116)	$(85)	$(414)
Other income (expense)	(28)	149	(53)	128
Other income (expense), net	$(37)	$33	$(138)	$(286)

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

NOTE 9. Income Taxes

The provision for income taxes for the six months ended June 30, 2014 and 2013 primarily reflects foreign and state taxes, and certain discrete items.

As of June 30, 2014 and December 31, 2013, the Company had unrecognized tax benefits of $3.3 million, of which $1.0 million, if recognized and in absence of a valuation allowance, would favorably impact the Company's effective tax rate.

NOTE 10. Segment Information and Information about Geographic Area

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
	(in thousands)			
United States	$22,620	$18,434	$43,910	$35,807
Other	9,682	7,857	18,748	15,367
Total revenues	$32,302	$26,291	$62,658	$51,174

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

	June 30, 2014	December 31, 2013
	(in thousands)	
United States	$21,003	$19,909
Other	3,009	3,166
Total property and equipment, net	$24,012	$23,075

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

NOTE 11. Net Income Per Share

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
	(in thousands)			
Numerator:				
Net income	$1,706	$873	$1,266	$270
Net income attributable to participating securities	—	(1)	—	—
Net income attributable to common stockholders - basic	1,706	872	1,266	270
Undistributed earnings reallocated to participating securities	—	—	—	—
Net income attributable to common stockholders - diluted	$1,706	$872	$1,266	$270
Denominator:				
Weighted-average shares used in computing net income per share:				
Basic	32,818	31,777	32,668	31,636
Effect of potentially dilutive securities:				
Common stock options	4,021	3,616	4,298	3,717
Diluted	36,839	35,393	36,966	35,353
Net income per share:				
Basic	$0.05	$0.03	$0.04	$0.01
Diluted	$0.05	$0.02	$0.03	$0.01

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
	(in thousands)			
Common stock options	1,780	989	1,315	756

Table of Contents

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

This Quarterly Report on Form 10-Q, including this Management’s Discussion and Analysis of Financial Condition and Results of Operations, should be read in conjunction with (1) our condensed consolidated financial statements (unaudited) and the related notes included elsewhere in this report, and (2) the audited consolidated financial statements and the related notes and management’s discussion and analysis of financial condition and results of operations included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2013, filed with the Securities and Exchange Commission, or SEC, on February 28, 2014.

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

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

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

Overview

We are a pioneer and leading provider of cloud security and compliance solutions that enable organizations to identify security risks to their IT infrastructures, help protect their IT systems and applications from ever-evolving cyber attacks and achieve compliance with internal policies and external regulations. Our cloud solutions address the growing security and compliance complexities and risks that are amplified by the dissolving boundaries between internal and external IT infrastructures and web environments, the rapid adoption of cloud computing and the proliferation of geographically dispersed IT assets. Our integrated suite of security and compliance solutions delivered on our QualysGuard Cloud Platform enables our customers to identify their IT assets, collect and analyze large amounts of IT security data, discover and prioritize vulnerabilities, recommend remediation actions and verify the implementation of such actions. Organizations use our integrated suite of solutions delivered on our

QualysGuard Cloud Platform to cost-effectively obtain a unified view of their security and compliance posture across globally-distributed IT infrastructures.

We were founded and incorporated in December 1999 with a vision of transforming the way organizations secure and protect their IT infrastructure and applications and initially launched our first cloud solution, QualysGuard Vulnerability Management, in 2000. This solution has provided the substantial majority of our revenues to date, representing 82% and 85% of total revenues for the six months ended June 30, 2014 and 2013, respectively. As this solution gained acceptance, we introduced new solutions to help customers manage increasing IT security and compliance requirements. In 2006, we added our PCI Compliance solution, and in 2008, we added our Policy Compliance solution. In 2009, we broadened the scope of our cloud services by adding Web Application Scanning. We continued our expansion in 2010, launching Malware Detection Service and Qualys SECURE Seal for automated protection of websites. In 2012, we introduced our virtualized private cloud platform as an additional deployment option of our solutions for customers and partners. In 2014, we released a new Continuous Security Monitoring service for Internet-facing systems, which allows customers to continuously monitor their mission-critical assets and to be alerted to security vulnerabilities or misconfigurations that may make them susceptible to a cyber attack.

