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

FORM 10-K

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

For the Annual Period Ended December 31, 2016

or

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

For the transition period from to

Commission file number 001-35662

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

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

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)

Securities registered pursuant to section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common stock, $0.001 par value per share	NASDAQ Stock Market

Securities registered pursuant to section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes x No o

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes o No x

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 o

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 o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K(§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

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

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

As of June 30, 2016, the aggregate market value of voting shares of common stock held by non-affiliates of the registrant was $874 million based on the last reported sale price of the registrant's common stock on June 30, 2016. Shares of common stock held by each executive officer and director and by each person who owns 10% or more of the outstanding common stock have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

The number of shares of the Registrant's common stock outstanding as of January 31, 2017 was 36,359,340 shares.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's Proxy Statement for its 2017 Annual Meeting of Stockholders are incorporated by reference in Part III of this Annual Report on Form 10-K where indicated. Such proxy statement will be filed with the Securities and Exchange Commission within 120 days of the registrant's fiscal year ended December 31, 2016.

Qualys, Inc.
TABLE OF CONTENTS

PART I

Forward-Looking Statements

In addition to historical information, this Annual Report on Form 10-K contains "forward-looking" statements within the meaning of the federal securities laws, which statements involve substantial risks and uncertainties. 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," "predicts," "projects," "seek," "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 Annual Report on 10-K include, but are not limited to, statements about:

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

We have based the forward-looking statements contained in this Annual Report on Form 10-K 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 I, Item 1A (Risk Factors) of this Annual Report. 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.

You should not rely on forward-looking statements as predictions of future events. Except as required by law, neither we nor any other person assumes responsibility for the accuracy and completeness of the forward-looking statements, and we undertake no obligation to update any forward-looking statements to reflect events or circumstances after the date of such statements.

Qualys, the Qualys logo and QualysGuard, and other trademarks and service marks of Qualys appearing in this Annual Report on Form 10-K are the property of Qualys. This Annual Report on Form 10-K also contains trademarks and trade names of other businesses that are the property of their respective holders. We have omitted the ® and ™ designations, as applicable, for the trademarks used in this Annual Report on Form 10-K.

Item 1. Business

Overview

We are 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. Our cloud solutions address the growing security and compliance complexities and risks that are amplified by the dissolving boundaries between internal and external IT infrastructures and web environments, the rapid adoption of cloud computing and the proliferation of geographically dispersed IT assets. Our integrated suite of security and compliance solutions delivered on our Qualys Cloud Platform enables our customers to identify their IT assets, collect and analyze large amounts of IT security data, discover and prioritize vulnerabilities, recommend remediation actions and verify the implementation of such actions. Organizations use our integrated suite of solutions delivered on our Qualys Cloud Platform to cost-effectively obtain a unified view of their security and compliance posture across globally-distributed IT infrastructures.

IT infrastructures are more complex and globally-distributed today than ever before, as organizations of all sizes increasingly rely upon a myriad of interconnected information systems and related IT assets, such as servers, databases, web applications, routers, switches, desktops, laptops, other physical and virtual infrastructure, and numerous external networks and cloud services. In this environment, new and evolving technologies intended to improve organizations' operations can also increase vulnerability to cyber attacks, which can expose sensitive data, damage IT and physical infrastructures, and result in serious financial or reputational consequences. In addition, the rapidly increasing amount of data and devices in IT environments makes it more difficult to identify and remediate vulnerabilities in a timely manner. The predominant approach to IT security has been to implement multiple disparate security products that can be costly and difficult to deploy, integrate and manage and may not adequately protect organizations. As a result, we believe there is a large and growing opportunity for comprehensive cloud-based security and compliance solutions.

We designed our Qualys Cloud Platform to transform the way organizations secure and protect their IT infrastructures and applications. Our cloud platform offers an integrated suite of solutions that automates the lifecycle of asset discovery, security assessments, and compliance management for an organization's IT infrastructure and assets, whether they reside inside the organization, on their network perimeter, on endpoints or in the cloud. Since inception, our solutions have been designed to be delivered through the cloud and to be easily and rapidly deployed on a global scale across a broad range of industries, enabling faster implementation and lower total cost of ownership than traditional on-premise enterprise software products. Our customers, ranging from some of the largest global organizations to small businesses, are served from our globally-distributed cloud platform, enabling us to rapidly deliver new solutions, enhancements and security updates.

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, Qualys Vulnerability Management (VM), in 2000. Our VM Solutions have provided a substantial majority of our revenues to date, representing 76%, 77% and 80% of total revenues in 2016, 2015 and 2014, respectively. In 2016, our VM Solutions included revenues from VM, Private Cloud Platform, Continuous Monitoring, Cloud Agent for VM, AssetView, and ThreatPROTECT. In 2015, our VM Solutions included revenues from VM, Private Cloud Platform, Continuous Monitoring and Cloud Agent for VM. In 2014, our VM Solutions included revenues from VM, Private Cloud Platform and Continuous Monitoring. In prior 10-Q and 10-K filings, we had included all revenues from scanners and credits for prepaid services in our VM Solutions revenues. In the fourth quarter of 2016, we changed the methodology to allocate revenues from scanners and credits across our products. Based on the prior methodology, our VM Solutions would have made up 78% of total revenues in 2016, down 1% from 79% in 2015.

As VM 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 (PC) solution. In 2009, we broadened the scope of our cloud services by adding Web Application Scanning. 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 Continuous Monitoring 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 more susceptible to a cyber-attack. In 2014, we also launched Web Application Firewall (WAF). Qualys WAF, currently is in limited release, it delivers enterprise-grade web application security without the costs, footprint, and complexity associated with appliance-based web application firewall solutions. In 2015, we introduced our Cloud Agent Platform (CAP), which provides customers with the ability to secure IT assets on a continuous basis regardless of where they reside, inside the enterprise, in the cloud or mobile endpoints. CAP allows organizations to perform vulnerability and compliance management on a continuous basis. It is a natural extension to our cloud platform and allows us to expand our footprint in the enterprise and provide VM and PC solutions to mobile endpoints and elastic cloud environments. In 2015, we also launched AssetView and Security Assessment Questionnaire. AssetView is a free, cloud-based asset inventory service that provides visibility and actionable data on global IT assets within an organization. We don't charge for AssetView but do charge for AssetView synchronization with ServiceNow CMDB (Configuration Management Database). This integrates our robust asset discovery and classification capabilities with ServiceNow's platform. Security Assessment Questionnaire enables organizations to better orchestrate security assessments or compliance audits with automated validation. In 2016, we introduced ThreatPROTECT, which prioritizes identified vulnerabilities for customers using our VM solution.

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. Revenues from customers existing at or prior to December 31, 2015 grew by $20.4 million to $184.7 million during 2016, representing 112% of total revenues in 2015. We expect revenue growth from existing customers to continue. Subscriptions from new customers added in 2016 contributed $13.2 million to the increase in revenues.

Our Qualys Cloud Platform is currently used by over 9,300 customers, excluding security consulting firms, in more than 100 countries, including a majority of each of the Forbes Global 100 and Fortune 100. Our revenues increased from $133.6 million in 2014 to $164.3 million in 2015, and reached $197.9 million in 2016. We generated net income of $30.2 million in 2014, $15.9 million in 2015, and $19.2 million in 2016. Net income in 2014 includes a tax benefit of $23.7 million due to reversal of deferred tax valuation allowance. Total assets as of December 31, 2016 and 2015 were $407.0 million and $323.5 million, respectively.

Our Growth Strategy

We intend to leverage our innovation and extensive expertise to strengthen our leadership position as a trusted provider of cloud-based security and compliance solutions. The key elements of our growth strategy are:

- ***Continue to innovate and enhance our cloud platform and suite of solutions.*** We intend to continue to make significant investments in research and development to extend our cloud platform's functionality by developing new security solutions and capabilities and further enhancing our existing suite of solutions. In 2015, we introduced our Cloud Agent Platform, which provides customers with the ability to secure IT assets on a continuous basis regardless of where they reside, inside the enterprise, in the cloud or mobile endpoints. Our CAP also enables us to deliver additional new solutions as we develop them. In 2015, we also launched AssetView and Security Assessment Questionnaire. AssetView is a free, cloud-based asset inventory service that provides visibility and actionable data on global IT assets within an organization. We don't charge for AssetView but do charge for AssetView synchronization with ServiceNow CMDB (Configuration Management Database). This integrates our robust asset discovery and classification capabilities with ServiceNow's platform. Security Assessment Questionnaire enables organizations to better orchestrate security assessments or compliance audits with automated validation. In 2016, we introduced ThreatPROTECT, which prioritizes identified vulnerabilities for customers using our VM solution.
- ***Expand the use of our suite of solutions by our large and diverse customer base.*** With more than 9,300 customers across many industries and geographies, we believe we have a significant opportunity to sell additional solutions to our customers and expand their use of our suite of solutions. Since typically our customers initially deploy one or two of our solutions and in select parts of their IT infrastructures, our existing customers serve as a strong source of new sales as they expand their scope and increase their subscriptions, or choose to adopt other solutions from our integrated suite of IT security and compliance offerings. In this regard, we continue to expand our sales execution and marketing functions to increase adoption of our newly developed solutions among our existing customers.

- ***Drive new customer growth.*** We are pursuing new customers by targeting key accounts and expanding our sales and marketing organization and network of channel partners. We will continue to seek to make significant investments to encourage organizations to replace their existing security products with our cloud solutions.
- ***Broaden our global reach.*** We intend to expand our relationships with key security consulting organizations, managed security service providers and value added resellers to accelerate the adoption of our cloud platform. We seek to strengthen existing relationships as well as establish new relationships to increase the distribution and market awareness of our cloud platform and target new geographic regions. We also plan to partner with such security providers that can host our Private Cloud offering within their data centers, helping us expand our reach in new markets and new geographies.
- ***Selectively pursue technology acquisitions to bolster our capabilities and leadership position.*** We may explore acquisitions that are complementary to and can expand the functionality of our cloud platform. We may also seek to acquire technology teams to supplement our own team and increase the breadth of our cloud-based security and compliance solutions.

Our Platform

Our Qualys Cloud Platform consists of a suite of IT security and compliance solutions that leverage our shared and extensible core services and our highly scalable multi-tenant cloud infrastructure.

Our suite of solutions provides security intelligence by automating the life cycle of IT asset discovery, security assessment and compliance management. Our core services layer provides a set of advanced shared technologies that are leveraged by our suite of security and compliance solutions, which we refer to as our Core Services.

Built on our cloud platform infrastructure, our Core Services provide an integrated framework with proprietary functionalities that act as building blocks to enable efficient and scalable delivery of our customer-facing cloud solutions. Our cloud platform's infrastructure includes integrated services that deliver a highly automated and scalable scanning infrastructure capable of scanning IT systems and web applications, inside and outside corporate firewalls.

The Core Services and infrastructure layers of our cloud platform deliver benefits to our entire suite of security and compliance solutions, including:

- Dynamic and interactive user interfaces with configurable report templates to present scan data with a wide range of presentation options to match a customer's needs;
- Fast searching of several extensive Qualys data sets, including scan results, asset data, scan profiles, users and vulnerabilities;
- Asset management technology for hierarchical asset categorization via dynamic tagging and role-based customer access management; and
- Distributed scanning platform for global cloud-based environments.

We also provide open application program interfaces, or APIs, and other developer tools that allow third parties to embed our technology into their solutions and build applications on our cloud platform.

Our cloud platform is delivered to customers via our shared platform offering from our global data centers or via our private platform offering (Qualys Private Cloud Platform, or PCP), for customers or partners that want the platform to reside within the customer's on-premise data center. The PCP is a standalone version of our multi-layer, multi-tenant services architecture and is a fully integrated turnkey solution, making it more scalable, cost effective and faster to deploy within a customer's on-premise data center. Solutions delivered through our PCP are typically on the same subscription basis as solutions delivered through our shared platform. Our PCP utilizes hardware and software owned by us and physically located on the customer's premises. The customer is not permitted to take possession of the software or access the software code. Our PCP provides our subscription-based platform services to the customer using a virtual version of our software. This virtualized PCP allows us to extend our security and compliance solutions without the complexity and cost associated with deploying traditional enterprise software. Additionally, we introduced in 2016, the Private Cloud Platform Appliance (PCPA), an on-premise security and compliance solution packaged in a form-factor for medium-sized companies.

Qualys Cloud Suite

Our suite of solutions, which we refer to as the Qualys Cloud Suite, currently includes ten solutions: Vulnerability Management, Continuous Monitoring, Cloud Agent, AssetView, ThreatPROTECT, Policy Compliance, PCI Compliance, Security Assessment Questionnaire, Web Application Scanning and Web Application Firewall. This integrated set of cloud solutions enables our customers to:

- Discover and catalogue information assets inside their organization, on the perimeter, on endpoints, or in the cloud;
- Manage assets on an ongoing basis to establish a trusted repository for IT system configurations and to maintain hierarchical relationships between them;
- Design policies to establish a secure and compliant IT infrastructure and automate ongoing security and compliance assessments of IT systems and applications in accordance with best practices;
- Proactively identify and help fix vulnerabilities to mitigate security risks and achieve compliance;
- Monitor and measure security and compliance through a unified user interface;
- Distribute security and compliance reports tailored to differing customer needs, including management personnel, auditors and security professionals; and
- Protect web applications from cyber-attacks in real time.

Our customers can subscribe to one or more of our security and compliance solutions based on their initial needs and expand their subscriptions over time to new areas within their organization or to additional Qualys solutions. We offer three editions of our Qualys Cloud Suite, the Enterprise edition for large enterprises, the Express edition for medium-sized businesses, and Express Lite for small-sized businesses. Qualys Cloud Suite solutions are described below.

Qualys Vulnerability Management

Qualys Vulnerability Management, or Qualys VM, is an industry leading and award-winning solution that automates network auditing and vulnerability management across an organization, including network discovery and mapping, asset management, vulnerability reporting, and remediation tracking. Driven by our comprehensive KnowledgeBase of known vulnerabilities, Qualys VM enables cost-effective protection against vulnerabilities without substantial resource deployment.

Qualys Continuous Monitoring

Qualys Continuous Monitoring gives our customers the ability to proactively identify threats and unexpected changes for their IT systems, which allows customers to continuously monitor their mission-critical assets and to be alerted to security vulnerabilities or misconfigurations that may make them more susceptible to a cyber-attacks.

Qualys Cloud Agents

Qualys Cloud Agents for VM and Policy Compliance provide lightweight agents (2 MBytes) that can be installed on any host such as a laptop, desktop, server or virtual machine. Qualys Cloud Agents extract and consolidate vulnerability and compliance data and update it continuously within the Qualys Cloud Platform for further analysis and correlation, thus providing a continuous view of the IT security compliance posture of their global network.

Qualys AssetView

Qualys AssetView is a free global asset inventory service enabling our customers to search for information on any IT asset, scaling to millions of assets for organizations of all sizes, helping IT and security personnel to search IT assets and maintain an up-to-date inventory on a continuous basis.

Qualys ThreatPROTECT

Qualys ThreatPROTECT correlates data from vulnerability scans and active threat data from multiple sources into a single dynamic dashboard to provide our customers a holistic and contextual view of their threat exposure.

Qualys Policy Compliance

Qualys Policy Compliance, or Qualys PC, allows our customers to analyze and collect configuration and access control information from their networked devices and web applications and automatically maps this information to internal policies and external regulations in order to document compliance. Qualys PC is fully automated and helps reduce customers' cost of compliance without requiring the use of software agents. It can be either performed via our network scanners (hardware or virtual) or via our Cloud Agents.

Qualys Policy Compliance Questionnaire, an additional Qualys PC offering, enables our customers to assess business processes and vendor risk against standards and mandates such as PCI-DSS, HIPAA, COBIT and ISO 27001/2.

Qualys PCI Compliance

Qualys PCI Compliance, or Qualys PCI, provides our customers that store cardholder data a cost-effective and highly automated solution to verify and document compliance with PCI DSS. Qualys PCI allows merchants to complete the annual PCI Self-Assessment Questionnaire, or SAQ**,** to perform vulnerability scanning for quarterly PCI audits and to meet the demands of PCI for web application security.

Qualys Security Assessment Questionnaire

Qualys Security Assessment Questionnaire enables our customers to better orchestrate security assessments or compliance audits with automated validation. Qualys SAQ enables our customers to better consolidate and orchestrate their assessment of third-party business processes and vendor risk by centrally capturing all relevant information from technical and human sources, drastically reducing time and cost. The service also allows our customers to demonstrate compliance against internal policies, standards and mandates such as PCI-DSS, HIPAA, COBIT and ISO 27001/2.

Qualys Web Application Scanning

Qualys Web Application Scanning, or Qualys WAS, uses the scalability of our cloud platform to allow customers to discover, catalog and scan a large number of web applications. Qualys WAS scans and analyzes custom web applications and identifies vulnerabilities that threaten underlying databases or bypass access controls. These web applications are often the main attack vectors for cyber-attackers.

Qualys Web Application Firewall

Qualys Web Application Firewall, or Qualys WAF, currently is in limited release, it delivers enterprise-grade web application security without the costs, footprint, and complexity associated with appliance-based web application firewall solutions. It is designed to protect web applications from attack vectors by enhancing default web application configurations and virtual patching. Qualys WAF can improve website performance by reducing page load times and optimizing bandwidth.

Qualys Core Services

Our Core Services enable integrated workflows, management and real-time analysis and reporting across all of our IT security and compliance solutions. Our Core Services include:

- *Asset Tagging and Management.* Enables customers to easily identify, categorize and manage large numbers of assets in highly dynamic IT environments and automates the process of inventory management and hierarchical organization of IT assets. Built on top of this core service is the Qualys AssetView service, which is a global asset inventory service enabling our customers to search for information on any IT asset, scaling to millions of assets for customers of all sizes, helping IT and security personnel to search IT assets and maintain an up-to-date inventory on a continuous basis.
- *Reporting and Dashboards.* A highly configurable reporting engine that provides customers with reports and dashboards based on their roles and access privileges.
- *Questionnaires and Collaboration.* A configurable workflow engine that enables customers to easily build questionnaires and capture existing business processes and workflows to evaluate controls and gather evidence to validate and document compliance.
- *Remediation and Workflow.* An integrated workflow engine that allows customers to automatically generate helpdesk tickets for remediation and to manage compliance exceptions based on customer-defined policies, enabling subsequent review, commentary, tracking and escalation. This engine automatically distributes remediation tasks to IT administrators upon scan completion, tracks remediation

progress and closes open tickets once patches are applied and remediation is verified in subsequent scans.

- *Big Data Correlation and Analytics Engine*. Provides capabilities for indexing, searching and correlating large amounts of security and compliance data with other security incidents and third-party security intelligence data. Embedded workflows enable customers to quickly assess risk and access information for remediation, incident analysis and forensic investigations.
- *Alerts and Notifications.* Creates email notifications to alert customers of new vulnerabilities, malware infections, scan completion, open trouble tickets and system updates.

