

QUALYS, INC.
Form 10-Q
November 05, 2018
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended September 30, 2018

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

For the transition period from _____ to _____

Commission file number 001-35662

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

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

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

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

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). 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. (Check one):

Large accelerated filer Accelerated filer

Non-accelerated filer Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the

extended transition period for complying with any
new or revised financial accounting standards
provided pursuant to Section 13(a) of the Exchange
Act.

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

The number of shares of the Registrant's common stock outstanding as of October 30, 2018 was 39,379,168.

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Qualys, Inc.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

Qualys, Inc.

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

(In thousands, except share and per share data)

	September 30, 2018	December 31, 2017
Assets		
Current assets:		
Cash and cash equivalents	\$ 97,964	\$86,591
Short-term marketable securities	228,542	201,823
Accounts receivable, net of allowance of \$764 and \$816 as of September 30, 2018 and December 31, 2017, respectively	58,612	64,412
Prepaid expenses and other current assets	16,623	16,524
Total current assets	401,741	369,350
Long-term marketable securities	64,103	67,224
Property and equipment, net	64,503	58,557
Deferred tax assets, net	28,248	25,066
Intangible assets, net	13,741	12,401
Long-term investment	2,500	—
Goodwill	1,849	1,549
Restricted cash	1,200	1,200
Other noncurrent assets	8,115	2,178
Total assets	\$ 586,000	\$537,525
Liabilities and Stockholders' Equity		
Current liabilities :		
Accounts payable	\$ 4,723	\$1,144
Accrued liabilities	23,208	21,444
Deferred revenues, current	155,115	143,186
Total current liabilities	183,046	165,774
Deferred revenues, noncurrent	17,558	17,136
Other noncurrent liabilities	11,256	11,071
Total liabilities	211,860	193,981
Commitments and contingencies (Note 7)		
Stockholders' equity:		
Preferred stock, \$0.001 par value; 20,000,000 shares authorized, no shares issued and outstanding at September 30, 2018 and December 31, 2017	—	—
Common stock, \$0.001 par value; 1,000,000,000 shares authorized; 39,341,476 and 38,598,117 shares issued and outstanding at September 30, 2018 and December 31, 2017	39	39
Additional paid-in capital	329,045	304,155
Accumulated other comprehensive loss	(752) (574)
Retained earnings	45,808	39,924
Total stockholders' equity	374,140	343,544
Total liabilities and stockholders' equity	\$ 586,000	\$537,525

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

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Qualys, Inc.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

(In thousands, except per share data)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2018	2017	2018	2017
Revenues	\$71,658	\$59,490	\$204,689	\$167,913
Cost of revenues	16,511	12,728	48,660	37,175
Gross profit	55,147	46,762	156,029	130,738
Operating expenses:				
Research and development	12,501	10,892	38,182	31,240
Sales and marketing	15,489	15,475	50,698	46,872
General and administrative	9,040	9,546	29,731	25,112
Total operating expenses	37,030	35,913	118,611	103,224
Income from operations	18,117	10,849	37,418	27,514
Other income (expense), net:				
Interest expense	(35)	—	(112)	(3)
Interest income	1,651	753	4,193	1,775
Other expense, net	(500)	(82)	(836)	(288)
Total other income, net	1,116	671	3,245	1,484
Income before income taxes	19,233	11,520	40,663	28,998
(Benefit from) provision for income taxes	(4,236)	3,068	(2,241)	(8,586)
Net income	\$23,469	\$8,452	\$42,904	\$37,584
Net income per share:				
Basic	\$0.60	\$0.22	\$1.10	\$1.01
Diluted	\$0.56	\$0.21	\$1.02	\$0.95
Weighted average shares used in computing net income per share:				
Basic	39,170	37,703	38,907	37,162
Diluted	42,197	40,299	42,113	39,601

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

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Qualys, Inc.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

(In thousands)

	Three Months Ended September 30, 2018		Nine Months Ended September 30, 2018	
Net income	\$23,469	\$8,452	\$42,904	\$37,584
Available-for-sale marketable securities:				
Change in net unrealized (loss) gain, net of tax	(85) 103	(427) 32
Reclassification adjustment for net realized gain included in net income, net of tax	154	12	249	4
Other comprehensive income (loss), net of tax	69	115	(178) 36
Comprehensive income	\$23,538	\$8,567	\$42,726	\$37,620

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

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CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(In thousands)