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

We market and sell our solutions to enterprises, government entities and to small and medium-sized businesses across a broad range of industries, including education, financial services, government, healthcare, insurance, manufacturing, media, retail, technology and utilities. In the six month periods ended June 30, 2014 and 2013, approximately 70% of our revenues were derived from customers in the United States. We sell our solutions to enterprises and government entities primarily through our field sales force and to small and medium-sized businesses through our inside sales force. We generate a significant portion of sales through our channel partners, including managed service providers, value-added resellers and consulting firms in the United States and internationally.

We have had continued revenue growth in the six months ended June 30, 2014 compared to the same period in 2013. Our revenues increased to $32.3 million in the three months ended June 30, 2014 from $26.3 million for the comparable period in 2013, representing an increase of $6.0 million or 23%. Revenues reached $62.7 million for the six months ended June 30, 2014, compared to $51.2 million for the six months ended June 30, 2013. For the three months ended June 30, 2014 and 2013, we had net income of $1.7 million and $0.9 million, respectively. For the six months ended June 30, 2014 and 2013, we had net income of $1.3 million and $0.3 million, respectively.

Adjusted EBITDA

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

Adjusted EBITDA should not be considered in isolation from, or as a substitute for, financial information prepared in accordance with U.S. GAAP. We calculate Adjusted EBITDA as net income before (1) other (income) expense, net, which includes interest income, interest expense and other income and expense, (2) provision for

Table of Contents

income taxes, (3) depreciation and amortization of property and equipment, (4) amortization of intangible assets and (5) stock-based compensation.

The following unaudited table presents the reconciliation of net income to Adjusted EBITDA for the three and six months ended June 30, 2014 and 2013:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
	(in thousands, except percentages)			
Net income	$1,706	$873	$1,266	$270
Other (income) expense, net	(90)	(102)	(93)	158
Provision for income taxes	174	92	356	162
Depreciation and amortization of property and equipment	2,879	2,267	5,586	4,279
Amortization of intangible assets	98	107	196	214
Stock-based compensation	2,480	1,238	4,606	2,187
Adjusted EBITDA	$7,247	$4,475	$11,917	$7,270
Percentage of revenues	22%	17%	19%	14%

Limitations of Adjusted EBITDA

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

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

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

Table of Contents

Key Components of Results of Operations

Revenues

We derive revenues from the sale of subscriptions to our security and compliance solutions, which are delivered on our cloud platform. We generate the substantial majority of our revenues through the sale of subscriptions to our QualysGuard Vulnerability Management solution, and we also have a growing number of customers who have purchased our additional solutions. Subscriptions to our solutions allow customers to access our cloud security and compliance solutions through a unified, web-based interface. Customers generally enter into one year renewable subscriptions. The subscription fee entitles the customer to an unlimited number of scans for a specified number of networked devices or web applications and, if requested by a customer as part of their subscription, a specified number of physical or virtual scanner appliances. Our physical and virtual scanner appliances are requested by certain customers as part of their subscriptions in order to scan IT infrastructures within their firewalls and do not function without, and are not sold separately from, subscriptions for our solutions. Customers are required to return physical scanner appliances if they do not renew their subscriptions.

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

Cost of Revenues

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

Operating Expenses

Research and Development

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

Sales and Marketing

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

General and Administrative

General and administrative expenses consist primarily of personnel expenses, comprised of salaries, benefits, performance-based compensation and stock-based compensation, for our executive, finance and accounting, legal, human resources and internal information technology support teams, as well as professional services, insurance, fees, certain other corporate governance-related expenses, and overhead allocations. We expect that general and administrative expenses will increase in absolute dollars, as we continue to add personnel and incur professional services to support our growth.

Other Income (Expense), Net
Our other income (expense), net consists primarily of interest and investment income from our short-term and long-term investments; foreign exchange gains and losses, the majority of which result from fluctuations between the U.S. dollar and the Euro, British pound and Japanese yen, and interest expense associated with our capital leases.

Provision for Income Taxes
Our provision for income taxes consists primarily of corporate income taxes resulting from profits generated in foreign jurisdictions by wholly-owned subsidiaries, along with state income taxes payable in the United States. The provision for income taxes also includes changes to unrecognized tax benefits related to uncertain tax positions.

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

We maintain a valuation allowance on our U.S. federal and state net deferred tax assets. Our cash tax expense is impacted by each jurisdiction’s individual tax rates, laws on timing of recognition of income and deductions and availability of net operating losses and tax credits. Given the valuation allowance and sensitivity of current cash taxes to local rules, our effective tax rate could fluctuate significantly on a quarterly basis, to the extent earnings are lower than anticipated in countries that have lower statutory rates and higher than anticipated in countries that have higher statutory rates, and also due to changes in our earnings projections, by changes in the valuation of our deferred tax assets or liabilities, or by changes in tax laws, regulations, or accounting principles, as well as certain discrete items.