Qualys Cloud Infrastructure

Our infrastructure layer, which we refer to as our Infrastructure, includes the data, data processing capabilities, software and hardware infrastructure and infrastructure management capabilities that provide the foundation for our cloud platform and allow us to automatically scale our Infrastructure and Core Services to scan millions of IPs. Each Infrastructure service is described below:

- *Scalable Capacity*. We have designed a modular and scalable infrastructure that leverages virtualization and cloud technologies. This allows our operations team to dynamically allocate additional capacity on-demand across our entire Qualys Cloud Platform to address the growth and scalability of our solutions.
- *Big Data Indexing and Storage.* Built on top of our secure data storage model, this engine indexes petabytes of data and uses this information in real-time to execute tags or rules to dynamically update IT assets' properties, which are used in various workflows for scanning, reporting and remediation.
- *Qualys KnowledgeBase.* *Qualys* relies on our comprehensive repository, which we refer to as our KnowledgeBase, of known vulnerabilities and compliance controls for a wide range of devices, technologies and applications that powers our security and compliance scanning technology. We update our KnowledgeBase daily with signatures for new vulnerabilities, control checks, validated fixes and improvements.
- *Managed Scanner Appliances.* As part of our cloud platform, we host and operate a large number of globally distributed physical scanner appliances that our customers use to scan their externally facing systems and web applications. To scan internal IT assets, customers can also deploy our scanners, which are available on a subscription basis as physical appliances or downloadable virtual images, within their internal networks. Our scanner appliances self-update daily in a transparent manner using our automated and proprietary scan management technology. These scanner appliances allow us to scale our cloud platform to scan networked devices and web applications across our customers' networks around the world.

Our Customers

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. As of December 31, 2016, we had over 9,300 customers, excluding security consulting firms, in more than 100 countries, including a majority of each of the Forbes Global 100 and Fortune 100. In each of 2016, 2015 and 2014, no one customer accounted for more than 10% of our revenues. In 2016, 2015 and 2014, 71%, 70% and 70% respectively, 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.

Sales and Marketing

Sales

We market and sell our IT security and compliance solutions to customers directly through our sales teams as well as indirectly through our network of channel partners.

Our global sales force is organized into a field sales team, which focuses on enterprises, generally including organizations with more than 5,000 employees, and an inside sales team, which focuses on small to medium businesses, which generally include organizations with less than 5,000 employees. Both our field and inside sales teams are divided into three geographic regions, including the Americas; Europe, Middle East and Africa; and Asia-Pacific. We also further segment each of our sales teams into groups that focus on adding new customers or managing relationships with existing customers.

Our channel partners maintain relationships with their customers throughout the territories in which they operate and provide their customers with services and third-party solutions to help meet those customers' evolving security and compliance requirements. As such, these partners offer our IT security and compliance solutions in conjunction with one or more of their own products or services and act as a conduit through which we can connect with these prospective customers to offer our solutions. Our channel partners include security consulting organizations, managed service providers and resellers, such as Deutsche Telekom AG, Fujitsu, Hewlett Packard Enterprise, Insight Technologies, Inc., Optiv Security, Inc., SecureWorks Corp, and Verizon Communications Inc.

For sales involving a channel partner, the channel partner engages with the prospective customer directly and involves our sales team as needed to assist in developing and closing an order. When a channel partner secures a sale, we sell the associated subscription to the channel partner who in turn resells the subscription to the customer, with the channel partner earning a fee based on the total value of the order. Once the order is completed, we provide these customers with direct access to our solutions and other associated back-office applications, enabling us to establish a direct relationship as part of ensuring customer satisfaction with our solutions. At the end of the subscription term, the channel partner engages with the customer to execute a renewal order, with our sales team providing assistance as required. In 2016, 2015 and 2014, 42%, 39% and 39% respectively, of our revenues were generated by channel partners.

Marketing

Our marketing programs include a variety of online marketing, advertising, conferences, events, public relations activities and web-based seminar campaigns targeted at key decision makers within our prospective customers.

We have a number of marketing initiatives to build awareness and encourage customer adoption of our solutions. We offer free trials and services to allow prospective customers to experience the quality of our solutions, to learn in detail about the features and functionality of our cloud platform, and to quantify the potential benefits of our solutions.

Customer Support

We deliver 24x7x365 day customer technical support from centers located in Redwood City, California; Raleigh, North Carolina; Reading, United Kingdom; and Pune, India. We recruit senior level technical personnel and trained subject matter experts who work closely with engineering and operations personnel to resolve issues quickly. Our security and compliance solutions can be deployed easily and are designed to be implemented and operated without the need for significant professional services. We also offer various training programs as part of our subscriptions to all of our customers. We believe that our customer support helps ensure customer satisfaction and is critical to retaining and expanding our customer base. In addition, we leverage the insights drawn from our customers to further improve the functionality of our security and compliance solutions.

Research and Development and Operations

We devote significant resources to maintain, enhance and add new functionality to our Qualys Cloud Platform and the integrated suite of solutions that we offer. Our development organization consists of agile engineering teams with substantial security expertise in specific areas of our solutions. In addition to our development teams, we have also built a sophisticated research team focused on identifying threats and developing signatures for vulnerabilities and compliance checks so that we can provide our customers with daily updates and enable them to scan their assets for the latest threats. We conduct our research and development in the United States, France, India, and the United Kingdom, which gives us access to some of the best research and engineering talent in the world. Our focus remains to attract engineering talent as we continue to add new solutions and improve existing ones.

Our development team works closely with our customers and partners to gain valuable insights into their environments and gather feedback for threat research, product development and innovations. We typically release updates to our solutions, including enhancements and new features multiple times a year, and we measure the quality of our scan results on a frequent basis in an effort to maintain the highest level of scan accuracy.

The modular architecture of our cloud platform enables our engineering teams to simultaneously work on different features, accelerating the delivery of new functionalities to customers. Our research and development team also works collaboratively with our technical support team to ensure customer satisfaction and with our sales team to accelerate the adoption of our solutions.

Research and development expenses were $35.3 million, $29.5 million and $26.3 million for 2016, 2015 and 2014, respectively.

Manufacturing Agreement

Our physical appliances are provided by SYNNEX Corporation, or SYNNEX, pursuant to a manufacturing services agreement dated March 1, 2011. Under this agreement, SYNNEX manufactures, assembles and tests our physical scanner appliances. This agreement has an initial term of one year, which is automatically renewed for additional one-year terms, unless terminated (i) at anytime upon the mutual written agreement of us and SYNNEX, (ii) by either party upon 90 days or more written notice, (iii) upon written notice, subject to applicable cure periods, if the other party has materially breached its obligations under the agreement or (iv) by either party upon the other party seeking an order for relief under the bankruptcy laws of the United States or similar laws of any other jurisdiction, a composition with or assignment for the benefit of creditors, or dissolution or liquidation.

Data Center Agreements

Our data center operations are provided by large third-party data center vendors and are located in the United States, Switzerland, the Netherlands and India. Our data center agreements have varying terms through 2018.

Competition

The expanding capabilities of our security and compliance solutions have enabled us to address a growing array of opportunities in the cloud IT security and compliance market. We compete with a large and broad array of established and emerging vulnerability management vendors, compliance vendors and data security vendors in a highly fragmented and competitive environment.

We compete with large public companies, such as Barracuda Networks, Hewlett-Packard Company, Imperva, Inc., International Business Machines Corporation, Rapid7, Inc. and Symantec Corporation, as well as privately held security providers including BeyondTrust Software, Inc., McAfee, NetIQ Corporation, Tenable Network Security, Inc., Tripwire, Inc. and Trustwave Holdings, Inc. We also seek to replace IT security and compliance solutions that organizations have developed internally. As we continue to extend our cloud platform's functionality by further developing security and compliance solutions, such as web application scanning and firewalls, we expect to face additional competition in these new markets.

We believe that the principal competitive factors affecting the market for cloud-based security and compliance solutions include product functionality, breadth of offerings, flexibility of delivery models, ease of deployment and use, total cost of ownership, scalability and performance, customer support and extensibility of platform. We believe that our suite of solutions generally competes favorably with respect to these factors. However, many of our primary competitors have greater name recognition, longer operating histories, more established customer relationships, larger marketing budgets and significantly greater resources than we do.

Intellectual Property

We rely on a combination of trade secrets, copyrights, patents and trademarks, as well as contractual protections, to establish and protect our intellectual property rights and protect our proprietary technology. We have six issued patents, several pending U.S. patent applications and an exclusive license to four U.S. patents, which was obtained in connection with our acquisition of Nemean. The inbound license remains in effect until the licensed patents are no longer enforceable, unless the applicable license agreement is first terminated by us or terminated by the licensor for a breach of the agreement or if we undergo certain bankruptcy events. The licenses are currently exclusive and will remain exclusive so long as we make an appropriately-timed written election and pay an annual fixed royalty for ten years thereafter. These exclusive licenses are subject to the licensor's reservation of certain rights in the patents and subject to the U.S. government's reserved rights in the technology. We have a number of registered and unregistered trademarks. We require our employees, consultants and other third parties to enter into confidentiality and proprietary rights agreements and control access to software, documentation and other proprietary information. We view our trade secrets and know-how as a significant component of our intellectual property assets, as we have spent years designing and developing our Qualys Cloud Platform, which we believe differentiates us from our competitors.

We expect that software and other solutions in our industry may be subject to third-party infringement claims as the number of competitors grows and the functionality of products in different industry segments overlaps. Any of these third parties might make a claim of infringement against us at any time.

Employees

As of December 31, 2016, we had 684 full-time employees, including 285 in research and development, 179 in sales and marketing, 136 in operations and customer support and 84 in general and administrative. As of December 31, 2016, we had 344 employees in the United States and 340 employees internationally. None of our U.S. employees are covered by collective bargaining agreements. Employees in certain European countries have collective bargaining arrangements at the national level. We believe our employee relations are good and we have not experienced any work stoppages.

Available Information

Our principal executive offices are located at 1600 Bridge Parkway, Redwood City, California 94065. The telephone number of our principal executive offices is (650) 801-6100, and our main corporate website is *www.qualys.com*. Information contained on, or that can be accessed through, our website, does not constitute part of this Annual Report on Form 10-K and inclusion of our website address in this Annual Report on Form 10-K is an inactive textual reference only.

We make available our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or Section 15(d) of the Securities Exchange Act of 1934, as amended, free of charge on our website, *www.qualys.com* as soon as reasonably practicable after they are electronically filed with or furnished to the Securities and Exchange Commission or SEC. Additionally, copies of materials filed by us with the SEC may be accessed at the SEC's Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549 or at the SEC's website, *www.sec.gov*. For information about the SEC's Public Reference Room, contact 1-800-SEC-0330.

Geographic Information

For a description of our revenue and property and equipment by geographic location, see Note 9 to our consolidated financial statements included elsewhere in this Annual Report on Form 10-K.

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 Annual Report on Form 10-K, including our 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.

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

We derived approximately 76%, 77% and 80% of our revenues from subscriptions to our VM Solutions for the years ended December 31, 2016, 2015 and 2014, respectively. In 2016, our VM Solutions included revenues from VM, Private Cloud Platform, Continuous Monitoring, Cloud Agent for VM, AssetView, and ThreatPROTECT. In 2015, our VM Solutions included revenues from VM, Private Cloud Platform, Continuous Monitoring and Cloud Agent for VM. In 2014, our VM Solutions included revenues from VM, Private Cloud Platform and Continuous Monitoring. In prior 10-Q and 10-K filings, we had included all revenues from scanners and credits for prepaid services in our VM Solutions revenues. In the fourth quarter of 2016, we changed the methodology to allocate revenues from scanners and credits across our products. Based on the prior methodology, our VM Solutions would have made up 78% of total revenues in 2016, down 1% from 79% in 2015.

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

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

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

- the level of demand for our solutions;
- publicity regarding security breaches generally and the level of perceived threats to IT security;
- expenses associated with our existing and new products and services;
- changes in customer renewals of our solutions;
- the extent to which customers subscribe for additional solutions;
- seasonal buying patterns of our customers;
- the level of perceived threats to IT security;
- security breaches, technical difficulties or interruptions with our service;
- changes in the growth rate of the IT security and compliance market;
- the timing and success of new product or service introductions by us or our competitors or any other changes in the competitive landscape of our industry, including consolidation among our competitors;
- the introduction or adoption of new technologies that compete with our solutions;
- decisions by potential customers to purchase IT security and compliance products or services from other vendors;

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

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

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

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

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

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

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

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

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

- failure to timely meet market demand for product functionality;
- inability to identify and provide intelligence regarding the attacks or techniques used by cyber-attackers;
- inability to inter-operate effectively with the database technologies, file systems or web applications of our prospective customers;
- defects, errors or failures;
- delays in releasing our enhancements or new solutions;
- negative publicity about their performance or effectiveness;
- introduction or anticipated introduction of products by our competitors;
- poor business conditions, causing customers to delay IT security and compliance purchases;
- easing or changing of external regulations related to IT security and compliance; and
- reluctance of customers to purchase cloud solutions for IT security and compliance.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

We compete with large and small public companies, such as Barracuda Networks, Inc., Hewlett-Packard Company, Imperva, Inc., International Business Machines Corporation, Symantec Corporation and Rapid7, Inc., as well as privately held security providers including BeyondTrust Software, Inc., Tripwire, Inc., NetIQ Corporation, Tenable Network Security, Inc. and Trustwave Holdings, Inc. We also seek to replace IT security and compliance solutions that organizations have developed internally. As we continue to extend our cloud platform's functionality by further developing security and compliance solutions, such as web application scanning and firewalls, we expect to face additional competition in these new markets. Our competitors may also attempt to further expand their presence in the IT security and compliance market and compete more directly against one or more of our solutions.

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

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

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

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

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

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

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

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

We may not maintain profitability in the future.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

In addition, as of December 31, 2016, approximately 50% of our employees were located outside of the United States, with a significant number of these employees located in Pune, India. Accordingly, we are exposed to changes in laws governing our employee relationships in various U.S. and foreign jurisdictions, including laws and regulations regarding wage and hour requirements, fair labor standards, employee data privacy, unemployment tax rates, workers' compensation rates, citizenship requirements and payroll and other taxes which may have a direct impact on our operating costs. We may continue to expand our international operations and international sales and marketing activities. Expansion in international markets has required, and will continue to require, significant management attention and resources. We may be unable to scale our infrastructure effectively or as quickly as our competitors in these markets and our revenues may not increase to offset any increased costs and operating expenses, which would cause our results to suffer.

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

The introduction of products and services embodying new technologies could render our existing solutions obsolete or less attractive to customers. Our business could be harmed if new security and compliance technologies are widely adopted. We may not be able to successfully anticipate or adapt to changing technology or customer requirements on a timely basis, or at all. If we fail to keep up with technological changes or to convince our customers and potential customers of the value of our solutions even in light of new technologies, our business could be harmed and our revenues may decline.

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

We have experienced significant growth over the last several years. From 2014 to 2016, our revenues have grown from $133.6 million to $197.9 million, and our headcount increased from 431 employees at the beginning of 2014 to 684 employees at December 31, 2016. We rely on information technology systems to help manage critical functions such as order processing, revenue recognition and financial forecasts. To manage any future growth effectively we must continue to improve and expand our IT systems, financial infrastructure, and operating and administrative systems and controls, and continue to manage headcount, capital and processes in an efficient manner. We may not be able to successfully implement improvements to these systems and processes in a timely or efficient manner.

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

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

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

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

Our success significantly depends upon establishing and maintaining relationships with a variety of channel partners and we anticipate that we will continue to depend on these partners in order to grow our business. For the years ended December 31, 2016, 2015 and 2014, we derived approximately 42%, 39% and 39%, respectively, of our revenues from sales of subscriptions for our solutions through channel partners, and the percentage of revenues derived from channel partners may increase in future periods. Our agreements with our channel partners are generally non-exclusive and do not prohibit them from working with our competitors or offering competing solutions, and many of our channel partners have more established relationships with our competitors. If our channel partners choose to place greater emphasis on products of their own or those offered by our competitors, do not effectively market and sell our solutions, or fail to meet the needs of our customers, then our ability to grow our business and sell our solutions may be adversely affected. In addition, the loss of one or more of our larger channel partners, who may cease marketing our solutions with limited or no notice, and our possible inability to replace them, could adversely affect our sales. Moreover, our ability to expand our distribution channels depends in part on our ability to educate our channel partners about our solutions, which can be complex. Our failure to recruit additional channel partners, or any reduction or delay in their sales of our solutions or conflicts between channel sales and our direct sales and marketing activities may harm our results of operations. Even if we are successful, these relationships may not result in greater customer usage of our solutions or increased revenues.

In addition, the financial health of our channel partners and our continuing relationships with them are important to our success. Some of these channel partners may be unable to withstand adverse changes in economic conditions, which could result in insolvency and/or the inability of such distributors to obtain credit to finance purchases of our products and services. In addition, weakness in the end-user market could negatively affect the cash flows of our channel partners who could, in turn, delay paying their obligations to us, which would increase our credit risk exposure. Our business could be harmed if the financial condition of some of these channel partners substantially weakened and we were unable to timely secure replacement channel partners.

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

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

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

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

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

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

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

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

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

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

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

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

Our reporting currency is the U.S. dollar and we generate a majority of our revenues in U.S. dollars. However, in 2016, we incurred approximately 19% of our expenses outside of the United States in foreign currencies, primarily Euros, British Pounds, and Indian Rupee, principally with respect to salaries and related personnel expenses associated with our European and Indian operations. Additionally, in 2016, approximately 17% of our revenues were generated in foreign currencies. Accordingly, changes in exchange rates may have a material adverse effect on our business, operating results and financial condition. The exchange rate between the U.S. dollar and foreign currencies has fluctuated substantially in recent years and may continue to fluctuate substantially in the future. We expect that a majority of our revenues will continue to be generated in U.S. dollars for the foreseeable future and that a significant portion of our expenses, including personnel costs, as well as capital and operating expenditures, will continue to be denominated in Euro, British Pound and Indian Rupee. The results of our operations may be adversely affected by foreign exchange fluctuations.

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

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

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

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

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

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

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

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

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

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

An adverse outcome of a dispute may require us to:

- pay substantial damages, including treble damages, if we are found to have willfully infringed a third party's patents or copyrights;
- cease making, licensing or using solutions that are alleged to infringe or misappropriate the intellectual property of others;
- expend additional development resources to attempt to redesign our solutions or otherwise develop non-infringing technology, which may not be successful;
- enter into potentially unfavorable royalty or license agreements in order to obtain the right to use necessary technologies or intellectual property rights; and
- indemnify our partners and other third parties.

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

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

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

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

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

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

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

We are required under accounting principles generally accepted in the United States ("U.S. GAAP") to recognize compensation expense in our operating results for employee stock-based compensation under our equity grant programs, which may negatively impact our operating results and may increase the pressure to limit stock-based compensation that we might otherwise offer to current or potential employees. In addition, to the extent we hire personnel from competitors, we may be subject to allegations that they have been improperly solicited or divulged proprietary or other confidential information.

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

We deliver our solutions through the Internet. Federal, state or foreign government bodies or agencies have in the past adopted, and may in the future adopt, laws or regulations affecting data privacy and the use of the Internet. In addition, government agencies or private organizations may begin to impose taxes, fees or other charges for accessing the Internet or on commerce conducted via the Internet. These laws or charges could limit the viability of Internet-based solutions such as ours and reduce the demand for our solutions.

