VERISIGN INC/CA
Form 10-Q
April 26, 2018

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

FORM 10-Q

(Mark One)
x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2018
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: 000-23593
VERISIGN, INC.
(Exact name of registrant as specified in its charter)

Delaware	94-3221585
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
12061 Bluemont Way, Reston, Virginia	20190
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: (703) 948-3200
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 Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES x NO o
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company." in Rule 12b-2 of the Exchange Act. (Check one):

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. o
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act.): YES o NO x
Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:

Class	Shares Outstanding as of April 20, 2018
Common stock, $.001 par value	97,005,831

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PART I—FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

VERISIGN, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except par value)
(Unaudited)

	March 31, 2018	December 31, 2017
ASSETS		
Current assets:		
Cash and cash equivalents	$1,703,722	$465,851
Marketable securities	652,740	1,948,900
Other current assets	52,066	31,402
Total current assets	2,408,528	2,446,153
Property and equipment, net	257,536	263,513
Goodwill	52,527	52,527
Deferred tax assets	15,425	15,392
Deposits to acquire intangible assets	145,000	145,000
Other long-term assets	26,307	18,603
Total long-term assets	496,795	495,035
Total assets	$2,905,323	$2,941,188
LIABILITIES AND STOCKHOLDERS' DEFICIT		
Current liabilities:		
Accounts payable and accrued liabilities	$181,567	$219,603
Deferred revenues	736,555	713,309
Subordinated convertible debentures	630,824	627,616
Total current liabilities	1,548,946	1,560,528
Long-term deferred revenues	289,970	286,097
Senior notes	1,783,159	1,782,529
Deferred tax liabilities	214,400	444,108
Other long-term tax liabilities	303,582	128,197
Total long-term liabilities	2,591,111	2,640,931
Total liabilities	4,140,057	4,201,459
Commitments and contingencies		
Stockholders' deficit:		
Preferred stock—par value $.001 per share; Authorized shares: 5,000; Issued and outstanding shares: none	—	—
Common stock—par value $.001 per share; Authorized shares: 1,000,000; Issued shares: 325,956 at March 31, 2018 and 325,218 at December 31, 2017; Outstanding shares: 97,005 at March 31, 2018 and 97,591 at December 31, 2017	326	325
Additional paid-in capital	16,305,653	16,437,135
Accumulated deficit	(17,538,015)	(17,694,790)
Accumulated other comprehensive loss	(2,698)	(2,941)
Total stockholders' deficit	(1,234,734)	(1,260,271)
Total liabilities and stockholders' deficit	$2,905,323	$2,941,188

See accompanying Notes to Condensed Consolidated Financial Statements.

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VERISIGN, INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(In thousands, except per share data)
(Unaudited)

	Three Months Ended March 31,	
	2018	2017
Revenues	$299,288	$288,614
Costs and expenses:		
Cost of revenues	48,152	50,669
Sales and marketing	17,275	18,322
Research and development	15,375	13,344
General and administrative	33,067	31,008
Total costs and expenses	113,869	113,343
Operating income	185,419	175,271
Interest expense	(40,788)	(29,023)
Non-operating income, net	7,804	1,301
Income before income taxes	152,435	147,549
Income tax expense	(18,172)	(31,137)
Net income	134,263	116,412
Other comprehensive income	243	346
Comprehensive income	$134,506	$116,758
Earnings per share:		
Basic	$1.38	$1.14
Diluted	$1.09	$0.94
Shares used to compute earnings per share		
Basic	97,250	102,467
Diluted	123,506	124,464

See accompanying Notes to Condensed Consolidated Financial Statements.

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VERISIGN, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	Three Months Ended March 31,	
	2018	2017
Cash flows from operating activities:		
Net income	$134,263	$116,412
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation of property and equipment	12,117	13,102
Stock-based compensation	12,978	12,563
Amortization of debt discount and issuance costs	3,918	3,493
Amortization of discount on investments in debt securities	(4,128)	(1,764)
Other, net	87	328
Changes in operating assets and liabilities:		
Other assets	(987)	14,196
Accounts payable and accrued liabilities	(36,271)	(67,608)
Deferred revenues	27,120	36,689
Net deferred income taxes and other long-term tax liabilities	(59,108)	20,775
Net cash provided by operating activities	89,989	148,186
Cash flows from investing activities:		
Proceeds from maturities and sales of marketable securities	1,931,930	1,049,795
Purchases of marketable securities	(631,456)	(813,459)
Purchases of property and equipment	(7,662)	(9,654)
Other investing activities	(160)	11,748
Net cash provided by investing activities	1,292,652	238,430
Cash flows from financing activities:		
Proceeds from employee stock purchase plan	7,811	7,997
Repurchases of common stock	(152,741)	(173,048)
Net cash used in financing activities	(144,930)	(165,051)
Effect of exchange rate changes on cash, cash equivalents, and restricted cash	167	738
Net increase in cash, cash equivalents, and restricted cash	1,237,878	222,303
Cash, cash equivalents, and restricted cash at beginning of period	475,139	241,581
Cash, cash equivalents, and restricted cash at end of period	$1,713,017	$463,884
Supplemental cash flow disclosures:		
Cash paid for interest	$43,326	$28,189
Cash paid for income taxes, net of refunds received	$72,959	$17,861

See accompanying Notes to Condensed Consolidated Financial Statements.