Table of Contents

Results of Operations

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
	(in thousands)			
Consolidated Statements of Operations Data:				
Revenues	$32,302	$26,291	$62,658	$51,174
Cost of revenues (1)	7,175	5,924	14,021	11,719
Gross profit	25,127	20,367	48,637	39,455
Operating expenses:				
Research and development (1)	6,411	5,291	12,815	10,588
Sales and marketing (1)	11,845	10,160	24,337	20,328
General and administrative (1)	5,081	4,053	9,956	7,949
Total operating expenses	23,337	19,504	47,108	38,865
Income from operations	1,790	863	1,529	590
Other income (expense), net	90	102	93	(158)
Income before provision for income taxes	1,880	965	1,622	432
Provision for income taxes	174	92	356	162
Net income	$1,706	$873	$1,266	$270

(1) Includes stock-based compensation as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
	(in thousands)			
Cost of revenues	$158	$111	$307	$204
Research and development	517	236	952	444
Sales and marketing	718	158	1,291	441
General and administrative	1,087	733	2,056	1,098
Total stock-based compensation	$2,480	$1,238	$4,606	$2,187

Table of Contents

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Revenues	100 %	100 %	100 %	100 %
Cost of revenues	22	23	22	23
Gross profit	78	77	78	77
Operating expenses:				
Research and development	20	20	20	21
Sales and marketing	36	39	39	40
General and administrative	16	15	16	15
Total operating expenses	72	74	75	76
Income from operations	6	3	3	1
Other income (expense), net	0	0	0	0
Income before provision for income taxes	6	3	3	1
Provision for income taxes	1	0	1	0
Net income	5 %	3 %	2 %	1 %

Comparison of Three Months Ended June 30, 2014 and 2013

Revenues

	Three Months Ended June 30,		Change	
	2014	2013	$	%
	(in thousands, except percentages)			
Revenues	$32,302	$26,291	$6,011	23 %

Revenues increased $6.0 million for the three months ended June 30, 2014 compared to the three months ended June 30, 2013, primarily due to new customer subscriptions entered into after June 30, 2013 and from an increase in the purchase of subscriptions from existing customers. Of the total increase of $6.0 million, $4.2 million was from customers in the United States and the remaining $1.8 million was from customers in foreign countries. The growth in revenues reflects increased demand for our solutions.

Table of Contents

Cost of Revenues

	Three Months Ended June 30,		Change	
	2014	2013	$	%
	(in thousands, except percentages)			
Cost of revenues	$7,175	$5,924	$1,251	21 %
Percentage of revenues	22 %	23 %		
Gross profit percentage	78 %	77 %		

Cost of revenues increased $1.3 million for the three months ended June 30, 2014 compared to the three months ended June 30, 2013, primarily due to a $0.5 million increase in depreciation expenses related to additional computer hardware and software for our new and existing data centers; increased personnel expenses of $0.3 million, principally driven by the addition of employees in our operations staff and higher stock-based compensation; increased third-party software maintenance expense of $0.2 million; increased consulting expenses of $0.2 million as well as increased data center costs of $0.1 million, driven by expanded storage and other data center-related costs.

Research and Development Expenses

	Three Months Ended June 30,		Change	
	2014	2013	$	%
	(in thousands, except percentages)			
Research and development	$6,411	$5,291	$1,120	21 %
Percentage of revenues	20 %	20 %		

Research and development expenses increased $1.1 million in the three months ended June 30, 2014 compared to the three months ended June 30, 2013, primarily due to an increase in personnel expenses of $0.9 million, including higher stock-based compensation, principally driven by the addition of employees as we continue to invest in enhancing our platform and developing new solutions; and $0.1 million in consulting and professional service expenses.

Sales and Marketing Expenses

	Three Months Ended June 30,		Change	
	2014	2013	$	%
	(in thousands, except percentages)			
Sales and marketing	$11,845	$10,160	$1,685	17 %
Percentage of revenues	36 %	39 %		

Sales and marketing expenses increased $1.7 million for the three months ended June 30, 2014 compared to the three months ended June 30, 2013, primarily due to an increase in personnel expenses of $1.8 million, including higher stock-based compensation, principally driven by the addition of employees as we continue to expand our domestic and international sales and marketing efforts, and higher sales commissions. We also incurred increased marketing expenses of $0.2 million, primarily related to increased marketing program activities. These increases were partially offset by lower consulting and professional service expenses of $0.2 million.