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

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

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

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

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

In order to remain competitive, we have in the past and may in the future seek to acquire additional businesses, products, services or technologies. The environment for acquisitions in our industry is very competitive and acquisition candidate purchase prices may exceed what we would prefer to pay. Moreover, achieving the anticipated benefits of future acquisitions will depend in part upon whether we can integrate acquired operations, products and technology in a timely and cost-effective manner, and even if we achieve benefits from acquisitions, such acquisitions may still be viewed negatively by customers, financial markets or investors. The acquisition and integration process is complex, expensive and time-consuming, and may cause an interruption of, or loss of momentum in, product development and sales activities and operations of both companies and we may incur substantial cost and expense, as well as divert the attention of management. We may issue equity securities which could dilute current stockholders' ownership, incur debt, assume contingent or other liabilities and expend cash in acquisitions, which could negatively impact our financial position, stockholder equity and stock price. We may not find suitable acquisition candidates, and acquisitions we complete may be unsuccessful. If we consummate a transaction, we may be unable to integrate and manage acquired products and businesses effectively or retain key personnel. If we are unable to effectively execute acquisitions, our business, financial condition and operating results could be adversely affected.

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

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, as provided in the section titled “Part II, Item 7 - Management's Discussion and Analysis of Financial Condition and Results of Operations,” the results of which form the basis for making judgments about the carrying values of assets, liabilities, equity, revenues and expenses that are not readily apparent from other sources. Our operating results may be adversely affected if our assumptions change or if actual circumstances differ from those in our assumptions, which could cause our operating results to fall below the expectations of securities analysts and investors, resulting in a decline in our stock price. Significant assumptions and estimates used in preparing our consolidated financial statements include those related to revenue recognition, accounting for income taxes, stock-based compensation, and fair value measurement.

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

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

Because we expense commissions associated with sales of our solutions immediately upon receipt of a subscription order from a customer and generally recognize the revenues associated with such sale over the term of the agreement, our operating income in any period may not be indicative of our financial health and future performance.

We expense commissions paid to our sales personnel in the quarter in which the related order is received. In contrast, we generally recognize the revenues associated with a sale of our solutions ratably over the term of the subscription, which is typically one year. Although we believe increased sales is a positive indicator of the long-term health of our business, increased sales would increase our operating expenses and decrease net income in any particular period. Thus, we may report poor operating results due to higher sales commissions in a period in which we experience strong sales of our solutions. Alternatively, we may report better operating results due to the reduction of sales commissions in a period in which we experience a slowdown in sales. Therefore, you should not rely on our operating results during any one quarter as an indication of our financial health and future performance.

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

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

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

We are subject to income taxes in the United States and various foreign jurisdictions, and our domestic and international tax liabilities are subject to the allocation of expenses in differing jurisdictions. Our tax rate is affected by changes in the mix of earnings and losses in countries with differing statutory tax rates, certain non-deductible expenses arising from the requirement to expense stock options, and the valuation of deferred tax assets and liabilities, including our ability to utilize our federal net operating losses, which were $31.5 million as of December 31, 2016. Increases in our effective tax rate could harm our operating results.

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

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

A significant natural disaster, such as an earthquake, fire or a flood, or a significant power outage could have a material adverse impact on our business, operating results and financial condition. Our corporate headquarters and a significant portion of our operations are located in the San Francisco Bay Area, a region known for seismic activity. In addition, natural disasters could affect our business partners’ ability to perform services for us on a timely basis. In the event we or our business partners are hindered by any of the events discussed above, our ability to provide our solutions to customers could be delayed, resulting in our missing financial targets, such as revenues and net income, for a particular quarter. Further, if a natural disaster occurs in a region from which we derive a significant portion of our revenues, customers in that region may delay or forego subscriptions of our solutions, which may materially and adversely impact our results of operations for a particular period. In addition, acts of terrorism could cause disruptions in our business or the business of our business partners, customers or the economy as a whole. All of the aforementioned risks may be exacerbated if the disaster recovery plans for us and our suppliers prove to be inadequate. To the extent that any of the above results in delays of customer subscriptions or commercialization of our solutions, our business, financial condition and results of operations could be adversely affected.

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

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

Our internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with GAAP. Our current controls and any new controls that we develop may become inadequate because of changes in conditions in our business. Any failure to maintain effective controls, or any difficulties encountered in their improvement, could harm our operating results or cause us to fail to meet our reporting obligations. Any failure to maintain effective internal control over financial reporting also could adversely affect the results of periodic management evaluations regarding the effectiveness of our internal control over financial reporting that we are required to include in our periodic reports we file with the SEC under Section 404 of the Sarbanes-Oxley Act. While we were able to assert in this Annual Report on Form 10-K that our internal control over financial reporting was effective as of December 31, 2016, we cannot predict the outcome of our testing in future periods. If we are unable to assert in any future reporting period that our internal control over financial reporting is effective (or if our independent registered public accounting firm is unable to express an opinion on the effectiveness of our internal controls), investors may lose confidence in our operating results and our stock price could decline. In addition, if we are unable to continue to meet these requirements, we may not be able to remain listed on the NASDAQ Stock Market.

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

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

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

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

Our actual operating results may differ significantly from our guidance.

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

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

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

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

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

As of December 31, 2016, our executive officers, directors and holders of 10% or more of our outstanding common stock beneficially own, in the aggregate, approximately 16% of our outstanding common stock. As a result, such persons, acting together, have significant ability to control our management and affairs and substantially all matters submitted to our stockholders for approval, including the election and removal of directors and approval of any significant transaction. These persons also have significant ability to control our management and business affairs. This concentration of ownership may have the effect of delaying, deferring or preventing a change in control, impeding a merger, consolidation, takeover or other business combination involving us, or discouraging a potential acquirer from making a tender offer or otherwise attempting to obtain control of our business, even if such a transaction would benefit other stockholders.

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

The market price of shares of our common stock could decline as a result of substantial sales of our common stock, particularly sales by our directors, executive officers, employees and significant stockholders, a large number of shares of our common stock becoming available for sale, or the perception in the market that holders of a large number of shares intend to sell their shares. As of December 31, 2016, we had approximately 35.8 million shares of our common stock outstanding. Certain holders of shares of common stock have rights, subject to some conditions, to require us to file registration statements covering their shares or to include these shares in registration statements that we may file for ourselves or other stockholders.

In addition, as of December 31, 2016, there were approximately 0.6 million restricted stock units and options to purchase approximately 7.5 million shares of our common stock outstanding. If such options are exercised and restricted stock units are released, these additional shares will become available for sale. As of December 31, 2016, we had an aggregate of 1.4 million shares of our common stock reserved for future issuance under our 2012 Equity Incentive Plan, which can be freely sold in the public market upon issuance. If a large number of these shares are sold in the public market, the sales could reduce the trading price of our common stock.

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

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

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

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

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

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

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

Our principal executive offices are located in Redwood City, California, where we occupy a 50,000 square-foot facility under a lease expiring on November 30, 2017. We have additional U.S. offices in Bellevue, Washington and Raleigh, North Carolina. We also lease offices in Courbevoie, France; Moscow, Russia; Munich, Germany; Frankfurt, Germany; Pune, India; Dubai, United Arab Emirates; Reading, United Kingdom; and Tokyo, Japan. We believe our facilities are adequate for our current needs and for the foreseeable future.

On October 14, 2016 the Company entered into a lease agreement for its new headquarter office facility. The lease commences May 1, 2018 and has a ten-year term through April 2028.

We operate principal data centers at third-party facilities in Santa Clara, California; Tukwilia, Washington; Ashburn, Virginia; Geneva, Switzerland; Pune, India; and Amsterdam, the Netherlands.

Item 3. 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 4. Mine Safety Disclosures.

Not Applicable.

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Market Information

Our common stock is listed on the NASDAQ Stock Market under the trading symbol “QLYS”. The following table sets forth the high and low per share sales prices for our common stock as reported on the NASDAQ Stock Market for the two most recent fiscal years:

	Low	High
Fiscal 2016:		
Fourth quarter	$ 30.61	$ 39.67
Third quarter	$ 29.69	$ 38.32
Second quarter	$ 23.77	$ 32.65
First quarter	$ 16.96	$ 32.48
Fiscal 2015:		
Fourth quarter	$ 28.05	$ 39.74
Third quarter	$ 25.32	$ 42.97
Second quarter	$ 36.21	$ 55.47
First quarter	$ 35.01	$ 50.00

Holders of Common Equity

As of January 31, 2017, there were approximately 119 holders of record of our common stock. Because many of our shares of common stock are held by brokers and other institutions on behalf of stockholders, we are unable to estimate the total number of stockholders represented by these record holders.

Dividend Policy

We have never declared or paid any cash dividends on our capital stock. We currently intend to retain any future earnings to fund business development and growth, and do not expect to pay any dividends in the foreseeable future. Any future determination to declare cash dividends will be made at the discretion of our board of directors, subject to applicable laws, and will depend on a number of factors, including our financial condition, results of operations, capital requirements, contractual restrictions, general business conditions and other factors that our board of directors may deem relevant.

Securities Authorized for Issuance under Equity Compensation Plans

The following table summarizes information about our equity compensation plans as of December 31, 2016. All outstanding awards relate to our common stock.

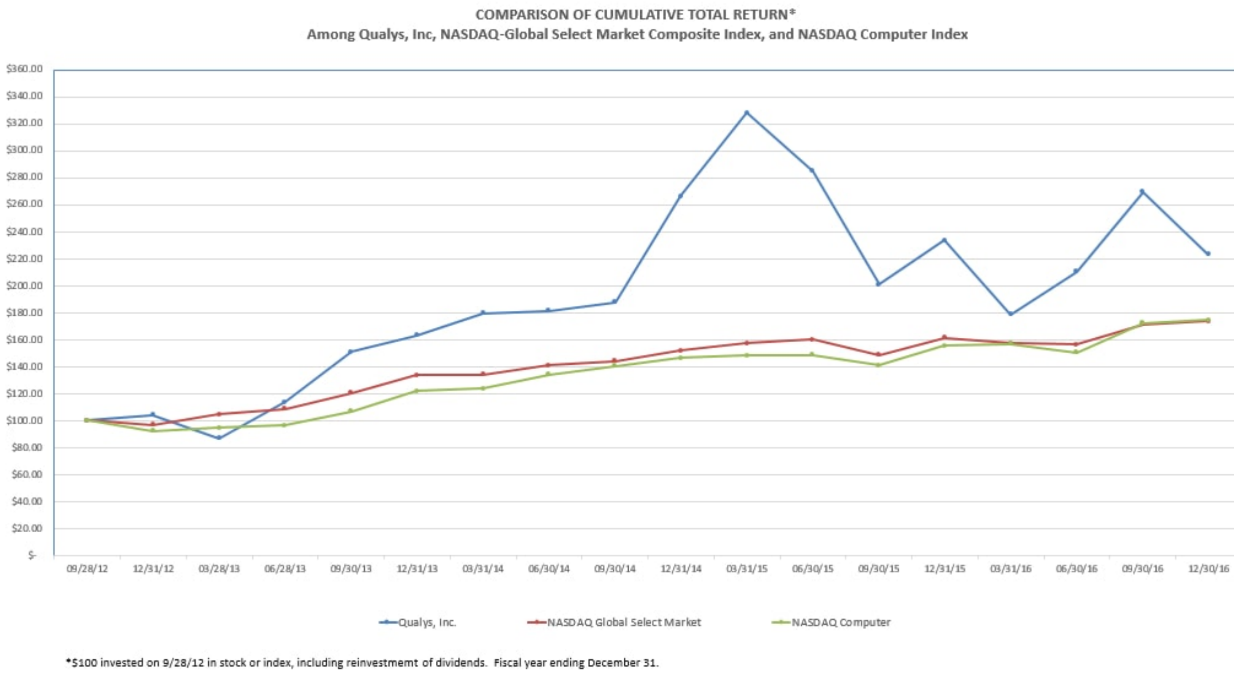
Plan Category	(a) Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights	(b) Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights	(c) Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column (a))
Equity compensation plans approved by security holders[1]	7,527,680	$ 19.25	1,425,230

[1] Equity compensation plans approved by stockholders include the 2000 Equity Incentive Plan, as amended and the 2012 Equity Incentive Plan. Prior to our IPO, we issued securities under our 2000 Equity Incentive Plan, as amended. Following our IPO, we issued securities under our 2012 Equity Incentive Plan.

Stock Price Performance Graph

The following graph shows a comparison from September 28, 2012 (the date our common stock commenced trading on the NASDAQ Stock Market) through December 31, 2016 of the cumulative total return for an investment of $100 (and the reinvestment of dividends) in our common stock, the NASDAQ Global Select Market and the NASDAQ Computer. Such returns are based on historical results and are not intended to suggest future performance.

COMPARISON OF CUMULATIVE TOTAL RETURN*
Among Qualys, Inc., NASDAQ-Global Select Market Composite Index, and NASDAQ Computer Index



$100 invested on 9/28/12 in stock or index, including reinvestment of dividends. Fiscal year ending December 31.

	Sep 28, 2012	Dec 31, 2012	Mar 28, 2013	Jun 28, 2013	Sep 30, 2013	Dec 31, 2013	Mar 31, 2014	Jun 30, 2014	Sep 30, 2014	Dec 31, 2014
Qualys Inc.	$ 100.00	$ 104.45	$ 87.15	$ 113.84	$ 151.06	$ 163.21	$ 179.59	$ 181.29	$ 187.85	$ 266.60
NASDAQ Global Select Market	$ 100.00	$ 96.97	$ 104.81	$ 109.04	$ 120.70	$ 133.81	$ 134.37	$ 141.29	$ 144.41	$ 152.15
NASDAQ Computer	$ 100.00	$ 92.56	$ 94.63	$ 96.42	$ 107.05	$ 122.12	$ 124.02	$ 134.09	$ 140.74	$ 146.40

	Mar 31, 2015	Jun 30, 2015	Sep 30, 2015	Dec 31, 2015	Mar 31, 2016	Jun 30, 2016	Sep 30, 2016	Dec 31, 2016
Qualys Inc.	$ 328.25	$ 284.96	$ 200.99	$ 233.69	$ 178.74	$ 210.52	$ 269.70	$ 223.52
NASDAQ Global Select Market	$ 157.37	$ 160.01	$ 148.73	$ 161.44	$ 157.46	$ 156.47	$ 171.45	$ 173.70
NASDAQ Computer	$ 148.28	$ 148.58	$ 141.11	$ 155.44	$ 156.87	$ 150.67	$ 172.63	$ 174.62

The information on the above Stock Price Performance Graph shall not be deemed to be “filed” for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to the liabilities of that section or Sections 11 and 12(a)(2) of the Securities Act of 1933, as amended, and shall not be incorporated by reference into any registration statement or other document filed by us with the Securities and Exchange Commission, whether made before or after the date of this Annual Report on Form 10-K, regardless of any general incorporation language in such filing, except as shall be expressly set forth by specific reference in such filing.

Purchases of Equity Securities by the Issuer and Affiliated Purchasers

No shares of our common stock were repurchased during the fourth quarter of 2016.

Item 6. Selected Consolidated Financial Data

The following selected consolidated financial data should be read in conjunction with "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" and our consolidated financial statements, related notes and other financial information included elsewhere in this Annual Report on Form 10-K. Our historical results are not necessarily indicative of the results that may be expected in the future, and the results for the year ended December 31, 2016 are not necessarily indicative of operating results to be expected for any other period.

	Year Ended December 31,				
	2016	2015	2014	2013	2012
	(in thousands, except per share data)				
Consolidated Statements of Operations Data:					
Revenues	$ 197,925	$ 164,284	$ 133,579	$ 107,962	$ 91,420
Cost of revenues(1)	42,473	33,885	28,963	24,660	18,404
Gross profit	155,452	130,399	104,616	83,302	73,016
Operating expenses:					
Research and development(1)	35,267	29,451	26,320	21,678	20,195
Sales and marketing(1)	57,970	49,569	48,049	42,523	37,738
General and administrative(1)	32,108	26,573	21,000	16,792	12,079
Total operating expenses	125,345	105,593	95,369	80,993	70,012
Income from operations	30,107	24,806	9,247	2,309	3,004
Other income (expense), net:					
Interest expense	(26)	(6)	(9)	(43)	(192)
Interest income	1,320	570	452	375	14
Other expense, net	(972)	(850)	(1,077)	(600)	(247)
Total other income (expense), net	322	(286)	(634)	(268)	(425)
Income before income taxes	30,429	24,520	8,613	2,041	2,579
Provision for (benefit from) income taxes (3)	11,205	8,655	(21,631)	500	358
Net income	$ 19,224	$ 15,865	$ 30,244	$ 1,541	$ 2,221
Net income attributable to common stockholders	$ 19,224	$ 15,865	$ 30,244	$ 1,539	$ 1,049
Net income per share attributable to common stockholders:(2)					
Basic	$ 0.55	$ 0.47	$ 0.92	$ 0.05	$ 0.09
Diluted	$ 0.50	$ 0.42	$ 0.81	$ 0.04	$ 0.08
Weighted-average shares used in computing net income per share attributable to common stockholders: (2)					
Basic	35,247	34,050	32,979	31,914	11,891
Diluted	38,369	38,184	37,170	35,973	28,352

	As of December 31,				
	2016	2015	2014	2013	2012
	(in thousands)				
Consolidated Balance Sheet Data:					
Cash, cash equivalents and short-term investments	$ 243,856	$ 178,966	$ 127,218	$ 97,196	$ 118,432
Long-term investments	45,725	43,277	39,448	35,608	—
Total assets	407,004	323,514	260,024	192,603	170,318
Deferred revenues, current	114,964	98,025	81,147	67,505	56,497
Deferred revenues, noncurrent	15,528	14,564	10,064	8,889	8,616
Convertible preferred stock	—	—	—	—	—
Total stockholders' equity	258,413	195,566	151,827	103,117	91,555

(1) Includes stock-based compensation as follows:

	Year Ended December 31,				
	2016	2015	2014	2013	2012
	(in thousands)				
Cost of revenues	$ 1,858	$ 1,250	$ 757	$ 432	$ 276
Research and development	5,678	4,936	2,470	1,047	672
Sales and marketing	4,870	3,867	2,407	1,244	1,074
General and administrative	7,743	7,441	4,915	2,783	1,430
Total stock-based compensation	$ 20,149	$ 17,494	$ 10,549	$ 5,506	$ 3,452

(2) See Notes 1 and 10 to our consolidated financial statements included elsewhere in this Annual Report on Form 10-K for an explanation of the calculations of our basic and diluted income per share attributable to common stockholders.

(3) Provision for income taxes prior to 2014 consists primarily of taxes on income in foreign jurisdictions and state income taxes in the U.S. In the fourth quarter of 2014, we recorded a tax benefit of $23.7 million to recognize our U.S. federal and certain state deferred tax assets.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

You should read the following discussion in conjunction with the section titled "Selected Consolidated Financial Data" and our consolidated financial statements and the related notes included elsewhere in this Annual Report on Form 10-K. In addition to historical information, this discussion contains forward-looking statements that involve risks and uncertainties that could cause our actual results to differ materially from our expectations, as discussed in "Forward-Looking Statements" in Part I of this Annual Report on Form 10-K. Factors that could cause such differences include, but are not limited to, those described in the section titled "Risk Factors" and elsewhere in this Annual Report on Form 10-K.