	Nine Months Ended September 30,	
	2018	2017
Cash flows from operating activities:		
Net income	\$42,904	\$37,584
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization expense	21,224	15,054
Bad debt expense	—	353
Loss on disposal of property and equipment	31	3
Stock-based compensation	22,672	18,522
Amortization of premiums and accretion of discounts on marketable securities	(586)	1,155
Deferred income taxes	(4,024)	(17,631)
Excess tax benefits included in deferred tax assets	—	7,880
Changes in operating assets and liabilities:		
Accounts receivable	5,800	317
Prepaid expenses and other assets	(5,733)	(405)
Accounts payable	182	(706)
Accrued liabilities	5,803	747
Deferred revenues	12,351	17,716
Other non-current liabilities	(1,804)	1,190
Net cash provided by operating activities	98,820	81,779
Cash flows from investing activities:		
Purchases of marketable securities	(242,056)	(198,866)
Sales and maturities of marketable securities	218,865	148,025
Purchases of property and equipment	(19,496)	(26,612)
Business acquisition	(3,359)	(5,753)
Purchase of privately-held investment	(2,500)	—
Net cash used in investing activities	(48,546)	(83,206)
Cash flows from financing activities:		
Proceeds from exercise of stock options	20,896	22,778
Payments for taxes related to net share settlement of equity awards	(12,010)	(17,571)
Principal payments under capital lease obligations	(1,203)	—
Repurchase of common stock	(46,542)	—
Net cash (used in) provided by financing activities	(38,859)	5,207
Effect of exchange rate changes on cash and cash equivalents	(42)	—
Net increase in cash, cash equivalents and restricted cash	11,373	3,780
Cash, cash equivalents and restricted cash at beginning of period	87,791	87,937
Cash, cash equivalents and restricted cash at end of period	\$99,164	\$91,717
Supplemental disclosures of cash flow information:		
Cash paid for interest expense	\$115	\$—
Cash paid for income taxes, net of refunds	\$2,018	\$1,083
Non-cash investing and financing activities		

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Purchases of property and equipment recorded in accounts payable and accrued liabilities	\$6,008	\$1,371
Purchase of assets under capital lease	\$2,300	\$—
Not yet received tenant allowance recorded in other assets, accrued liabilities and other non-current liabilities	\$—	\$8,076

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

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Qualys, Inc.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

NOTE 1. The Company and Summary of Significant Accounting Policies

Description of Business

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

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements and condensed footnotes have been prepared by the Company in accordance with accounting principles generally accepted in the United States ("U.S. GAAP") for interim financial information as well as the instructions to Form 10-Q and the rules and regulations of the U.S. Securities and Exchange Commission ("SEC"). Certain information and note disclosures normally included in the financial statements prepared in accordance with U.S. GAAP have been condensed or omitted pursuant to such rules and regulations. The condensed consolidated balance sheet as of December 31, 2017, included herein, was derived from the audited financial statements as of that date but does not include all disclosures, including notes required by U.S. GAAP. In the opinion of management, the accompanying unaudited condensed consolidated financial statements reflect all adjustments, which include only normal recurring adjustments, necessary for the fair presentation of the financial position, results of operations and cash flows for the interim periods. The results of operations for the three and nine month periods ended September 30, 2018 are not necessarily indicative of the results of operations expected for the entire year ending December 31, 2018 or for any other future annual or interim periods. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2017, filed with the SEC on February 23, 2018.

Use of Estimates

The preparation of the unaudited 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 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, capitalization of new internally developed software, stock-based compensation and the provision for income taxes. Actual results could differ from those estimates and such differences may be material to the accompanying unaudited condensed consolidated financial statements.

Internally Developed Software Costs

The Company capitalizes costs incurred to develop new internal-use software. Capitalized costs include salaries, benefits, and stock-based compensation charges for employees that are directly involved in developing its cloud security platform during the application development stage. These capitalized costs are included in other noncurrent assets on the accompanying condensed consolidated balance sheets. Such costs are amortized on a straight-line basis over its estimated useful life of three years. Amortization of product related to new internal-use software is recorded to cost of revenues. Capitalization of new internally developed software cost was \$0.8 million for the nine months ended September 30, 2018. Unamortized cost for capitalized new internally developed software was \$0.7 million at September 30, 2018. Amortization expense for capitalized new internally developed software was less

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

than \$0.1 million for the three and nine months ended September 30, 2018. Management evaluates the useful lives of these assets on an annual basis and tests for impairment whenever events or changes in circumstances occur that could impact the recoverability of these assets.

Cost Method Investments

In the second quarter of fiscal 2018, the Company invested \$2.5 million in a privately-held company. The Company used the cost method of accounting to account for the investment because it does not hold a controlling interest in this entity and the Company does not have the ability to exercise significant influence over the entity's operating and financial policies. The investment is included in long term assets on the accompanying condensed consolidated balance sheets. The Company's cost method investment is assessed for impairment when events or changes in circumstances indicate that the carrying amount may not be recoverable. The Company has not recorded any dividends or other-than-temporary impairment charges related to its cost method investment. The fair value of the investment is not readily available, and there are no quoted market prices for the investment.

Recently Adopted Accounting Pronouncements

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