Table of Contents

General and Administrative Expenses

	Three Months Ended June 30,		Change	
	2014	2013	$	%
	(in thousands, except percentages)			
General and administrative	$5,081	$4,053	$1,028	25 %
Percentage of revenues	16 %	15 %		

General and administrative expenses increased $1.0 million for the three months ended June 30, 2014 compared to the three months ended June 30, 2013, primarily driven by increased personnel expenses of $0.5 million, including higher employee stock-based compensation, principally due to the addition of employees to support the growth of our business; increased professional services of $0.2 million; and increased bad debt expense and other fees of $0.2 million relative to the same period a year ago.

Other Income (Expense), Net

	Three Months Ended June 30,		Change	
	2014	2013	$	%
	(in thousands, except percentages)			
Other income (expense), net	$90	$102	$(12)	12 %
Percentage of revenues	0 %	0 %		

Other income (expense), net remained relatively constant during the three months ended June 30, 2014 compared to the three months ended June 30, 2013. Other income (expense) during the three months ended June 30, 2014 consisted primarily of interest and investment income of $0.1 million, partially offset by minimal foreign exchange losses. Other income (expense) during the three months ended June 30, 2013 consisted primarily of proceeds of $0.2 million from a negotiated settlement, partially offset by foreign currency exchange losses of $0.1 million.

Provision for Income Taxes

	Three Months Ended June 30,		Change	
	2014	2013	$	%
	(in thousands, except percentages)			
Provision for income taxes	$174	$92	$82	89 %
Percentage of revenues	1 %	0 %		

Provision for income taxes increased $0.1 million for the three months ended June 30, 2014 compared to the three months ended June 30, 2013. The provision for income taxes is primarily for taxes on income in foreign jurisdictions and state income taxes in the United States. The increase is due to higher taxable income in foreign and state jurisdictions, primarily resulting from higher non-deductible stock-based compensation in the three months ended June 30, 2014.

Table of Contents

Comparison of Six months ended June 30, 2014 and 2013

Revenues

	Six Months Ended June 30,		Change	
	2014	2013	$	%
	(in thousands, except percentages)			
Revenues	$62,658	$51,174	$11,484	22 %

Revenues increased $11.5 million for the six months ended June 30, 2014 compared to the six months ended June 30, 2013, primarily due to new customer subscriptions entered into after June 30, 2013 and from an increase in the purchase of subscriptions from existing customers. Of the total increase of $11.5 million, $8.1 million was from customers in the United States and the remaining $3.4 million was from customers in foreign countries. The growth in revenues reflects increased demand for our solutions.

Cost of Revenues

	Six Months Ended June 30,		Change	
	2014	2013	$	%
	(in thousands, except percentages)			
Cost of revenues	$14,021	$11,719	$2,302	20 %
Percentage of revenues	22 %	23 %		
Gross profit percentage	78 %	77 %		

Cost of revenues increased $2.3 million for the six months ended June 30, 2014 compared to the six months ended June 30, 2013, primarily due to a $1.1 million increase in depreciation expenses related to additional computer hardware and software for our new and existing data centers; increased personnel expenses of $0.5 million, principally driven by the addition of employees in our operations staff and higher stock-based compensation; increased third-party software maintenance expense of $0.4 million; and increased consulting expenses of $0.3 million.

Research and Development Expenses

	Six Months Ended June 30,		Change	
	2014	2013	$	%
	(in thousands, except percentages)			
Research and development	$12,815	$10,588	$2,227	21 %
Percentage of revenues	20 %	21 %		

Research and development expenses increased $2.2 million in the six months ended June 30, 2014 compared to the six months ended June 30, 2013, primarily due to an increase in personnel expenses of $1.6 million, including higher stock-based compensation, principally driven by the addition of employees as we continue to invest in enhancing our platform and developing new solutions; higher corporate overhead costs of $0.3 million, principally due to our expansion in India; and $0.2 million in consulting and professional service expenses.