Overview

We are 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. Our cloud solutions address the growing security and compliance complexities and risks that are amplified by the dissolving boundaries between internal and external IT infrastructures and web environments, the rapid adoption of cloud computing and the proliferation of geographically dispersed IT assets. Our integrated suite of security and compliance solutions delivered on our Qualys Cloud Platform enables our customers to identify their IT assets, collect and analyze large amounts of IT security data, discover and prioritize vulnerabilities, recommend remediation actions and verify the implementation of such actions. Organizations use our integrated suite of solutions delivered on our Qualys Cloud Platform to cost-effectively obtain a unified view of their security and compliance posture across globally-distributed IT infrastructures.

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, Qualys Vulnerability Management (VM), in 2000. Our VM Solutions have provided a substantial majority of our revenues to date, representing 76%, 77% and 80% of total revenues in 2016, 2015 and 2014, respectively. In 2016, our VM Solutions included revenues from VM, Private Cloud Platform, Continuous Monitoring, Cloud Agent for VM, AssetView, and ThreatPROTECT. In 2015, our VM Solutions included revenues from VM, Private Cloud Platform, Continuous Monitoring and Cloud Agent for VM. In 2014, our VM Solutions included revenues from VM, Private Cloud Platform and Continuous Monitoring. In prior 10-Q and 10-K filings, we had included all revenues from scanners and credits for prepaid services in our VM Solutions revenues. In the fourth quarter of 2016, we changed the methodology to allocate revenues from scanners and credits across our products. Based on the prior methodology, our VM Solutions would have made up 78% of total revenues in 2016, down 1% from 79% in 2015.

As VM 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 (PC) solution. In 2009, we broadened the scope of our cloud services by adding Web Application Scanning. 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 Continuous Monitoring 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 more susceptible to a cyber-attack. In 2014, we also launched Web Application Firewall (WAF). Qualys WAF, currently is in limited release, it delivers enterprise-grade web application security without the costs, footprint, and complexity associated with appliance-based web application firewall solutions. In 2015, we introduced our Cloud Agent Platform (CAP), which provides customers with the ability to secure IT assets on a continuous basis regardless of where they reside, inside the enterprise, in the cloud or mobile endpoints. CAP allows organizations to perform vulnerability and compliance management on a continuous basis. It is a natural extension to our cloud platform and allows us to expand our footprint in the enterprise and provide VM and PC solutions to mobile endpoints and elastic cloud environments. In 2015, we also launched AssetView and Security Assessment Questionnaire. AssetView is a free, cloud-based asset inventory service that provides visibility and actionable data on global IT assets within an organization. We do not charge for AssetView but do charge for AssetView synchronization with ServiceNow CMDB (Configuration Management Database). This integrates our robust asset discovery and classification capabilities with ServiceNow's platform. Security Assessment Questionnaire enables organizations to better orchestrate security assessments or compliance audits with automated validation. In 2016, we introduced ThreatPROTECT, which prioritizes identified vulnerabilities for customers using our VM solution.

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. Revenues from customers existing at or prior to December 31, 2015 grew by $20.4 million to $184.7 million during 2016, representing 112% of total revenues in 2015. We expect revenue growth from existing customers to continue. Subscriptions from new customers added in 2016 contributed $13.2 million to the increase in revenues.

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. As of December 31, 2016, we had over 9,300 customers, excluding security consulting firms, in more than 100 countries, including a majority of each of the Forbes Global 100 and Fortune 100. In 2016, 2015 and 2014, approximately 71%, 70% and 70% respectively, 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 over the past three years. Our revenues increased from $133.6 million in 2014 to $164.3 million in 2015, and reached $197.9 million in 2016, representing period-over-period increases of $30.7 million, and $33.6 million, or 23% and 20%, respectively. We generated net income of $30.2 million in 2014, $15.9 million in 2015, and $19.2 million in 2016. Net income in 2014 includes a tax benefit of $23.7 million for recognition of our U.S. federal and certain state deferred tax assets.

Key Metrics

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

	Year Ended December 31,		
	2016	2015	2014
	(in thousands)		
Adjusted EBITDA	$ 67,966	$ 56,660	$ 31,693
Free cash flows	44,865	45,810	27,411

Adjusted EBITDA

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

Adjusted EBITDA should not be considered in isolation from, or as a substitute for, financial information prepared in accordance with U.S. GAAP. We calculate Adjusted EBITDA as net income before (1) other (income) expense, net, which includes interest income, interest expense and other income and expense, (2) provision for (benefit from) income taxes, (3) depreciation and amortization of property and equipment, (4) amortization of intangible assets, (5) stock-based compensation and (6) one-time tax related expense.

The following unaudited table presents the reconciliation of net income to Adjusted EBITDA for each of the periods presented.

	Year Ended December 31,		
	2016	2015	2014
	(in thousands)		
Net income	$ 19,224	$ 15,865	$ 30,244
Other income (expense), net	(322)	286	634
Provision for (benefit from) income taxes	11,205	8,655	(21,631)
Depreciation and amortization of property and equipment	16,621	13,974	11,504
Amortization of intangible assets	373	386	393
Stock-based compensation	20,149	17,494	10,549
One-time tax related expense[1]	716	—	—
Adjusted EBITDA	$ 67,966	$ 56,660	$ 31,693
Percentage of revenues	34%	34%	24%

[1] Adjusted EBITDA for 2016 excludes approximately $0.7 million of a non-recurring expense related to the remittance of payroll taxes from fiscal year 2013 through May 2016. During this same period, we have not excluded any amounts related to other non-recurring items from Adjusted EBITDA because we have considered such amounts to be immaterial.

Free Cash Flow

We define free cash flow, a non-GAAP measure, as net cash provided by operating activities less purchases of property and equipment and capitalization of software development costs. We monitor free cash flow as a liquidity measure because we believe it provides useful information to management and investors about the amount of cash we generated, that, after the acquisition of property and equipment and capitalized software development costs, can be used for strategic opportunities, including investing in our business, making strategic acquisitions and strengthening the balance sheet. We also believe free cash flow provides an additional tool for investors to use in comparing our recurring core business operating results over multiple periods.

A limitation of using free cash flow as a means for evaluating liquidity is that free cash flow does not represent the total increase or decrease in cash and cash equivalents for the period because it excludes cash provided by or used in other investing and financing activities. In addition, it is important to note that other companies, including companies in our industry, may not use free cash flow, may calculate free cash flow in a different manner than we do, or may use other financial measures to evaluate their performance, all of which could reduce the usefulness of free cash flow as a comparative measure. A reconciliation of free cash flow to net cash provided by operating activities, the most directly comparable financial measure calculated and presented in accordance with GAAP, is provided below:

	Year Ended December 31,		
	2016	2015	2014
	(in thousands)		
Net cash provided by operating activities	$ 68,110	$ 65,960	$ 41,423
Less:			
Purchases of property and equipment	(23,245)	(20,051)	(13,914)
Capitalized software development costs	—	(99)	(98)
Free cash flow	$ 44,865	$ 45,810	$ 27,411

Limitations of Adjusted EBITDA and Free Cash Flow

Adjusted EBITDA and free cash flow, non-GAAP financial measures, have limitations as analytical tools, 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;
- Free cash flow does not represent the total increase or decrease in the cash and cash equivalents for the period; and
- Other companies, including companies in our industry, may calculate Adjusted EBITDA and free cash flow differently or not at all, which reduces their usefulness as a comparative measure.

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

Key Components of Results of Operations

Revenues

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

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

Cost of Revenues

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

Operating Expenses

Research and Development

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

General and Administrative

General and administrative expenses consist primarily of personnel expenses, comprised of salaries, benefits, performance-based compensation and stock-based compensation, for our executive, finance and accounting, legal, human resources and internal information technology support teams, as well as professional services, insurance, fees, 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 and compliance with legal requirements.

Other Income (Expense), Net

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

Provision for Income Taxes

We are subject to federal, state and foreign income taxes for jurisdictions in which we operate, and we use estimates in determining our provision for these income taxes and deferred tax assets. Earnings from our non-U.S. activities are subject to income taxes in the local country which are generally lower than U.S. tax rates, and may be subject to U.S. income taxes. Our effective rates differ from the U.S. statutory rate primarily due to foreign income subject to different tax rates than the U.S., research and development tax credits, non-deductible stock-based compensation expense and other adjustments.

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

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

Our provision for income taxes in 2016 consists of income taxes for federal and certain states in the United States, as well as income taxes for profits generated in foreign jurisdictions by wholly-owned subsidiaries. Our benefit from income taxes in 2014 included a tax benefit for the recognition of our U.S. federal and certain state deferred tax assets. The tax benefit was partially offset by our income tax provision for federal and certain state income taxes in the United States, as well as income taxes for profits generated in foreign jurisdictions by wholly-owned subsidiaries.

Results of Operations

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

	Year Ended December 31,		
	2016	2015	2014
		(in thousands)	
Consolidated Statements of Operations data:			
Revenues	$ 197,925	$ 164,284	$ 133,579
Cost of revenues [1]	42,473	33,885	28,963
Gross profit	155,452	130,399	104,616
Operating expenses:			
Research and development [1]	35,267	29,451	26,320
Sales and marketing [1]	57,970	49,569	48,049
General and administrative [1]	32,108	26,573	21,000
Total operating expenses	125,345	105,593	95,369
Income from operations	30,107	24,806	9,247
Other income (expense), net	322	(286)	(634)
Income before income taxes	30,429	24,520	8,613
Provision for (benefit from) income taxes	11,205	8,655	(21,631)
Net income	$ 19,224	$ 15,865	$ 30,244

(1) Includes stock-based compensation as follows:

	Year Ended December 31,		
	2016	2015	2014
		(in thousands)	
Cost of revenues	$ 1,858	$ 1,250	$ 757
Research and development	5,678	4,936	2,470
Sales and marketing	4,870	3,867	2,407
General and administrative	7,743	7,441	4,915
Total stock-based compensation	$ 20,149	$ 17,494	$ 10,549

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

	Year Ended December 31,		
	2016	2015	2014
Revenues	100%	100%	100 %
Cost of revenues	21	21	22
Gross profit	79	79	78
Operating expenses:			
Research and development	18	18	19
Sales and marketing	29	30	36
General and administrative	16	16	16
Total operating expenses	63	64	71
Income from operations	15	15	7
Other expense, net	0	0	0
Income before income taxes	15	15	6
Provision for (benefit from) income taxes	6	5	(16)
Net income	10%	10%	23 %

Comparison of Years Ended December 31, 2016 and 2015

Revenues

	Year Ended December 31,		Change	
	2016	2015	$	%
	(in thousands, except percentages)			
Revenues	$ 197,925	$ 164,284	$ 33,641	20%

Revenues increased $33.6 million in 2016 compared to 2015. Revenues from customers existing at or prior to December 31, 2015 grew by $20.4 million to $184.7 million during 2016, representing 112% of total revenues in 2015. We expect revenue growth from existing customers to continue. Subscriptions from new customers added in 2016 contributed $13.2 million to the increase in revenues. Of the total increase of $33.6 million, $24.3 million was from customers in the United States and the remaining $9.3 million was from customers in foreign countries. The growth in revenues reflects the continued demand for our solutions.

Cost of Revenues

	Year Ended December 31,		Change	
	2016	2015	$	%
	(in thousands, except percentages)			
Cost of revenues	$ 42,473	$ 33,885	$ 8,588	25%
Percentage of revenues	21%	21%		
Gross profit percentage	79%	79%		

Cost of revenues increased $8.6 million in 2016 compared to 2015, primarily due to an increase in personnel expenses of $2.7 million to support the continued growth of our business; a $2.2 million increase in depreciation expense related to additional computer hardware and software; increased third-party software license maintenance expense of $2.1 million; increased data center costs and equipment repairs and maintenance of $0.5 million; increased overhead costs of $0.5 million; and increased temporary services of $0.2 million as we continue to grow.

Research and Development Expenses

	Year Ended December 31,		Change	
	2016	2015	$	%
	(in thousands, except percentages)			
Research and development	$ 35,267	$ 29,451	$ 5,816	20%
Percentage of revenues	18%	18%		

Research and development expenses increased $5.8 million in 2016 compared to 2015, primarily due to an increase in personnel expenses of $4.9 million, driven by the increase in the number of employees; increased temporary services of $0.5 million; and increased overhead costs of $0.5 million as we continue to grow. We continue to significantly invest in and expand our research and development teams to continuously improve our platform and existing solutions, as well as develop new solutions and capabilities.

Sales and Marketing Expenses

	Year Ended December 31,		Change	
	2016	2015	$	%
	(in thousands, except percentages)			
Sales and marketing	$ 57,970	$ 49,569	$ 8,401	17%
Percentage of revenues	29%	30%		

Sales and marketing expenses increased $8.4 million in 2016 compared to 2015, primarily due to an increase in personnel expenses of $5.2 million, principally due to the increase in the number of employees; increased marketing expenses of $2.1 million, primarily trade show, lead generation and branding expenses; and increased software license and maintenance fees of $0.9 million.

General and Administrative Expenses

	Year Ended December 31,		Change	
	2016	2015	$	%
	(in thousands, except percentages)			
General and administrative	$ 32,108	$ 26,573	$ 5,535	21%
Percentage of revenues	16%	16%		

General and administrative expenses increased $5.5 million in 2016 compared to 2015, primarily driven by increased legal, accounting, consulting and temporary services of $2.8 million; increased personnel expenses of $2.4 million, principally due to additional employees to support the growth of our business; $0.7 million of a non-recurring expense in 2016 related to the remittance of payroll taxes from fiscal year 2013 through May 2016; and a $0.3 million increase in dues and subscriptions. These increases were partially offset by lower bad debt expense of $0.7 million.

Other Income (Expense), Net

	Year Ended December 31,		Change	
	2016	2015	$	%
	(in thousands, except percentages)			
Other income (expense), net	$ 322	$ (286)	$ 608	(213)%
Percentage of revenues	0%	0%		

Other income (expense), net, increased $0.6 million in 2016 compared to 2015, primarily due to an increase in investment and interest income and lower foreign exchange losses.

Provision for Income Taxes

	Year Ended December 31,		Change	
	2016	2015	$	%
	(in thousands, except percentages)			
Provision for income taxes	$ 11,205	$ 8,655	$ 2,550	29%
Percentage of revenues	6%	5%		

The increase in the provision for income taxes in 2016 compared to 2015 is primarily due to the significant increase in income before tax of $30.4 million in 2016 compared to $24.5 million in 2015.

Comparison of Years Ended December 31, 2015 and 2014

Revenues

	Year Ended December 31,		Change	
	2015	2014	$	%
	(in thousands, except percentages)			
Revenues	$ 164,284	$ 133,579	$ 30,705	23%

Revenues increased $30.7 million in 2015 compared to 2014. Revenues from customers existing at or prior to December 31, 2014 grew by $18.9 million to $152.5 million in 2015, representing 114% of total revenues in 2014, primarily due to increased subscriptions and purchases of additional solutions. Subscriptions from new customers added in 2015 contributed $11.8 million to the increase in revenues. Of the total increase of $30.7 million, $22.0 million was from customers in the United States and the remaining $8.7 million was from customers in foreign countries. The growth in revenues reflects increased demand for our solutions.

Cost of Revenues

	Year Ended December 31,		Change	
	2015	2014	$	%
	(in thousands, except percentages)			
Cost of revenues	$ 33,885	$ 28,963	$ 4,922	17%
Percentage of revenues	21%	22%		
Gross profit percentage	79%	78%		

Cost of revenues increased $4.9 million in 2015 compared to 2014, primarily due to a $2.3 million increase in depreciation expenses related to additional computer hardware and software; increased third-party software maintenance expense of $1.6 million; increased stock-based compensation expense of $0.5 million; and increased data center costs of $0.3 million to support the continued growth of our business.

Research and Development Expenses

	Year Ended December 31,		Change	
	2015	2014	$	%
	(in thousands, except percentages)			
Research and development	$ 29,451	$ 26,320	$ 3,131	12%
Percentage of revenues	18%	19%		

Research and development expenses increased $3.1 million in 2015 compared to 2014, primarily due to an increase in personnel expenses of $3.2 million, due to addition of new employees and higher stock-based compensation. We continue to significantly invest in and expand our research and development teams to continuously improve our platform and existing solutions as well as develop new solutions and capabilities.

Sales and Marketing Expenses

	Year Ended December 31,		Change	
	2015	2014	$	%
	(in thousands, except percentages)			
Sales and marketing	$ 49,569	$ 48,049	$ 1,520	3%
Percentage of revenues	30%	36%		

Sales and marketing expenses increased $1.5 million in 2015 compared to 2014, primarily due to an increased marketing program and trade show activities of $0.8 million due to growth of the business and introduction of new solutions; and an increase in personnel expenses of $0.6 million, principally due to higher stock-based compensation.

General and Administrative Expenses

	Year Ended December 31,		Change	
	2015	2014	$	%
	(in thousands, except percentages)			
General and administrative	$ 26,573	$ 21,000	$ 5,573	27%
Percentage of revenues	16%	16%		

General and administrative expenses increased $5.6 million in 2015 compared to 2014, primarily due to an increase in personnel expenses of $2.9 million, principally due to higher employee stock-based compensation and the addition of new employees to support the growth of our business; increased professional services of $1.0 million to support growth and compliance with legal and regulatory requirements, including the additional requirements of the Sarbanes-Oxley Act now that we are no longer an Emerging Growth Company; and increased bad debt expense and other fees of $1.0 million.

Other Expense, Net

	Year Ended December 31,		Change	
	2015	2014	$	%
	(in thousands, except percentages)			
Other expense, net	$ (286)	$ (634)	$ 348	(55)%
Percentage of revenues	0%	0 %		

Other expense, net increased $0.3 million in 2015 compared to 2014, primarily due to lower foreign exchange losses in 2015.

Provision for (Benefit from) Income Taxes

	Year Ended December 31,		Change	
	2015	2014	$	%
	(in thousands, except percentages)			
Provision for (benefit from) income taxes	$ 8,655	$ (21,631)	$ 30,286	NM*
Percentage of revenues	5%	(16)%		

*NM - Not meaningful

The increase in the provision for (benefit from) income taxes in 2015 compared to 2014 is primarily due to a tax benefit of $23.7 million for the recognition of our U.S. federal and certain state deferred tax assets in 2014. In the fourth quarter of 2014, management determined it was more likely than not that certain deferred tax assets were realizable, primarily due to the increased and expected sustainable profitability in our U.S. operations. The tax benefit in 2014 was partially offset by taxes on income for U.S. federal and certain state jurisdictions as well as taxes on income in foreign jurisdictions for our wholly-owned subsidiaries. The increase in the provision for tax is also due to the significant increase in income before tax of $24.5 million in 2015 compared to $8.6 million in 2014.

Liquidity and Capital Resources

At December 31, 2016, our principal source of liquidity was cash, cash equivalents and short-term and long-term investments of $289.6 million, including $3.9 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 years ended December 31, 2016, 2015 and 2014, respectively. 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. We expect to spend approximately $20.0 to $25.0 million through December 31, 2017 for capital expenditures, primarily related to infrastructure to support the anticipated growth in our business. In addition, we expect to spend $13.0 to $15.0 million related to the construction of certain leasehold improvements for our new headquarters with approximately 50% to be reimbursed by the landlord not to exceed $8.0 million. 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, type and extent of our spending on research and development efforts, international expansion and investment in data centers. We may also seek to invest in or acquire complementary businesses or technologies.