Table of Contents

Sales and Marketing Expenses

	Six Months Ended June 30,		Change	
	2014	2013	$	%
	(in thousands, except percentages)			
Sales and marketing	$24,337	$20,328	$4,009	20 %
Percentage of revenues	39 %	40 %		

Sales and marketing expenses increased $4.0 million for the six months ended June 30, 2014 compared to the six months ended June 30, 2013, primarily due to an increase in personnel expenses of $3.3 million, including higher stock-based compensation, principally driven by the addition of employees as we continue to expand our domestic and international sales and marketing efforts, and higher sales commissions. We also incurred increased marketing expenses of $0.6 million, primarily related to increased trade show and marketing program activities.

General and Administrative Expenses

	Six Months Ended June 30,		Change	
	2014	2013	$	%
	(in thousands, except percentages)			
General and administrative	$9,956	$7,949	$2,007	25 %
Percentage of revenues	16 %	15 %		

General and administrative expenses increased $2.0 million for the six months ended June 30, 2014 compared to the six months ended June 30, 2013, primarily driven by increased personnel expenses of $1.2 million, including higher employee stock-based compensation, principally due to the addition of employees to support the growth of our business; increased professional services of $0.4 million; and increased bad debt expense and other fees of $0.2 million relative to the same period a year ago.

Other Income (Expense), Net

	Six Months Ended June 30,		Change	
	2014	2013	$	%
	(in thousands, except percentages)			
Other income (expense), net	$93	$(158)	$251	159 %
Percentage of revenues	0 %	0 %		

Other income (expense), net increased $0.3 million for the six months ended June 30, 2014 compared to the six months ended June 30, 2013. The increase is primarily due to lower foreign currency exchange losses of $0.3 million and higher interest and investment income, partially offsetting the decrease resulting from the proceeds of $0.2 million received from a negotiated settlement in 2013.

Table of Contents

Provision for Income Taxes

	Six Months Ended June 30,		Change	
	2014	2013	$	%
	(in thousands, except percentages)			
Provision for income taxes	$356	$162	$194	120 %
Percentage of revenues	1 %	0 %		

Provision for income taxes increased $0.2 million for the six months ended June 30, 2014 compared to the six months ended June 30, 2013. The provision for income taxes is primarily for taxes on income in foreign jurisdictions and state income taxes in the United States. The increase is due to higher taxable income in foreign and state jurisdictions, primarily resulting from higher non-deductible stock-based compensation in the six months ended June 30, 2014.

Liquidity and Capital Resources

At June 30, 2014, our principal source of liquidity was cash, cash equivalents, and short-term and long-term investments of $143.8 million, including $1.9 million held outside of the United States by our foreign subsidiaries. We do not anticipate that we will need funds generated from foreign operations to fund our domestic operations. However, if we repatriate these funds, we could be subject to U.S. income taxes on such amounts, less previously paid foreign income taxes.

We have experienced positive cash flows from operations during the six months ended June 30, 2014 and 2013. We believe our existing cash, cash equivalents, short-term and long-term investments, and cash from operations will be sufficient to fund our operations for at least the next twelve months. Our future capital requirements will depend on many factors, including our rate of revenue growth, the expansion of our sales and marketing activities, the timing and extent of our spending on research and development efforts, international expansion and investment in data centers. We may also seek to invest in or acquire complementary businesses or technologies.

Cash Flows

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

	Six Months Ended June 30,	
	2014	2013
	(in thousands)	
Cash provided by operating activities	$15,175	$12,870
Cash (used in) provided by investing activities	(18,442)	19,452
Cash provided by financing activities	2,600	1,508
Effect of exchange rate changes on cash and cash equivalents	(30)	(96)
Net (decrease) increase in cash and cash equivalents	$(697)	$33,734

Table of Contents

Cash Flows from Operating Activities

In the six months ended June 30, 2014, cash flows from operating activities of $15.2 million resulted from our net income of approximately $1.3 million, as adjusted by an increase in deferred revenues of $4.2 million, attributable to our continued growth. These working capital increases were further increased by non-cash items including depreciation and amortization expense of $5.8 million and stock-based compensation expense of $4.6 million. These increases are partially offset by an increase in prepaid expenses and other assets of $0.8 million due to prepayment of certain maintenance contracts.

In the six months ended June 30, 2013, cash flows from operating activities of $12.9 million resulted from our net income of approximately $0.3 million, as adjusted by an increase in deferred revenues of $2.5 million, attributable to our continued growth; a decrease in accounts receivable of $1.5 million due to lower bookings in the three months ended June 30, 2013 compared to the three months ended December 31, 2012; and an increase in accrued liabilities of $1.2 million. These working capital increases are further increased by non-cash items including depreciation and amortization expense of $4.5 million and stock-based compensation expense of $2.2 million.

Cash Flows from Investing Activities

In the six months ended June 30, 2014, cash used in investing activities of $18.4 million was primarily attributable to the use of $6.5 million of cash for capital expenditures, including computer hardware and software for our data centers to support our growth and development, and to purchase physical scanner appliances and computer hardware provided to certain customers as part of their subscriptions; purchases of investments of $76.9 million, partially offset by the sales and maturities of investments of $65.0 million.

In the six months ended June 30, 2013, investing activities provided $19.5 million. This increase is primarily attributable to the sales and maturities of investments of $100.6 million, partially offset by the purchase of investments of $75.0 million, and the use of $6.2 million of cash for capital expenditures, including computer hardware and software for our data centers to support our growth and development, and to purchase physical scanner appliances and computer hardware provided to certain customers as part of their subscriptions.

Cash Flows from Financing Activities

In the six months ended June 30, 2014, cash provided by financing activities of $2.6 million was primarily attributable to $3.1 million of proceeds from the exercise of stock options, partially offset by repayments on our capital lease obligations of $0.5 million.

In the six months ended June 30, 2013, cash provided by financing activities of $1.5 million was primarily attributable to $2.2 million of proceeds from the exercise of stock options, partially offset by repayments on our capital lease obligations of $0.7 million.

Table of Contents

Contractual Obligations

Our principal commitments consist of obligations under our outstanding leases for office space and third-party data centers, and capital lease and third-party software maintenance obligations. The following table summarizes our contractual cash obligations, including future interest payments, at June 30, 2014 and the effect such obligations are expected to have on our liquidity and cash flows in future periods:

Contractual Obligations	Payment Due by Period Total	Remainder of 2014	2015-2016	2017-2018
	(in thousands)			
Operating lease obligations (1)	$8,715	$2,111	$4,787	$1,817
Capital lease obligations (2)	271	271	—	—
Total	$8,986	$2,382	$4,787	$1,817

(1) Operating lease obligations represent our obligations to make payments under the lease agreements for our facilities, data centers, and office equipment leases. During the six months ended June 30, 2014, we made regular payments on our operating lease obligations of $2.2 million.

(2) Capital lease obligations represent financing on computer software purchases. During the six months ended June 30, 2014, we made regular payments on our capital lease obligations of $0.5 million.

Off-Balance Sheet Arrangements

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

Recent Accounting Pronouncements

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

Critical Accounting Policies and Estimates

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

We believe that of our significant accounting policies, which are described in the notes to our consolidated financial statements in our Annual Report on Form 10-K for the fiscal year ended December 31, 2013, filed with the SEC on February 28, 2014, the accounting policies related to revenue recognition, income taxes and stock-based compensation involve the greatest degree of judgment and complexity and have the greatest potential impact on our consolidated financial statements. A critical accounting policy is one that is material to the presentation of our consolidated financial statements and requires us to make difficult, subjective or complex judgments for uncertain matters that could have a material effect on our financial condition and results of operations. Accordingly, these are the policies we believe are the most critical to aid in fully understanding and evaluating our financial condition and results of operations. There have been no material changes to our critical accounting policies and estimates as compared to the critical accounting policies and estimates as described in our Annual Report on Form 10-K for the fiscal year ended December 31, 2013.

35

Table of Contents

Item 3. Quantitative and Qualitative Disclosures about Market Risk

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

Foreign Currency Risk

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

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

Interest Rate Sensitivity

We have $143.8 million in cash, cash equivalents and short-term and long-term investments at June 30, 2014. Cash and cash equivalents include cash held in banks and highly liquid money market funds, corporate bonds and commercial paper. Investments consist of fixed-income U.S. government agency securities, corporate bonds, asset-backed securities, municipal bonds and commercial paper. All of these investments, excluding long-term investments, have maturities of less than one year from date of purchase. Long-term investments have maturities that extend more than one year from date of purchase.

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

Table of Contents

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and our Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of June 30, 2014. The term "disclosure controls and procedures," as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company's management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on the evaluation of our disclosure controls and procedures as of June 30, 2014, our Chief Executive Officer and Chief Financial Officer concluded that, as of such date, our disclosure controls and procedures were effective at the reasonable assurance level.

Changes in Internal Control over Financial Reporting

There was no change in our internal control over financial reporting identified in connection with the evaluation required by Rule 13a-15(d) and 15d-15(d) of the Exchange Act that occurred during the period covered by this report that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

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

Item 1A. Risk Factors

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