Cash Flows

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

	Year Ended December 31,		
	2016	2015	2014
	(in thousands)		
Cash provided by operating activities	$ 68,110	$ 65,960	$ 41,423
Cash used in investing activities	(96,490)	(61,348)	(14,333)
Cash provided by financing activities	23,419	10,582	7,093
Effect of exchange rate changes on cash and cash equivalents	—	—	(48)
Net (decrease) increase in cash and cash equivalents	$ (4,961)	$ 15,194	$ 34,135

Cash Flows from Operating Activities

In 2016, cash flows from operating activities of $68.1 million resulted primarily from our net income of approximately $19.2 million, as adjusted by increases in deferred revenues of $17.9 million, attributable to our continued growth in sales; accrued liabilities of $9.7 million; non-cash items including depreciation and amortization expense of $17.0 million and stock-based compensation expense of $20.1 million. These increases are partially offset by the non-cash effect of excess tax benefits from stock based compensation of $8.7 million, an increase in prepaid expenses and other assets of $2.1 million and an increase in accounts receivable of $4.9 million.

In 2015, cash flows from operating activities of $66.0 million resulted primarily from our net income of approximately $15.9 million, as adjusted by an increase in deferred revenues of $21.4 million, attributable to our continued growth and an increase in subscriptions exceeding one year, and by non-cash items including depreciation and amortization expense of $14.4 million, stock-based compensation expense of $17.5 million and net utilization of deferred income taxes of $6.6 million. These increases are partially offset by an increase in accounts receivable of $10.2 million.

In 2014, cash flows from operating activities of $41.4 million resulted primarily from our net income of approximately $30.2 million, as adjusted by an increase in deferred revenues of $14.8 million, attributable to our continued growth. These working capital increases are further increased by non-cash items including depreciation and amortization expense of $11.9 million and stock-based compensation expense of $10.5 million. These increases are partially offset by an increase in accounts receivable of $4.9 million, due to the overall growth of our business and by a non-cash change in deferred tax assets of $22.6 million.

Cash Flows from Investing Activities

In 2016, cash used in investing activities of $96.5 million was primarily attributable to net purchases of investments of $73.2 million, arising from cash provided from operating activities. Additionally, $23.2 million of cash was used for capital expenditures, including computer hardware and software for our data centers to support our growth and development, and to purchase physical scanner appliances and computer hardware provided to certain customers as part of their subscriptions.

In 2015, cash used in investing activities of $61.3 million was primarily attributable to $20.1 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. Additionally, there were also net purchases of investments of $41.2 million, arising from cash provided from operating activities.

In 2014, cash used in investing activities of $14.3 million was primarily attributable to $13.9 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. Additionally, there were also purchases of investments of $157.7 million, partially offset by the sales and maturities of investments of $157.3 million.

Cash Flows from Financing Activities

In 2016, cash provided by financing activities of $23.4 million was primarily attributable to $15.2 million of proceeds from the exercise of stock options and $8.7 million of excess tax benefits from stock based compensation.

In 2015, cash provided by financing activities of $10.6 million was primarily attributable to $10.1 million of proceeds from the exercise of stock options.

In 2014, cash provided by financing activities of $7.1 million was primarily attributable to proceeds of $7.6 million from the exercise of stock options, partially offset by repayments on our capital lease obligations of $0.8 million.

Contractual Obligations

Our principal commitments consist of obligations under our outstanding leases for office space, third-party data centers and office equipment. The following table summarizes our contractual cash obligations at December 31, 2016 and the effect such obligations are expected to have on our liquidity and cash flows in future periods:

		Payment Due by Period			
Contractual Obligations	**Total**	**Less Than 1 Year**	**1-3 Years**	**3-5 Years**	**More than 5 Years**
	(in thousands)				
Operating lease obligations	$ 41,397	$ 7,128	$ 9,419	$ 7,371	$ 17,479

On October 14, 2016, we entered into a lease agreement (included in the table above) for our new headquarter office facility. The lease commences May 1, 2018 and has a ten-year term through April 2028. The total commitment of $38.6 million is payable monthly with escalating rental payments throughout the lease term. We will be provided access to the facility in the first half of 2017 to begin construction of certain leasehold improvements.

In connection with this lease, we have provided the landlord with a $1.2 million standby letter of credit (classified as restricted cash) to secure our obligations through the end of the lease term.

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 consolidated financial statements in Part II, Item 8 of this Annual Report on Form10-K for a discussion of recent accounting pronouncements.

Critical Accounting Policies and Estimates

Our 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, the following accounting policies 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.

Revenue Recognition

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

Subscriptions for unlimited scans and certain limited scan arrangements with firm expiration dates are recognized ratably over the period in which the services are performed, generally one year. We recognize revenues for certain other limited scan arrangements, where expiration dates can be extended, on an as-used basis. We recognize the subscription of physical scanner appliances and other computer equipment as revenues ratably over the period of the subscription, which is commensurate with the term of the related subscription. Because the customer's access to our cloud solutions are delivered at the same time or within close proximity to the delivery of physical scanner appliances and the terms are commensurate for these services and equipment, we consider these elements as a single unit of accounting recognized ratably over the subscription term. Costs of shipping and handling charges associated with physical scanner appliances and other computer equipment are included in cost of revenues.

Deferred revenues consist of revenues billed or received that will be recognized in the future under subscriptions existing at the balance sheet date.

Income Taxes

We are subject to income taxes in the United States as well as other tax jurisdictions in which we conduct business. Earnings from our non-U.S. activities are subject to local income tax and may also be subject to U.S. income tax.

Income tax expense or benefit is recognized for the amount of taxes payable or refundable for the current year, and for deferred tax assets and liabilities for the tax consequences of events that have been recognized in an entity's financial statements or tax returns. We must make significant assumptions, judgments and estimates to determine our current provision for (benefit from) income taxes, our deferred tax assets and liabilities, and any valuation allowance to be recorded against our deferred tax assets. Our judgments, assumptions and estimates relating to the current provision for (benefit from) income taxes include the geographic mix and amount of income (loss), our interpretation of current tax laws, and possible outcomes of current and future audits conducted by foreign and domestic tax authorities. Our judgments also include anticipating the tax positions we will record in the financial statements before actually preparing and filing the tax returns. Our estimates and assumptions may differ from the actual results as reflected in our income tax returns and we record the required adjustments when they are identified or resolved. Changes in our business, tax laws or our interpretation of tax laws, and developments in current and future tax audits, could significantly impact the amounts provided for income taxes in our results of operations, financial position, or cash flows.

Deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to tax benefit carry-forwards and to differences between the financial statement amounts of assets and liabilities and their respective tax basis. We regularly review our deferred tax assets for recoverability and establish a valuation allowance if it is more likely than not that some portion or all of the deferred tax assets will not be realized. To make this assessment, we take into account predictions of the amount and category of taxable income from various sources and all available positive and negative evidence about these possible sources of taxable income. The weight given to the potential effect of negative and positive evidence is commensurate with the extent to which the strength of the evidence can be objectively verified.

Based on the analysis of positive and negative factors noted above, we do not have a valuation allowance against U.S. federal and certain state deferred tax assets. We believe it is more likely than not that our California deferred tax assets will not be realized because the income attributed to California is not expected to be sufficient to recognize these deferred tax assets. Accordingly, we continue to record a valuation allowance as of December 31, 2016 for our California deferred tax assets. If, in the future, we determine that these deferred tax assets are more likely than not to be realized, a release of all or part, of the related valuation allowance could result in an income tax benefit in the period such determination is made.

In the fourth quarter of 2014, we considered our increasing realized profitability, forecasted future profitability, our ability to better absorb uncertainties in future profits, and the cumulative effect of changes in the macro-economic environment surrounding the IT security industry, which ultimately resulted in increased demand for our solutions. We determined that the objective and verifiable positive evidence outweighed the negative evidence and recorded a $23.7 million tax benefit for the recognition of our U.S. federal and certain state deferred tax assets.

We recognize an income tax expense or benefit with respect to uncertain tax positions in our financial statements that we judge is more likely than not to be sustained solely on its technical merits in a tax audit, including resolution of any related appeals or litigation processes. To make this judgment, we must interpret complex and sometimes ambiguous tax laws, regulations and administrative practices. If an income tax position meets the more likely than not recognition threshold, then we must measure the amount of the tax benefit to be recognized by determining the largest amount of tax benefit that has a greater than a 50% likelihood of being realized upon effective settlement with a taxing authority that has full knowledge of all of the relevant facts. It is inherently difficult and subjective to estimate such amounts, as this requires us to determine the probability of various possible settlement outcomes. To determine if a tax position is effectively settled after a tax examination has been completed, we must also estimate the likelihood that another taxing authority could review the respective tax position. We must also determine when it is reasonably possible that the amount of unrecognized tax benefits will significantly increase or decrease in the 12 months after each fiscal year-end. These judgments are difficult because a taxing authority may change its behavior as a result of our disclosures in our financial statements. We must reevaluate our income tax positions on a quarterly basis to consider factors such as changes in facts or circumstances, changes in tax law, effectively settled issues under audit, the potential for interest and penalties, and new audit activity. Such a change in recognition or measurement would result in recognition of a tax benefit or an additional charge to the tax provision.

Stock-Based Compensation

We recognize the fair value of our employee stock options and restricted stock units over the requisite service period for those awards ultimately expected to vest. The fair value of each option is estimated on date of grant using the Black-Scholes option pricing model and the fair value of each restricted stock unit is based on the fair value of our stock on the date of grant. Forfeitures are estimated on the date of grant and revised if actual or expected forfeiture activity differs materially from original estimates.

Determining the appropriate fair value model and calculating the fair value of employee stock options requires the use of highly subjective assumptions, including the expected life of the stock option and stock price volatility. The assumptions used in calculating the fair value of employee stock options represent management's best estimates, but the estimates involve inherent uncertainties and the application of management's judgment. As a result, if factors change and we use different assumptions, our stock-based compensation expense could be materially different in the future.

We also record compensation representing the fair value of stock options granted to non-employees. Stock-based non-employee compensation is recognized over the vesting periods of the options. The value of options granted to non-employees is periodically remeasured as they vest over a performance period.

Fair Value Measurement

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 our financial instruments, including cash and 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.

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

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

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

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

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

Item 7A. Quantitative and Qualitative Disclosures about Market Risk

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

Foreign Currency Risk

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

Derivative financial instruments are utilized by the Company to reduce foreign currency exchange risks. We use foreign currency forward contracts to partially mitigate the impact of fluctuations in cash and accounts receivable balances denominated in Euros and British Pound. 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 $289.6 million in cash, cash equivalents and short-term and long-term investments at December 31, 2016. Cash and cash equivalents include cash held in banks, highly liquid money market funds, U.S. government agency securities, and commercial paper. Investments consist of fixed-income U.S. government agency securities, corporate bonds, asset-backed securities and commercial paper. We determine the appropriate balance sheet classification of our investments at the time of purchase and reevaluate such designation at each balance sheet date. We classify our investments as either short-term or long-term based on each instrument's underlying contractual maturity date.

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

Item 8. Financial Statements and Supplementary Data

Qualys, Inc.
INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

Table of Contents

Report of Independent Registered Public Accounting Firm

Board of Directors and Shareholders

Qualys, Inc.

We have audited the accompanying consolidated balance sheets of Qualys Inc. (a Delaware corporation) and subsidiaries (the "Company") as of December 31, 2016 and 2015, and the related consolidated statements of operations, comprehensive income, cash flows, and changes in shareholders' equity for each of the three years in the period ended December 31, 2016. Our audits of the basic consolidated financial statements included the financial statement schedule listed in the index appearing under Item 15(a)(1). These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Qualys Inc. and subsidiaries as of December 31, 2016 and 2015, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2016 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the related financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of December 31, 2016, based on criteria established in the 2013 *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated February 24, 2017 expressed unqualified opinion.

/s/ GRANT THORNTON LLP

San Francisco, CA

February 24, 2017

Report of Independent Registered Public Accounting Firm

Board of Directors and Shareholders
Qualys, Inc.

We have audited the internal control over financial reporting of Qualys, Inc. (a Delaware corporation) and subsidiaries (the "Company") as of December 31, 2016, based on criteria established in the 2013 *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control over Financial Reporting ("Management's Report"). Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2016, based on criteria established in the 2013 *Internal Control-Integrated Framework* issued by COSO.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements of the Company as of and for the year ended December 31, 2016, and our report dated February 24, 2017 expressed an unqualified opinion on those financial statements.

/s/ GRANT THORNTON LLP

San Francisco, California
February 24, 2017

Qualys, Inc.
CONSOLIDATED BALANCE SHEETS
(in thousands, except share and per share data)

	December 31, 2016	December 31, 2015
Assets		
Current assets:		
Cash and cash equivalents	$ 86,737	$ 91,698
Short-term investments	157,119	87,268
Accounts receivable, net of allowance of $702 and $769 at December 31, 2016 and 2015, respectively	47,024	42,325
Prepaid expenses and other current assets	9,808	7,945
Total current assets	300,688	229,236
Long-term investments	45,725	43,277
Property and equipment, net	39,401	31,329
Deferred tax assets, net	16,590	16,079
Intangible assets, net	987	1,360
Restricted cash	1,200	—
Goodwill	317	317
Other noncurrent assets	2,096	1,916
Total assets	$ 407,004	$ 323,514
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$ 2,051	$ 2,368
Accrued liabilities	13,317	11,786
Deferred revenues, current	114,964	98,025
Total current liabilities	130,332	112,179
Deferred revenues, noncurrent	15,528	14,564
Other noncurrent liabilities	2,731	1,205
Total liabilities	148,591	127,948
Commitments and contingencies (Note 5)		
Stockholders' equity:		
Preferred stock: $0.001 par value; 20,000,000 shares authorized, no shares issued and outstanding at December 31, 2016 and 2015	—	—
Common stock, $0.001 par value; 1,000,000,000 shares authorized, 35,841,001 and 34,414,631 shares issued and outstanding at December 31, 2016 and 2015, respectively	36	34
Additional paid-in capital	266,794	223,228
Accumulated other comprehensive loss	(156)	(211)
Accumulated deficit	(8,261)	(27,485)
Total stockholders' equity	258,413	195,566
Total liabilities and stockholders' equity	$ 407,004	$ 323,514

See accompanying Notes to Consolidated Financial Statements

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

	Year Ended December 31,		
	2016	2015	2014
Revenues	$ 197,925	$ 164,284	$ 133,579
Cost of revenues	42,473	33,885	28,963
Gross profit	155,452	130,399	104,616
Operating expenses:			
Research and development	35,267	29,451	26,320
Sales and marketing	57,970	49,569	48,049
General and administrative	32,108	26,573	21,000
Total operating expenses	125,345	105,593	95,369
Income from operations	30,107	24,806	9,247
Other income (expense), net:			
Interest expense	(26)	(6)	(9)
Interest income	1,320	570	452
Other expense, net	(972)	(850)	(1,077)
Total other income (expense), net	322	(286)	(634)
Income before income taxes	30,429	24,520	8,613
Provision for (benefit from) income taxes	11,205	8,655	(21,631)
Net income	$ 19,224	$ 15,865	$ 30,244
Net income per share:			
Basic	$ 0.55	$ 0.47	$ 0.92
Diluted	$ 0.50	$ 0.42	$ 0.81
Weighted average shares used in computing net income per share:			
Basic	35,247	34,050	32,979
Diluted	38,369	38,184	37,170

See accompanying Notes to Consolidated Financial Statements

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

	Year Ended December 31,		
	2016	2015	2014
Net income	$ 19,224	$ 15,865	$ 30,244
Available-for-sale investments:			
Change in net unrealized loss on investments, net of tax	(57)	(202)	—
Less: reclassification adjustment for net realized gain (loss) included in net income, net of tax	112	(19)	(28)
Net change	55	(221)	(28)
Other comprehensive income (loss), net	55	(221)	(28)
Comprehensive income	$ 19,279	$ 15,644	$ 30,216

See accompanying Notes to Consolidated Financial Statements

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

	Year Ended December 31,		
	2016	2015	2014
Cash flows from operating activities:			
Net income	$ 19,224	$ 15,865	$ 30,244
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization expense	16,994	14,360	11,897
Bad debt expense	199	851	470
Loss on disposal of property and equipment	55	5	324
Stock-based compensation	20,149	17,494	10,549
Amortization of premiums and accretion of discounts on investments	1,000	594	565
Excess tax benefits from stock-based compensation	(8,700)	(487)	(259)
Impairment of intangible assets	—	255	—
Deferred income taxes	(440)	6,564	(22,599)
Changes in operating assets and liabilities:			
Accounts receivable	(4,898)	(10,183)	(4,882)
Prepaid expenses and other assets	(2,107)	(1,011)	(3,456)
Restricted cash	(1,200)	—	—
Accounts payable	(1,220)	(3,293)	2,332
Accrued liabilities	9,696	3,339	1,622
Deferred revenues	17,903	21,378	14,817
Other noncurrent liabilities	1,455	229	(201)
Net cash provided by operating activities	68,110	65,960	41,423
Cash flows from investing activities:			
Purchases of investments	(222,953)	(146,707)	(157,660)
Sales and maturities of investments	149,708	105,509	157,339
Purchases of property and equipment	(23,245)	(20,051)	(13,914)
Capitalized software development costs	—	(99)	(98)
Net cash used in investing activities	(96,490)	(61,348)	(14,333)
Cash flows from financing activities:			
Proceeds from exercise of stock options	15,157	10,095	7,639
Excess tax benefits from stock-based compensation	8,700	487	259
Payments for taxes related to net share settlement of equity awards	(438)	—	—
Principal payments under capital lease obligations	—	—	(805)
Net cash provided by financing activities	23,419	10,582	7,093
Effect of exchange rate changes on cash and cash equivalents	—	—	(48)
Net (decrease) increase in cash and cash equivalents	(4,961)	15,194	34,135
Cash and cash equivalents at beginning of period	91,698	76,504	42,369
Cash and cash equivalents at end of period	$ 86,737	$ 91,698	$ 76,504
Supplemental disclosures of cash flow information			
Cash paid for interest expense	$ 27	$ 6	$ 9
Cash paid for income taxes, net of refunds	856	995	347
Non-cash investing and financing activities			
Purchases of property and equipment recorded in accounts payable and accrued liabilities	1,438	—	1,399
Vesting of early exercised common stock options	—	19	47

See accompanying Notes to Consolidated Financial Statements

Qualys, Inc.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(in thousands, except share data)

	Common Stock		Additional Paid-In Capital	Accumulated Other Comprehensive Income (Loss)	Accumulated Deficit	Total Stockholders' Equity
	Shares	Amount				
Balances at December 31, 2013	32,375,299	$ 32	$ 176,641	$ 38	$ (73,594)	$ 103,117
Net income	—	—	—	—	30,244	30,244
Change in unrealized loss on investments	—	—	—	(28)	—	(28)
Issuance of common stock upon exercise of stock options	1,216,710	2	7,637	—	—	7,639
Vesting of early exercised common stock options	—	—	47	—	—	47
Excess tax benefits from stock-based compensation	—	—	259	—	—	259
Repurchase of unvested early exercised stock options	(125)	—	—	—	—	—
Issuance of common stock in exchange for services	2,401	—	50	—	—	50
Stock-based compensation	—	—	10,499	—	—	10,499
Balances at December 31, 2014	33,594,285	34	195,133	10	(43,350)	151,827
Net income	—	—	—	—	15,865	15,865
Change in unrealized loss on investments	—	—	—	(221)	—	(221)
Issuance of common stock upon exercise of stock options	807,846	—	10,095	—	—	10,095
Issuance of common stock upon vesting of restricted stock units	12,500	—	—	—	—	—
Vesting of early exercised common stock options	—	—	19	—	—	19
Excess tax benefits from stock-based compensation	—	—	487	—	—	487
Stock-based compensation	—	—	17,494	—	—	17,494
Balances at December 31, 2015	34,414,631	34	223,228	(211)	(27,485)	195,566
Net income	—	—	—	—	19,224	19,224
Change in unrealized gain in investments	—	—	—	55	—	55
Issuance of common stock upon exercise of stock options	1,399,157	2	15,155	—	—	15,157
Issuance of common stock upon vesting of restricted stock units	25,213	—	—	—	—	—
Issuance of common stock in exchange for services	2,000	—	26	—	—	26
Excess tax benefits from stock-based compensation	—	—	8,700	—	—	8,700
Taxes from release of the restricted share units	—	—	(438)	—	—	(438)
Stock-based compensation	—	—	20,123	—	—	20,123
Balances at December 31, 2016	35,841,001	$ 36	$ 266,794	$ (156)	$ (8,261)	$ 258,413

See accompanying Notes to Consolidated Financial Statements

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-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 consolidated financial statements and footnotes have been prepared by the Company in accordance with accounting principles generally accepted in the United States (“U.S. GAAP”) as well as the instructions to Form 10-K and the rules and regulations of the U.S. Securities and Exchange Commission ("SEC"). In the opinion of management, the accompanying consolidated financial statements include all adjustments necessary for the fair presentation of the Company’s consolidated financial position, results of operations and cash flows for the periods presented. The accompanying 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 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 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 provision for income taxes. Actual results could differ from those estimates and such differences may be material to the accompanying 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. 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 once collection efforts are unsuccessful. As of December 31, 2016 and 2015, 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, highly liquid money market funds, commercial paper, and fixed-income U.S. government agency securities, 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, asset-backed securities 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 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.

Accounts Receivable

Accounts receivable are recorded at the invoiced amount and do not bear interest. The allowance for doubtful accounts represents the Company’s best estimate of the amount of probable credit losses and is determined based on a review of existing accounts receivable by aging category to identify significant customers or invoices with collectability issues. For those invoices not specifically reviewed, the reserve is calculated based on the age of the receivable.

Any change in the assumptions used in analyzing a specific account receivable may result in an additional provision for doubtful accounts being recognized in the period in which the change occurs. When the Company ultimately concludes that a receivable is uncollectible, the balance is written off against the allowance for doubtful accounts. Payments subsequently received on such receivables are credited back to the allowance for doubtful accounts.

Property and Equipment, net

Property and equipment are stated at cost less accumulated depreciation and amortization. Depreciation is computed using the straight-line method over the estimated useful lives of the assets, which range from three to five years. Leasehold improvements are amortized on a straight-line basis over the lesser of the estimated useful life of the asset or the lease term.

The Company purchases physical scanner appliances and other computer equipment that are provided to customers on a subscription basis. This equipment is recorded within property and equipment on the accompanying consolidated balance sheet, and the depreciation is recorded to cost of revenues over an estimated useful life of three years.

Upon retirement or disposal, the cost of assets and the related accumulated depreciation are removed from the accounts and any resulting gain or loss is reflected in the consolidated statements of operations. Repairs and maintenance that do not extend the life of an asset are expensed as incurred and major improvements are capitalized as property and equipment.

Impairment of Long-Lived Assets

The Company evaluates its long-lived assets, which consist of property and equipment, and intangible assets subject to amortization, for indicators of possible impairment when events or changes in circumstances indicate the carrying amount of an asset may not be recoverable. Impairment exists if the carrying amounts of such assets exceed the estimates of future undiscounted cash flows expected to be generated by such assets. Should an impairment exist, the impairment loss would be measured based on the excess carrying value of the asset over the asset’s estimated fair value. As of December 31, 2016, the Company has not written down any of its long-lived assets as a result of impairment.

Goodwill and Intangible Assets

Goodwill represents the excess of the purchase price over the fair value of the net tangible and identifiable intangible assets acquired in a business combination and is not subject to amortization. Goodwill and other intangible assets with indefinite lives are not amortized, but tested for impairment annually or if certain circumstances indicate a possible impairment may exist. These tests are performed at the reporting unit level. The Company's operations are organized as one reporting unit.

In testing for a potential impairment of goodwill, the Company first performs a qualitative assessment of its reporting unit to determine if it is more likely than not (a more than 50% likelihood) that the fair value of the reporting unit is less than its carrying amount. If the fair value is not considered to be less than the carrying amount, no further evaluation is necessary. The Company performed the annual qualitative assessment for the year ended December 31, 2016 and concluded there was no impairment of goodwill.

In testing for a potential impairment of intangible assets with indefinite lives that are not subject to amortization, the Company first performs a qualitative assessment to determine if it is more likely than not (a more than 50% likelihood) that the fair value of the indefinite-lived intangible assets is less than the carrying amount. If the fair value is not considered to be less than the carrying amount, no further evaluation is necessary. The Company performed the annual qualitative assessment in 2016 and concluded that as of December 31, 2016, there was no impairment of the indefinite-lived intangible assets.

If the qualitative assessment indicates there is more than a 50% likelihood that the fair value is less than the carrying amount of the reporting unit or the intangible asset, the Company would perform a two-step test. In the first step, the carrying value of the reporting unit or intangible asset is compared to its estimated fair value. If the estimated fair value is less than the carrying value, then potential impairment exists. In the second step, for goodwill, the Company calculates the amount of any impairment by determining the implied fair value of goodwill using a hypothetical purchase price allocation, similar to that which would be applied if it were an acquisition and the purchase price was equivalent to fair value as calculated in the first step. Impairment is equivalent to any excess of goodwill carrying value over its implied fair value. For indefinite-lived intangible assets, the Company performs the currently prescribed quantitative impairment test by comparing the fair value of the indefinite-lived intangible asset with its carrying value. In 2015, the Company determined there was an impairment of certain indefinite-lived intangible assets and recorded a write-off of $0.3 million, recorded in other expense, net.

Certain other intangible assets acquired are amortized over their estimated useful lives and tested for impairment if certain circumstances indicate an impairment may exist. The Company's intangible assets are comprised primarily of existing technology, patent license, and non-competition agreements and are amortized over periods ranging from three to fourteen years on a straight-line basis. As of December 31, 2016, the Company has not written down any of these intangible assets as a result of impairment.

Software Development Costs

The Company capitalizes qualifying software costs developed for internal use. These costs generally include internal costs, such as payroll and benefits of those employees directly associated with the development of the software, and other consulting expenses. Total capitalized development costs are $0.4 million and $0.4 million at December 31, 2016 and 2015, respectively, and the related accumulated amortization is $0.4 million and $0.3 million at December 31, 2016 and 2015.

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 in the 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 consolidated statements of operations in the period in which the exchange rates change and offset the foreign currency gains and losses on the underlying exposure being hedged. The Company does not enter into derivative financial instruments for trading or speculative purposes.

At December 31, 2016, the Company had two outstanding forward contracts with notional amounts of 7.6 million Euros and 4.6 million British Pounds, respectively, both with the expiry date of February 2, 2017. At December 31, 2015, the Company had two outstanding forward contracts with notional amounts of 6.1 million Euros and 2.6 million British Pounds, which expired on January 31, 2016. These forward contracts were entered into as of December 30, 2016 and December 31, 2015, respectively, and had a fair value of $0 at both December 31, 2016 and 2015. These derivatives did not meet the criteria to be designated as hedges. These instruments were valued using Level 2 inputs.

The following summarizes the gains (losses) recognized from forward contracts and other foreign currency transactions:

	Year Ended December 31,		
	2016	2015	2014
Net gain from forward contracts	$ 554	$ 608	$ 727
Other foreign currency transaction losses	(1,324)	(1,051)	(1,391)
Total foreign exchange loss, net	$ (770)	$ (444)	$ (664)

Stock-Based Compensation

The Company recognizes the fair value of its employee stock options and restricted stock units (RSUs) over the requisite service period for those awards ultimately expected to vest. The fair value of each option is estimated on date of grant using the Black-Scholes option pricing model and the fair value of each restricted stock unit is based on the fair value of the Company's stock on the date of grant. Forfeitures are estimated on the date of grant and revised if actual or expected forfeiture activity differs materially from original estimates.

Option grants to non-employees are accounted for at the fair value of the equity instrument issued, as calculated using the Black-Scholes option-pricing model and the expense 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.

Revenue Recognition

The Company derives revenues from subscriptions that require customers to pay a fee in order to access the Company’s cloud solutions. 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. The Company’s 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 the Company’s solutions. In some limited cases, the Company also provides certain computer equipment used to extend its Qualys Cloud Platform into its customers’ private cloud environment. Customers are required to return physical scanner appliances and computer equipment if they do not renew their subscriptions.

The Company recognizes revenues when all of the following conditions are met:

- There is persuasive evidence of an arrangement.
- The service has been provided to the customer.
- The collection of the fees is reasonably assured.
- The amount of fees to be paid by the customer is fixed or determinable.

Subscriptions are recognized ratably over the subscription period. The Company recognizes revenues from subscriptions that include physical scanner appliances and other computer equipment ratably over the period of the subscription.

We recognize revenues for certain limited scan arrangements, for which expiration dates can be extended, on an as-used basis.

Deferred revenues consist of revenues billed or received that will be recognized in the future under subscriptions existing at the balance sheet date. The current portion of deferred revenues represents amounts that are expected to be recognized within one year of the balance sheet date.

Costs of shipping and handling charges incurred by the Company associated with physical scanner appliances and other computer equipment are included in cost of revenues.

Sales taxes and other taxes collected from customers to be remitted to government authorities are excluded from revenues.

Advertising Expenses

Advertising costs are expensed as incurred and include costs of advertising, trade show costs and promotional materials. The Company incurred advertising costs of $7.7 million, $6.1 million and $5.3 million for 2016, 2015 and 2014, respectively.

Income Taxes

The Company provides for the effect of income taxes in its consolidated financial statements using the asset and liability method which requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the consolidated financial statements. Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases, net operating loss carryovers, and tax credit carry forwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the period that includes the enactment date.

Income tax expense or benefit is recognized for the amount of taxes payable or refundable for the current year, and for deferred tax assets and liabilities for the tax consequences of events that have been recognized in an entity’s financial statements or tax returns. The Company must make significant assumptions, judgments and estimates to determine its current provision (benefit) for income taxes, its deferred tax assets and liabilities, and any valuation allowance to be recorded against its deferred tax assets. The Company's judgments, assumptions and estimates relating to the current provision (benefit) for income taxes include the geographic mix and amount of income (loss), its interpretation of current tax laws, and possible outcomes of current and future audits conducted by foreign and domestic tax authorities. The Company's judgments also include anticipating the tax positions the Company will record in the consolidated financial statements before actually preparing and filing the tax returns. The Company's estimates and assumptions may differ from the actual results as reflected in its income tax returns and the Company records the required adjustments when they are identified or resolved. Changes in the Company's business, tax laws or the Company's interpretation of tax laws, and developments in current and future tax audits, could significantly impact the amounts provided for income taxes in the Company's results of operations, financial position, or cash flows.

Deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to tax benefit carry-forwards and to differences between the financial statement amounts of assets and liabilities and their respective tax basis. The Company regularly reviews its deferred tax assets for recoverability and establishes a valuation allowance if it is more likely than not that some portion or all of the deferred tax assets will not be realized. To make this assessment, the Company takes into account predictions of the amount and category of taxable income from various sources and all available positive and negative evidence about these possible sources of taxable income. The weight given to the potential effect of negative and positive evidence is commensurate with the extent to which the strength of the evidence can be objectively verified.

The Company applies a two-step approach to determining the financial statement recognition and measurement of uncertain tax positions. The Company only recognizes an income tax expense or benefit with respect to uncertain tax positions in its financial statements that the Company judges is more likely than not to be sustained solely on its technical merits in a tax audit, including resolution of any related appeals or litigation processes. To make this judgment, the Company must interpret complex and sometimes ambiguous tax laws, regulations and administrative practices. If an income tax position meets the more likely than not recognition threshold, then the Company must measure the amount of the tax benefit to be recognized by determining the largest amount of tax benefit that has a greater than a 50% likelihood of being realized upon effective settlement with a taxing authority that has full knowledge of all of the relevant facts. It is inherently difficult and subjective to estimate such amounts, as this requires the Company to determine the probability of various possible settlement outcomes. To determine if a tax position is effectively settled after a tax examination has been completed, the Company must also estimate the likelihood that another taxing authority could review the respective tax position. The Company must also determine when it is reasonably possible that the amount of unrecognized tax benefits will significantly increase or decrease in the 12 months after each fiscal year-end. These judgments are difficult because a taxing authority may change its behavior as a result of the Company's disclosures in its financial statements. The Company must reevaluate its income tax positions on a quarterly basis to consider factors such as changes in facts or circumstances, changes in tax law, effectively settled issues under audit, and new audit activity. Such a change in recognition or measurement would result in recognition of a tax benefit or an additional charge to the tax provision. The Company's policy is to recognize interest and penalties related to unrecognized tax benefits as a component of the provision for income taxes.

Comprehensive Income (Loss)

Other comprehensive income (loss) consists of unrealized gains (losses) on available-for-sale investments, net of tax, which are not included in the Company’s net income. Total comprehensive income includes net income and other comprehensive income (loss) and is included in the consolidated statements of comprehensive income.

Foreign Currency Transactions

The Company’s operations are conducted in various countries around the world and the financial statements of its foreign subsidiaries are reported in the U.S. dollar as their respective functional currency. Monetary assets and liabilities denominated in foreign currencies have been remeasured into U.S. dollars using the exchange rates in effect at the balance sheet date, and income and expenses are remeasured at average exchange rates during the period. Foreign currency remeasurement gains and losses and foreign currency transaction gains and losses are recognized in other income (expense), net. The Company recorded total foreign currency transaction losses of $0.8 million, $0.4 million and $0.7 million during 2016, 2015 and 2014, respectively.

Fair Value Measurements

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

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

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

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

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

Net Income Per Share

Basic net income per share is computed by dividing net income by the weighted-average number of common shares outstanding during the period. All participating securities are excluded from basic weighted average common shares outstanding. In computing diluted net income per share, undistributed earnings are reallocated to reflect the potential impact of dilutive securities. Diluted net income per share is computed by dividing net income by the weighted-average number of shares of common stock outstanding during the period, adjusted for the effects of potentially dilutive common shares, which are comprised of outstanding stock options. The dilutive potential common shares are computed using the treasury stock method or the as-if converted method, as applicable. The effects of outstanding stock options are excluded from the computation of diluted net income per common share in periods in which the effect would be antidilutive.

Recent Accounting Pronouncements

Revenue from Contracts with Customers

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, *Revenue from Contracts with Customers (*ASU 2014-09), as amended, which will supersede nearly all existing revenue recognition guidance. Under ASU 2014-09, an entity is required to recognize revenue upon transfer of promised goods or services to customers in an amount that reflects the expected consideration received in exchange for those goods or services. ASU 2014-09 defines a five-step process in order to achieve this core principle, which may require the use of judgment and estimates, and also requires expanded qualitative and quantitative disclosures relating to the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers, including significant judgments and estimates used.

The FASB has recently issued several amendments to the new standard, including clarification on accounting for licenses of intellectual property and identifying performance obligations. The amendments include ASU 2016-08, *Revenue from Contracts with Customers (Topic 606)-Principal versus Agent Considerations*, which was issued in March 2016, and clarifies the implementation guidance for principal versus agent considerations in ASU 2014-09, and ASU 2016-10, *Revenue from Contracts with Customers (Topic 606)-Identifying Performance Obligations and Licensing*, which was issued in April 2016, and amends the guidance in ASU 2014-09 related to identifying performance obligations and accounting for licenses of intellectual property. The new standard permits adoption either by using (i) a full retrospective approach for all periods presented in the period of adoption or (ii) a modified retrospective approach with the cumulative effect of initially applying the new standard recognized at the date of initial application and providing certain additional disclosures. The new standard is effective for annual reporting periods beginning after December 15, 2017, with early adoption permitted for annual reporting periods beginning after December 15, 2016. The Company will adopt the new standard effective January 1, 2018.

The Company currently plans to adopt using the modified retrospective approach. However, a final decision regarding the adoption method has not been finalized at this time.

While the Company's assessment is ongoing, it currently believes that the most significant impacts are related to the potential deferral of sales commissions and contract costs and the accounting for financing components of certain long term contracts.

In January 2016, the FASB issued ASU 2016-01, *Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*, which will impact certain aspects of recognition, measurement, presentation and disclosure of financial instruments. The guidance will impact the accounting for equity investments, financial liabilities under the fair value option, and the presentation and disclosure requirements for financial instruments. This guidance is effective for public business entities in fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017. The Company is currently evaluating the impact this ASU will have on its consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842),* which requires, among other things, lease assets and lease liabilities arising from leases, including operating leases, to be recognized on the balance sheet. In addition, this ASU requires disclosing key information about leasing arrangements. This guidance supersedes existing lease guidance and is effective for public business entities in fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. Pursuant to the leasing criteria, most of our leased space and equipment leases will be capitalized assets on the balance sheet with an offsetting financing obligation. In the statement of operations, what was formerly rent expense will be bifurcated into depreciation and interest expense.

In March 2016, the FASB issued ASU 2016-09, *Compensation – Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting*, intended to simplify and improve various aspects related to how employee-share based payment transactions are accounted for and presented in the financial statements. The ASU addresses income tax consequences, classification of awards as either equity or liabilities, classification on the statement of cash flows and forfeiture rate calculations. This guidance is effective for public business entities in fiscal years, and interim periods within those fiscal years, beginning after December 15, 2016. The Company will adopt this guidance in its first quarter of 2017. Currently, excess tax benefits or deficiencies from the Company's equity awards are recorded as additional paid-in capital in its consolidated balance sheets. Upon adoption, the Company will record any excess tax benefits or deficiencies from its equity awards in its consolidated statements of operations in the reporting periods in which vesting or exercise occurs. As a result, subsequent to adoption, the Company's income tax expense and associated effective tax rate will be impacted by fluctuations in stock price between the grant dates and vesting or exercise dates of equity awards. Additionally, this guidance must be adopted using a modified retrospective transition method. As a result, upon adoption, the Company anticipates recording an increase of approximately $8.5 million in deferred tax assets with a corresponding reduction in retained earnings on its consolidated balance sheets.

In August 2016, the FASB issued ASU 2016-15, *Classification of Certain Cash Receipts and Cash Payments (a consensus of the Emerging Issues Task Force)*, to provide guidance on the presentation of certain cash receipts and cash payments in the statement of cash flows in order to reduce diversity in existing practice. The amendments in this ASU are effective for public business entities for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. Early adoption is permitted, including adoption in an interim period. The Company is currently evaluating the impact of the adoption of this update on its consolidated financial statements.

In November 2016, the FASB issued ASU 2016-18, *Statement of Cash Flows (Topic 230): Restricted Cash*, which requires the statement of cash flows to explain the change during the period in the total of cash, cash equivalents and restricted cash or restricted cash equivalents. Therefore, amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. This guidance is effective for public business entities in fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017. Early adoption is permitted. The Company is currently evaluating the impact this ASU will have on its consolidated financial statements.

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

NOTE 2. Fair Value of Financial Instruments

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

	December 31, 2016			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
	(in thousands)			
Cash and cash equivalents:				
Cash	$ 72,673	$ —	$ —	$ 72,673
Money market funds	473	—	—	473
Commercial paper	13,591	—	—	13,591
Total	86,737	—	—	86,737
Short-term investments:				
Commercial paper	14,782	5	—	14,787
Corporate bonds	13,490	—	(11)	13,479
Asset-backed securities	1,235	—	—	1,235
U.S. government agencies	127,660	—	(42)	127,618
Total	157,167	5	(53)	157,119
Long-term investments:				
Asset-backed securities	5,091	2	—	5,093
U.S. government agencies	29,501	—	(71)	29,430
Corporate bonds	11,243	—	(41)	11,202
Total	45,835	2	(112)	45,725
Total	$ 289,739	$ 7	$ (165)	$ 289,581

	December 31, 2015			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
	(in thousands)			
Cash and cash equivalents:				
Cash	$ 61,372	$ —	$ —	$ 61,372
Money market funds	3,980	—	—	3,980
U.S. government agencies	8,999	1	—	9,000
Commercial paper	17,345	1	—	17,346
Total	91,696	2	—	91,698
Short-term investments:				
Commercial paper	10,447	1	—	10,448
Corporate bonds	12,448	—	(13)	12,435
U.S. government agencies	64,422	3	(40)	64,385
Total	87,317	4	(53)	87,268
Long-term investments:				
Asset-backed securities	7,007	—	(18)	6,989
U.S. government agencies	32,683	—	(142)	32,541
Corporate bonds	3,751	—	(4)	3,747
Total	43,441	—	(164)	43,277
Total	$ 222,454	$ 6	$ (217)	$ 222,243

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

	December 31, 2016			
	Level 1	Level 2	Level 3	Fair Value
	(in thousands)			
Commercial paper	$ —	$ 28,378	$ —	$ 28,378
U.S. government agencies	—	157,048	—	157,048
Corporate bonds	—	24,681	—	24,681
Asset-backed securities	—	6,328	—	6,328
Total	$ —	$ 216,435	$ —	$ 216,435

	December 31, 2015			
	Level 1	Level 2	Level 3	Fair Value
	(in thousands)			
Commercial paper	$ —	$ 27,794	$ —	$ 27,794
U.S. government agencies	—	105,926	—	105,926
Corporate bonds	—	16,182	—	16,182
Asset-backed securities	—	6,989	—	6,989
Total	$ —	$ 156,891	$ —	$ 156,891

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

	December 31, 2016			
	Mature within One Year	After One Year through Two Years	Over Two Years	Fair Value
	(in thousands)			
Commercial paper	$ 28,378	$ —	$ —	$ 28,378
U.S. government agencies	127,619	29,430	—	157,049
Corporate bonds	15,149	9,532	—	24,681
Asset-backed securities	6,327	—	—	6,327
Total	$ 177,473	$ 38,962	$ —	$ 216,435

	December 31, 2015			
	Mature within One Year	After One Year through Two Years	Over Two Years	Fair Value
	(in thousands)			
Commercial paper	$ 27,794	$ —	$ —	$ 27,794
U.S. government agencies	73,385	32,541	—	105,926
Corporate bonds	12,435	3,747	—	16,182
Asset-backed securities	—	3,411	3,578	6,989
Total	$ 113,614	$ 39,699	$ 3,578	$ 156,891

At December 31, 2016 and 2015, derivative financial instruments, consisting of foreign currency forward contracts, were valued at $0 as the contracts were entered into on the last day of the respective reporting periods. 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 consists of the following:

	December 31, 2016	December 31, 2015
	(in thousands)	
Computer equipment	$ 57,295	$ 48,192
Computer software	19,716	12,484
Furniture, fixtures and equipment	3,425	2,804
Scanner appliances	14,776	22,627
Leasehold improvements	3,694	3,367
Total property and equipment	98,906	89,474
Less: accumulated depreciation and amortization	(59,505)	(58,145)
Property and equipment, net	$ 39,401	$ 31,329

Physical scanner appliances and other computer equipment that are or will be subject to subscriptions by customers have a net carrying value of $8.3 million and $8.4 million at December 31, 2016 and 2015, respectively, including assets that have not been placed in service of $1.3 million and $1.4 million, respectively. Other fixed assets not placed in service at December 31, 2016 and 2015, included in computer equipment and leasehold improvements, were $3.6 million and $4.3 million, respectively. Depreciation and amortization expense relating to property and equipment was $16.6 million, $13.9 million and $11.5 million for 2016, 2015 and 2014, respectively.

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):

			December 31,			
			2016		2015	
	Estimated Lives	Cost	Accumulated Amortization	Net Book Value	Accumulated Amortization	Net Book Value
Existing technology	7 years	$ 1,910	$ (1,728)	$ 182	$ (1,456)	$ 454
Patent license	14 years	1,388	(623)	765	(522)	866
Non-competition agreements and other	3 years	171	(171)	—	(171)	—
Total intangibles subject to amortization		$ 3,469	$ (2,522)	947	$ (2,149)	1,320
Intangible assets not subject to amortization				40		40
Total intangible assets, net				$ 987		$ 1,360

Intangibles amortization expense for each of 2016, 2015 and 2014 was $0.4 million. In 2015, the Company wrote off $0.3 million related to the impairment of certain intangible assets that were not subject to amortization.

As of December 31, 2016, the Company expects amortization expense in future periods to be as follows (in thousands):

2017	$ 282
2018	100
2019	100
2020	100
2021	100
2022 and thereafter	265
Total expected future amortization expense	$ 947

Goodwill, which is not subject to amortization, totaled $0.3 million as of December 31, 2016 and 2015.

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 2028.

The following are the minimum annual lease payments due under operating leases at December 31, 2016 (in thousands):

2017	$	7,128
2018		5,371
2019		4,048
2020		3,846
2021		3,525
Thereafter		17,479
Total minimum lease payments	$	41,397

Rent expense was $7.1 million, $6.6 million and $6.2 million for 2016, 2015 and 2014, 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 December 31, 2016 and 2015, the Company has accrued $0.4 million and $0.5 million of deferred rent related to these agreements, which is reflected in accrued liabilities and other noncurrent liabilities in the accompanying consolidated balance sheets.

On October 14, 2016, the Company entered into a lease agreement (included in the table above) for its new headquarter office facility. The lease commences May 1, 2018 and has a ten-year term through April 2028. The total commitment of $38.6 million is payable monthly with escalating rental payments throughout the lease term. The Company will be provided access to the facility in the first half of fiscal 2017 to begin construction of certain leasehold improvements.

In connection with this lease, the Company has provided the landlord with a $1.2 million standby letter of credit to secure the Company’s obligations through the end of the lease term.

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 December 31, 2016, the Company has not recorded any material liabilities for contingencies.

NOTE 6. Stockholders' Equity and Stock-based Compensation

Common Stock

The Company had reserved shares of common stock for future issuance as of December 31, 2016 as follows:

Options and RSUs outstanding under equity incentive plans	
2000 Equity Incentive Plan	2,718,517
2012 Equity Incentive Plan	5,396,496
Shares available for future grants under an equity incentive plan	
2012 Equity Incentive Plan	1,425,230
Total shares reserved for future issuance	9,540,243

Preferred Stock

Effective October 3, 2012, the Company is authorized to issue 20,000,000 shares of undesignated preferred stock with a par value of $0.001 per share. Each series of preferred stock will have such rights and preferences including dividend rights, dividend rate, conversion rights, voting rights, rights and terms of redemption (including sinking fund provisions), redemption price, and liquidation preferences as determined by the Board. As of December 31, 2016 and 2015, there are no issued or outstanding shares of preferred stock.

Stock Options

2012 Equity Incentive Plan

The 2012 Equity Incentive Plan (the 2012 Plan) was adopted and approved in September 2012 and became effective on September 26, 2012. Under the 2012 Plan, the Company is authorized to grant to eligible participant's 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 8,069,184 shares of common stock as of December 31, 2016. The number of shares of common stock available for issuance under the 2012 Plan includes an annual increase on January 1 of each year by an amount equal to the least of 3,050,000 shares; 5% of the outstanding shares of stock as of the last day of the immediately preceding fiscal year; or an amount determined by the board of directors. 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. Options granted generally vest over a period of up to four years, with a maximum term of ten years. ISOs may only be granted to employees and any subsidiary corporations' employees. All other awards may be granted to employees, directors and consultants and subsidiary corporations' employees and consultants. Options, SARs, RSAs, RSUs, performance units and performance awards may be granted with vesting terms as determined by the board of directors and expire no more than ten years after the date of grant or earlier if employment or service is terminated. As of December 31, 2016, 1,425,230 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 ISOs were granted at a price per share not less than the fair market value at the date of grant. The NSOs were granted at a price per share not less than 85% of the fair market value at the date of grant. Options granted generally vest over a period of up to four years, with a maximum term of ten years. The 2000 Plan was terminated in connection with the closing of the IPO, and accordingly, no shares are currently available for issuance under the 2000 Plan. The 2000 Plan continues to govern outstanding awards granted thereunder.

Options granted under the 2000 Plan were immediately exercisable, and unvested shares are subject to repurchase by the Company. Upon termination of employment of an option holder, the Company has the right to repurchase at the original purchase price any issued but unvested common shares. The amounts paid for shares purchased under an early exercise of stock options and subject to repurchase by the Company are not reported as a component of stockholders' equity (deficit) until those shares vest. The amounts received in exchange for these shares are recorded as an accrued liability in the accompanying consolidated balance sheets and will be reclassified to common stock and additional paid-in capital as the shares vest.

Stock-based Compensation

Stock-based compensation included in the consolidated statements of operations is as follows:

	Year Ended December 31,		
	2016	2015	2014
	(in thousands)		
Cost of revenues	$ 1,858	$ 1,250	$ 757
Research and development	5,678	4,936	2,470
Sales and marketing	4,870	3,867	2,407
General and administrative	7,743	7,441	4,915
Total stock-based employee compensation	$ 20,149	$ 17,494	$ 10,549

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 December 31, 2016, the Company had $23.2 million of total unrecognized employee compensation cost related to unvested awards that it expects to recognize over a weighted-average period of 2.8 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:

	Year Ended December 31,		
	2016	2015	2014
Expected term (in years)	5.0 to 5.9	4.9 to 5.9	5.3 to 5.9
Volatility	45% to 49%	45% to 48%	48% to 52%
Risk-free interest rate	1.1% to 1.3%	1.3% to 1.7%	1.5% to 1.7%
Dividend yield	—	—	—

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 a combination of the historical volatility of the Company and of several public entities that are similar to the Company. The Company bases volatility on this combination because it does not have sufficient historical transactions in its own shares on which to solely base expected volatility. The Company has not historically declared 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 $0.7 million, $0.6 million and $0.7 million for 2016, 2015 and 2014, respectively. 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	2,744,150	$ 26.16		
Exercised	(1,216,710)	$ 6.28		
Canceled	(961,126)	$ 16.91		
Balance as of December 31, 2014	7,605,407	$ 12.93	6.5	$ 188,743
Granted	1,526,450	$ 39.50		
Exercised	(807,846)	$ 12.50		
Canceled	(744,953)	$ 27.67		
Balance as of December 31, 2015	7,579,058	$ 16.88	5.9	$ 131,345
Granted	2,120,633	$ 26.64		
Exercised	(1,399,157)	$ 10.83		
Canceled	(772,854)	$ 31.57		
Balance as of December 31, 2016	7,527,680	$ 19.25	6.0	$ 101,717
Vested and expected to vest—December 31, 2016	7,008,375	$ 18.43	5.7	$ 99,875
Exercisable—December 31, 2016	5,137,869	$ 14.49	4.6	$ 91,928

The following table summarizes the outstanding and vested stock options at December 31, 2016:

	Outstanding			Exercisable	
Exercise Price	Number of Shares	Weighted Average Exercise Price Per Share	Weighted Average Remaining Contractual Life (Years)	Number of Shares	Weighted Average Exercise Price Per Share
$1.90 - $1.90	938,282	$ 1.90	0.07	938,282	$ 1.90
$2.10 - $2.80	161,970	$ 2.73	2.21	161,970	$ 2.73
$3.80 - $3.80	1,057,235	$ 3.80	2.92	1,057,235	$ 3.80
$4.10 - $12.68	841,480	$ 8.50	4.87	835,654	$ 8.49
$13.50 - $25.17	1,126,929	$ 22.19	7.74	592,323	$ 20.13
$25.56 - $25.56	1,064,551	$ 25.56	9.28	146,263	$ 25.56
$26.86 - $30.58	1,065,841	$ 28.78	7.37	968,961	$ 28.74
$31.67 - $37.28	905,161	$ 35.41	8.88	220,324	$ 36.55
$40.68 - $40.89	225,661	$ 40.82	7.55	154,011	$ 40.79
$52.14 - $52.14	140,570	$ 52.14	7.46	62,846	$ 52.14
	7,527,680	$ 19.25	5.96	5,137,869	$ 14.49

The weighted-average grant date fair value of the Company's stock options granted during 2016, 2015 and 2014 was $11.12, $16.51 and $12.07, respectively. The aggregate grant date fair value of the Company's stock options granted during 2016, 2015 and 2014 was $23.6 million, $25.2 million and $33.1 million, respectively.

The intrinsic value of options exercised was $25.0 million, $22.7 million and $25.7 million during 2016, 2015 and 2014, respectively. Intrinsic value of an option is the difference between the fair value of the Company's common stock at the time of exercise and the exercise price paid.

Restricted Stock

The terms and conditions of RSUs and RSAs, including vesting criteria and timing are set by the board of directors. The cost of RSUs and 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.

A summary of the Company's RSUs and RSAs activity is as follows:

	Number of Shares		Weighted-Average Grant Date Fair Value Per Share
Balance as of December 31, 2014	—	$	—
Granted	60,000	$	37.28
Vested	(12,500)	$	37.28
Cancelled	—	$	—
Balance as of December 31, 2015	47,500	$	37.28
Granted	681,350	$	28.52
Vested	(39,998)	$	27.49
Cancelled	(101,519)	$	31.12
Balance as of December 31, 2016	587,333	$	28.85
Expected to vest as of December 31, 2016	409,789	$	28.81

As of December 31, 2016, the Company had $10.6 million of unrecognized compensation cost related to unvested awards that it expects to recognize over a weighted-average period of 3.2 years.

401(k) Plan

The Company's 401(k) Plan (the "401(k) Plan") was established in 2000 to provide retirement and incidental benefits for its employees. As allowed under section 401(k) of the Internal Revenue Code, the 401(k) Plan provides tax-deferred salary deductions for eligible employees. Contributions to the 401(k) Plan are limited to a maximum amount as set periodically by the Internal Revenue Service. As of December 31, 2016 and 2015, the Company has made contributions to the 401(k) Plan of $0.6 million and $0 million, respectively.

NOTE 7. Other Income (Expense), Net

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

	Year Ended December 31,					
	2016		2015		2014	
	(in thousands)					
Foreign exchange losses	$	(770)	$	(444)	$	(664)
Other expense		(202)		(406)		(413)
Other expense, net	$	(972)	$	(850)	$	(1,077)

NOTE 8. Income Taxes

The Company's geographical breakdown of income before income taxes is as follows:

	Year Ended December 31,		
	2016	2015	2014
	(in thousands)		
Domestic	$ 28,982	$ 22,540	$ 7,384
Foreign	1,447	1,980	1,229
Income before income taxes	$ 30,429	$ 24,520	$ 8,613

The provision for (benefit from) income taxes consists of the following:

	Year Ended December 31,		
	2016	2015	2014
	(in thousands)		
Current			
Federal	$ 8,334	$ 115	$ —
State	1,125	1,041	317
Foreign	963	693	651
Total current provision	10,422	1,849	968
Deferred			
Federal	611	7,115	(22,184)
State	126	(247)	(433)
Foreign	46	(62)	18
Total deferred provision (benefit)	783	6,806	(22,599)
Total provision for (benefit from) income taxes	$ 11,205	$ 8,655	$ (21,631)

The reconciliation of the statutory federal income tax rate to the Company's effective tax rate is as follows:

	Year Ended December 31,		
	2016	2015	2014
Federal statutory rate	35.0%	35.0%	35.0%
State taxes	2.1	2.2	1.4
Stock-based compensation	2.4	0.5	1.3
Foreign source income	0.9	0.6	3.9
Change in valuation allowance	1.3	1.3	(270.5)
Incremental federal rate benefit previously not recognized	—	—	(7.0)
Federal and state research and development credit	(3.6)	(3.9)	(11.3)
Other	(1.3)	(0.4)	(3.9)
Provision for (benefit from) income taxes	36.8 %	35.3 %	(251.1)%

Deferred income taxes reflect the tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. The components of the Company’s deferred tax assets and liabilities are as follows:

	December 31,	
	2016	2015
	(in thousands)	
Deferred tax assets		
Net operating loss carryforwards	$ 1,472	$ 1,936
Research and development credit carryforwards	3,334	6,508
Accrued liabilities	681	614
Deferred revenues	5,018	3,838
Deferred rent	74	142
Intangible assets	409	246
Stock-based compensation	12,513	8,301
Other	1,225	1,396
Gross deferred tax assets	24,726	22,981
Valuation allowance	(3,688)	(3,303)
Net deferred tax assets	21,038	19,678
Deferred tax liabilities		
Fixed assets	(4,448)	(3,599)
Intangible assets	—	—
Total deferred tax liabilities	(4,448)	(3,599)
Net deferred tax assets	$ 16,590	$ 16,079

Realization of deferred tax assets is dependent upon future earnings, if any, and the timing and amount of such assets are uncertain. Prior to the fourth quarter of 2014, the Company had provided a valuation allowance for its U.S. federal and state deferred tax assets that it believed were not more likely than not realizable. Management determined that the objective and verifiable negative evidence, such as relatively low U.S. operating income and uncertainty of sustaining or growing future operating profits, continued to outweigh positive evidence that would be necessary to reduce the valuation allowance.

In the fourth quarter of 2014, the Company recorded a $23.7 million tax benefit for the recognition of its U.S. federal and certain state deferred tax assets, primarily due to the increased and expected sustainable profitability in its U.S. operations. In reaching this conclusion, management considered the Company's increasing realized profitability in the fourth quarter of 2014, forecasted future profitability, its ability to better absorb uncertainties in future profits, and the cumulative effect of changes in the macro-economic environment surrounding the IT security industry, which ultimately resulted in increased demand for its solutions.

The Company believes it is more likely than not that its California deferred tax assets will not be realized because the income attributed to California is not expected to be sufficient to recognize these deferred tax assets. Accordingly, the Company continues to record the valuation allowance of $3.7 million as of December 31, 2016 for its California deferred tax assets. During the year ended December 31, 2016, the valuation allowance had increased by $0.4 million to $3.7 million.

At December 31, 2016, the Company had federal and state net operating loss carryforwards of approximately $31.5 million and $4.6 million respectively, available to reduce federal and state taxable income. The excess tax benefits included in net operating loss carryforwards but not reflected in deferred tax assets for federal is $29.0 million. The Company’s federal net operating losses expire in the years 2022 to 2034, and its state net operating losses expire from 2016 to 2033. Utilization of the Company’s net operating loss carryforwards may be subject to a substantial annual limitation due to the ownership change limitations provided by the Internal Revenue Code and similar state provisions. Such an annual limitation could result in the expiration of the net operating loss carryforwards before utilization. As of December 31, 2016, the Company had federal and state research and development credits of $7.0 million and $6.7 million, respectively. Federal research and development credits expire in the years 2022 to 2036. State research and development credits do not expire.

U.S. income taxes and foreign withholding taxes have not been provided on undistributed earnings for non-U.S. subsidiaries. The Company intends to continue to reinvest the earnings of these foreign subsidiaries indefinitely. The Company's share of undistributed earnings of foreign subsidiaries that could be subject to additional U.S. income tax if remitted was approximately $11.0 million and $8.7 million as of December 31, 2016 and 2015, respectively. Determination of the amount of unrecognized deferred tax liability for temporary differences related to investments in these non-U.S. subsidiaries that are essentially permanent in duration is not practicable. If the undistributed earnings are remitted to the U.S. these amounts would be taxable in the U.S. at the current federal and state tax rates net of foreign tax credits. Also, depending on the jurisdiction any distribution would potentially be subject to withholding taxes at rates applicable to that jurisdiction.

The evaluation of an unrecognized tax position is a two-step process. The first step requires the Company to determine whether it is more likely than not that a tax position will be sustained upon examination based on the technical merits of the position. The second step requires the Company to recognize in the financial statement each tax position that meets the more likely than not criteria, measured at the amount of benefit that has a greater than fifty percent likelihood of being realized.

A reconciliation of the Company's unrecognized tax benefits is as follows:

	Year Ended December 31,		
	2016	2015	2014
	(in thousands)		
Unrecognized tax benefits beginning balance	$ 3,506	$ 3,330	$ 3,255
Gross increase for tax positions of prior years	2	20	—
Gross decrease for tax positions of prior years	(15)	(171)	(127)
Gross increase for tax positions of current year	659	418	332
Lapse of statute of limitations	(81)	(91)	(130)
Total unrecognized tax benefits	$ 4,071	$ 3,506	$ 3,330

The unrecognized tax benefits, if recognized, would impact the income tax provision by $2.4 million, $2.1 million and $2.1 million as of December 31, 2016, 2015 and 2014, respectively.

The Company has elected to include interest and penalties as a component of income tax expense. The amounts were not material for 2016, 2015 and 2014.

The Company files income tax returns in the United States, including various state jurisdictions. The Company's subsidiaries file tax returns in various foreign jurisdictions. The tax years 2011 to 2016 remain open to examination by the major taxing jurisdictions in which the Company is subject to tax, with the exception of France which remains open to examination for the 2012 through 2015 tax years only. As of December 31, 2016, the Company was not under examination by the Internal Revenue Service or any state tax jurisdictions.

A retroactive and permanent reinstatement of the federal research and development tax credit was signed into law on December 18, 2015 in accordance with the Protecting Americans from Tax Hikes Act of 2015. The Company recorded a 2016 federal research and development credit of $0.7 million, net of reserves, in the fourth quarter of 2016. The California research and development credit estimated for 2016, net of reserves, is $0.6 million.

NOTE 9. 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:

	Year Ended December 31,		
	2016	2015	2014
	(in thousands)		
United States	$ 139,743	$ 115,384	$ 93,425
Foreign	58,182	48,900	40,154
Total revenues	$ 197,925	$ 164,284	$ 133,579

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

	December 31,	
	2016	2015
	(in thousands)	
United States	$ 30,733	$ 25,623
Foreign	8,668	5,706
Total property and equipment, net	$ 39,401	$ 31,329

NOTE 10. Net Income Per Share

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

	Year Ended December 31,		
	2016	2015	2014
	(in thousands, except per share data)		
Numerator:			
Net income - basic and diluted	$ 19,224	$ 15,865	$ 30,244
Denominator:			
Weighted-average shares used in computing net income per share - basic	35,247	34,050	32,979
Effect of potentially dilutive securities:			
Common stock options	3,052	4,134	4,191
RSUs	70	—	—
Weighted-average shares used in computing net income per share - diluted	38,369	38,184	37,170
Net income per share:			
Basic	$ 0.55	$ 0.47	$ 0.92
Diluted	$ 0.50	$ 0.42	$ 0.81

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

	Year Ended December 31,		
	2016	2015	2014
	(in thousands)		
Common stock options	3,241	1,582	1,689
RSUs	24	—	—

NOTE 11. Quarterly Financial Information (Unaudited)

The following table sets forth unaudited consolidated statements of operations data for each of the quarters in the two-year period ended December 31, 2016. The unaudited quarterly consolidated statements of operations data set forth below have been prepared on the same basis as the audited consolidated financial statements included elsewhere in this Annual Report on Form 10-K and, in the opinion of management, reflect all necessary adjustments, which consist only of normal recurring adjustments, necessary for a fair presentation of such data. Historical results are not necessarily indicative of the results for the full year or any other period. This data should be read together with the consolidated financial statements and the related notes included elsewhere in this Annual Report on Form 10-K.

	Three Months Ended							
	Mar. 31, 2015	Jun. 30, 2015	Sep. 30, 2015	Dec 31, 2015	Mar. 31, 2016	Jun. 30, 2016	Sep. 30, 2016	Dec 31, 2016
	(unaudited) (in thousands, except per share data)							
Revenues	$ 37,493	$ 39,877	$ 42,469	$ 44,445	$ 46,248	$ 48,466	$ 50,987	$ 52,224
Cost of revenues	7,964	8,157	8,762	9,002	9,416	10,092	11,288	11,677
Gross profit	29,529	31,720	33,707	35,443	36,832	38,374	39,699	40,547
Operating expenses:								
Research and development	7,150	7,205	7,564	7,532	7,834	9,143	9,405	8,885
Sales and marketing	11,443	12,776	12,282	13,068	13,933	14,451	14,240	15,346
General and administrative	6,016	6,427	6,983	7,147	7,468	9,068	8,067	7,505
Total operating expenses	24,609	26,408	26,829	27,747	29,235	32,662	31,712	31,736
Income from operations	4,920	5,312	6,878	7,696	7,597	5,712	7,987	8,811
Other income (expense), net	(77)	128	(154)	(183)	168	40	230	(116)
Income before income taxes	4,843	5,440	6,724	7,513	7,765	5,752	8,217	8,695
Provision for income taxes	1,841	2,124	2,601	2,089	2,982	2,214	3,221	2,788
Net income	$ 3,002	$ 3,316	$ 4,123	$ 5,424	$ 4,783	$ 3,538	$ 4,996	$ 5,907
Net income per share:								
Basic	$ 0.09	$ 0.10	$ 0.12	$ 0.16	$ 0.14	$ 0.10	$ 0.14	$ 0.17
Diluted	$ 0.08	$ 0.09	$ 0.11	$ 0.14	$ 0.13	$ 0.09	$ 0.13	$ 0.15

Item 9. Changes In and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Item 9A. 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 December 31, 2016. 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 December 31, 2016, 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.

Management's Annual Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Rules 13a-15(f) and 15d-15(f) of the Exchange Act. Our internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with U.S. generally accepted accounting principles, or GAAP. Our internal control over financial reporting includes those policies and procedures that: (i) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of our assets, (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with GAAP, and that our receipts and expenditures are being made only in accordance with authorizations of our management and directors, and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on our financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting as of December 31, 2016 based on the criteria established in the 2013 Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission, or COSO. Based on our evaluation under the criteria set forth in the 2013 Internal Control - Integrated Framework issued by the COSO, our management concluded our internal control over financial reporting was effective as of December 31, 2016.

The effectiveness of the Company's internal control over financial reporting as of December 31, 2016 has been audited by Grant Thornton LLP, an independent registered public accounting firm, as stated in its report, which is included in Item 8 of this Annual Report on Form 10-K.

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 fourth quarter ended December 31, 2016 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Item 9B. Other Information

None.

PART III

Item 10. Directors, Executive Officers and Corporate Governance

Executive Officers and Directors

Except as set forth below, the information required by this item is incorporated by reference to our Proxy Statement for our 2017 Annual Meeting of Stockholders to be filed with the SEC within 120 days after the end of the fiscal year ended December 31, 2016.

Codes of Business Conduct and Ethics

Our board of directors has adopted a code of business conduct and ethics that applies to all of our employees, officers and directors, including our Chief Executive Officer, Chief Financial Officer and other executive and senior financial officers. The code of business conduct and ethics is available on our website. We expect that, to the extent required by law, any amendments to the code, or any waivers of its requirements, will be disclosed on our website. We intend to disclose any waiver to the provisions of the code of business conduct and ethics that applies specifically to directors or executive officers by filing such information on a Current Report on Form 8-K with the SEC, to the extent such filing is required by the NASDAQ Stock Market's listing requirements; otherwise, we will disclose such waiver by posting such information on our website.

Item 11. Executive Compensation

The information required by this item is incorporated by reference to our Proxy Statement for our 2017 Annual Meeting of Stockholders to be filed with the SEC within 120 days after the end of the fiscal year ended December 31, 2016.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

Security Ownership of Certain Beneficial Owners and Management

The information required by this item with respect to Item 403 of Regulation S-K regarding security ownership of certain beneficial owners and management is incorporated by reference to our Proxy Statement for our 2017 Annual Meeting of Stockholders to be filed with the SEC within 120 days after the end of the fiscal year ended December 31, 2016. For the information required by this item with respect to Item 201(d) of Regulation S-K regarding securities authorized for issuance under equity compensation plans, see “Item 5: Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities—Securities Authorized for Issuance under Equity Compensation Plans.”

Item 13. Certain Relationships and Related Transactions, and Director Independence

The information required by this item is incorporated by reference to our Proxy Statement for our 2017 Annual Meeting of Stockholders to be filed with the SEC within 120 days after the end of the fiscal year ended December 31, 2016.

Item 14. Principal Accounting Fees and Services

The information required by this item is incorporated by reference to our Proxy Statement for our 2017 Annual Meeting of Stockholders to be filed with the SEC within 120 days after the end of the fiscal year ended December 31, 2016.

PART IV

Item 15. Exhibits and Financial Statement Schedules

(a)(1) Financial Statements - The financial statements filed as part of this Annual Report on Form 10-K are listed on the Index to Consolidated Financial Statements in Item 8.

(a)(2) Financial Statement Schedules

SCHEDULE II
SUPPLEMENTARY CONSOLIDATED FINANCIAL STATEMENT SCHEDULE
VALUATION AND QUALIFYING ACCOUNTS
(in thousands)

		Additions		
	Balance at Beginning of Year	Charged to Costs and Expenses	Deductions and Other [1]	Balance at End of Year
Allowance for Doubtful Accounts				
Year Ended December 31, 2016	$ 769	$ 199	$ (266)	$ 702
Year Ended December 31, 2015	$ 590	$ 851	$ (672)	$ 769
Year Ended December 31, 2014	$ 389	$ 470	$ (269)	$ 590

[1] Primarily represents write-offs of uncollectible accounts, net of recoveries.

All other schedules have been omitted because they are not required, not applicable, or the required information is otherwise included.

(b) Exhibits

The exhibits listed on the Exhibit Index (following the Signatures section of this report) are included, or incorporated by reference, in this Annual Report on Form 10-K.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this Annual Report on Form 10-K to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of Redwood City, State of California on February 24, 2017.

QUALYS, INC.

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

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities indicated:

Signature	Title	Date
/s/ PHILIPPE F. COURTOT Philippe F. Courtot	Chairman, President and Chief Executive Officer (principal executive officer)	February 24, 2017
/s/ MELISSA B. FISHER Melissa B. Fisher	Chief Financial Officer (principal financial and accounting officer)	February 24, 2017
/s/ SANDRA E. BERGERON Sandra E. Bergeron	Director	February 24, 2017
/s/ DONALD R. DIXON Donald R. Dixon	Director	February 24, 2017
/s/ JEFFREY P. HANK Jeffrey P. Hank	Director	February 24, 2017
/s/ TODD P. HEADLEY Todd P. Headley	Director	February 24, 2017
/s/ GENERAL PETER PACE General Peter Pace	Director	February 24, 2017
/s/ KRISTI M. ROGERS Kristi M. Rogers	Director	February 24, 2017
/s/ HOWARD A. SCHMIDT Howard A. Schmidt	Director	February 24, 2017

EXHIBIT INDEX

Exhibit Number	Description	Filed Herewith	Incorporated by Reference Form	File No.	Exhibit No.	Filing Date
3.1	Amended and Restated Certificate of Incorporation of Qualys, Inc.		S-1/A	333-182027	3.3	September 12, 2012
3.2	Amended and Restated Bylaws of Qualys, Inc.		S-1/A	333-182027	3.5	September 12, 2012
4.1	Form of common stock certificate.		S-1/A	333-182027	4.1	September 12, 2012
4.2	Amended and Restated Investor Rights Agreement, by and among Qualys, Inc. and the investors party thereto, dated July 12, 2005.		S-1	333-182027	4.2	June 8, 2012
10.1*	2000 Equity Incentive Plan, as amended, and the form of stock option agreement thereunder.		S-1	333-182027	10.1	June 8, 2012
10.2*	2012 Equity Incentive Plan and forms of agreements thereunder.		S-1/A	333-182027	10.2	September 12, 2012
10.3*	Offer Letter, between Qualys, Inc. and Philippe F. Courtot, dated December 7, 2000.		S-1	333-182027	10.3	June 8, 2012
10.4*	Offer Letter, between Qualys, Inc. and Amer S. Deeba, dated September 4, 2001.		S-1	333-182027	10.4	June 8, 2012
10.5*	Offer Letter, between Qualys, Inc. and Sumedh S. Thakar, dated January 20, 2003.		S-1	333-182027	10.5	June 8, 2012
10.6*	Offer Letter, between Qualys, Inc. and Melissa B. Fisher, dated April 15, 2016, as amended.		8-K	001-35662	10.1	May 2, 2016
10.7*	Offer Letter, between Qualys, Inc. and Bruce K. Posey, dated May 8, 2012.		S-1	333-182027	10.9	June 8, 2012
10.8*	Form of director and executive officer indemnification agreement.		S-1/A	333-182027	10.1	August 10, 2012
10.9	Lease Agreement, between Qualys, Inc. and Westport Office Park, LLC, dated July 11, 2006, as amended August 10, 2007, May 20, 2010 and December 5, 2011.		S-1	333-182027	10.11	June 8, 2012
10.10	Lease Agreement, between Qualys, Inc. and Hudson Metro Center, LLC, dated October 14, 2016.		8-K	001-35662	10.1	October 19, 2016
10.11*	2011 Corporate Bonus Plan.		S-1	333-182027	10.12	June 8, 2012
10.12*	2012 Corporate Bonus Plan.		S-1	333-182027	10.13	June 8, 2012
10.13*	Qualys, Inc. Executive Performance Bonus Plan.		Schedule 14A, Appendix A	001-35662	N/A	April 25, 2016
10.14*†	Qualys, Inc. 2016 Corporate Bonus Plan, as amended.		10-Q	135,662,000	10.3	August 4, 2016
10.15	Master Services Agreement, between Qualys, Inc. and Savvis Communications Corporation, dated June 22, 2010.		S-1/A	333-182027	10.14	September 12, 2012
10.16†	Master Agreement, between Qualys, Inc. and Interoute Communications Limited, dated March 31, 2008.		S-1/A	333-182027	10.15	September 12, 2012
10.17†	Manufacturing Services Agreement, between Qualys, Inc. and Synnex Corporation, dated March 1, 2011.		S-1/A	333-182027	10.16	September 12, 2012

21.1	List of subsidiaries of Qualys, Inc.	X
23.1	Consent of Grant Thornton LLP, independent registered public accounting firm.	X
31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of The Sarbanes-Oxley Act of 2002.	X
31.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of The Sarbanes-Oxley Act of 2002.	X
32.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(b) or Rule 15d-14(b) of the Securities Exchange Act of 1934 and 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of The Sarbanes-Oxley Act of 2002.	X
32.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(b) or Rule 15d-14(b) of the Securities Exchange Act of 1934 and 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of The Sarbanes-Oxley Act of 2002.	X
101.INS	XBRL Instance Document	X
101.SCH	XBRL Taxonomy Extension Schema Document	X
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document	X
101.DEF	XBRL Taxonomy Extension Definition Linkbase	X
101.LAB	XBRL Taxonomy Extension Labels Linkbase Document	X
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document	X

* Indicates a management contract or compensatory plan or arrangement.

† Portions of this exhibit have been omitted due to a determination by the Securities and Exchange Commission that these portions should be granted confidential treatment.

Exhibit 31.1

CERTIFICATION OF CHIEF EXECUTIVE OFFICER
PURSUANT TO RULE 13a-14(a) OR RULE 15d-14(a)
OF THE SECURITIES EXCHANGE ACT OF 1934

I, Philippe F. Courtot, certify that:

1. I have reviewed this annual report on Form 10-K of Qualys, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 24, 2017

By: /s/ PHILIPPE F. COURTOT

Philippe F. Courtot
Chairman, President and Chief Executive Officer
Qualys, Inc.

Exhibit 31.2

**CERTIFICATION OF CHIEF FINANCIAL OFFICER
PURSUANT TO RULE 13a-14(a) OR RULE 15d-14(a)
OF THE SECURITIES EXCHANGE ACT OF 1934**

I, Donald C. McCauley, certify that:

1. I have reviewed this annual report on Form 10-K of Qualys, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
    (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
    (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
    (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
    (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
    (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
    (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 24, 2017

By: /s/ MELISSA B. FISHER

Melissa B. Fisher
Chief Financial Officer
Qualys, Inc.

Exhibit 32.1

CERTIFICATION OF CHIEF EXECUTIVE OFFICER
PURSUANT TO RULE 13a-14(b) OR RULE 15d-14(b)
OF THE SECURITIES EXCHANGE ACT OF 1934 AND 18 U.S.C. SECTION 1350

In connection with the Annual Report of Qualys, Inc. (the “Company”) on Form 10-K for the year ended December 31, 2016, as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Philippe F. Courtot, Chairman, President and Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that, to the best of my knowledge:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: February 24, 2017

By: /s/ PHILIPPE F. COURTOT

Philippe F. Courtot
Chairman, President and Chief Executive Officer
Qualys, Inc.

Exhibit 32.2

CERTIFICATION OF CHIEF FINANCIAL OFFICER
PURSUANT TO RULE 13a-14(b) OR RULE 15d-14(b)
OF THE SECURITIES EXCHANGE ACT OF 1934 AND 18 U.S.C. SECTION 1350

In connection with the Annual Report of Qualys, Inc. (the "Company") on Form 10-K for the year ended December 31, 2016, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Melissa B. Fisher, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that, to the best of my knowledge:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: February 24, 2017

By: /s/ MELISSA B. FISHER

Melissa B. Fisher
Chief Financial Officer
Qualys, Inc.