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VERISIGN, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 1. Basis of Presentation

Interim Financial Statements

The accompanying unaudited Condensed Consolidated Financial Statements have been prepared by VeriSign, Inc. ("Verisign" or the "Company") in accordance with the instructions to Form 10-Q pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC") and, therefore, do not include all information and notes normally provided in audited financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals and other adjustments) considered necessary for a fair presentation have been included. The results of operations for any interim period are not necessarily indicative of, nor comparable to, the results of operations for any other interim period or for a full fiscal year. These unaudited Condensed Consolidated Financial Statements should be read in conjunction with the Consolidated Financial Statements and related notes contained in Verisign's fiscal 2017 Annual Report on Form 10-K (the "2017 Form 10-K") filed with the SEC on February 16, 2018.

Reclassifications

Certain reclassifications have been made to prior period amounts to conform to current period presentation. Such reclassifications have no effect on net income as previously reported.

Adoption of New Accounting Standards

Effective January 1, 2018, the Company adopted Accounting Standards Update ("ASU") 2014-09, Revenue from Contracts with Customers, and several related amendments, issued by the Financial Accounting Standards Board ("FASB"). ASU 2014-09 replaces the previous numerous and disparate revenue recognition guidance, and provides companies with a single revenue recognition model for recognizing revenue from contracts with customers. The core principle of the new standard is that a company should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. The adoption of ASU 2014-09 did not have any impact on our revenue recognition, but did result in a change in the accounting for costs incurred to obtain a contract. Pursuant to the new guidance, the Company will recognize the fees that it pays to ICANN for each annual increment of .com domain name registrations and renewals, as an asset which will be amortized on a straight-line basis over the related domain name term. This change was adopted using the modified retrospective method. As a result, the Company recorded current and long-term assets of $19.7 million and $7.6 million, respectively, a deferred tax liability of $4.8 million and a decrease to the opening balance of accumulated deficit of $22.5 million.

Effective January 1, 2018, the Company adopted ASU 2016-18, Restricted Cash, issued by the FASB. ASU 2016-18 requires restricted cash to be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts set forth on the statement of cash flows instead of presenting changes in restricted cash in cash flows from investing activities. As a result of the adoption, the changes in restricted cash are included with cash and cash equivalents on the statement of cash flows for both periods presented. The change in the amounts presented for the prior period was not significant.

Recent Accounting Pronouncements

In February 2016, the FASB issued ASU No. 2016-02, Leases. The guidance introduces a lessee model that requires most leases to be reported on the balance sheet. This ASU will become effective for the Company on January 1, 2019 and requires the modified retrospective transition method. Based on its current portfolio of leases, the Company does not expect the adoption of this standard to have a material impact on its consolidated financial statements.

Note 2. Revenue

Revenues are recognized when control of the promised services is transferred to our customers, in an amount that reflects the consideration we expect to be entitled to in exchange for those services.

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The Company generates revenues in the U.S.; Europe, the Middle East and Africa ("EMEA"); China; and certain other countries, including Canada, Australia, and Japan.
The following table presents our revenues disaggregated by geography, based on the billing addresses of our customers:

	Three Months Ended March 31,	
	2018	2017
	(In thousands)	
U.S.	$177,542	$173,082
EMEA	53,417	52,727
China	25,858	27,453
Other	42,471	35,352
Total revenues	$299,288	$288,614

Revenues for the Company's Registry Services business are attributed to the country of domicile and the respective regions in which registrars are located, however, this may differ from the regions where the registrars operate or where registrants are located. Revenue for each region may be impacted by registrars reincorporating, relocating, or from acquisitions or changes in affiliations of resellers. Revenue for each region may also be impacted by registrars domiciled in one region, registering domain names in another region.

Registry Services

Registry Services revenues primarily arise from fixed fees charged to registrars for the initial registration or renewal of .com, .net, and other domain names. Fees for domain name registrations and renewals are generally due at the time of registration or renewal. Domain name registration terms range from one year up to ten years.

Most customers either maintain a deposit with Verisign or provide an irrevocable letter of credit in excess of the amounts owed. New customers are subjected to a credit review process that evaluates the customer's financial condition and, ultimately, their ability to pay.

Verisign also offers promotional marketing programs to its registrars based upon market conditions and the business environment in which the registrars operate. Amounts payable to these registrars for such promotional marketing programs are usually recorded as a reduction of revenue. If Verisign obtains an identifiable benefit separate from the services it provides to the registrars, then amounts payable up to the fair value of the benefit received are recorded as advertising expenses and the excess, if any, is recorded as a reduction of revenue.

Performance Obligations

A performance obligation is a promise in a contract to transfer a distinct good or service to the customer. A contract's transaction price is allocated to each distinct performance obligation and recognized as revenue when, or as, the performance obligation is satisfied. Each domain name registration or renewal is considered a separate optional purchase and represents a single performance obligation, which is to allow its registration and maintain that registration (by allowing updates, DNS resolution and Whois services) through the registration term. These services are provided continuously throughout each registration term, and as such, revenues from the initial registration or renewal of domain names are deferred and recognized ratably over the registration term. Fees for renewals and advance extensions to the existing term are deferred until the new incremental period commences. These fees are then recognized ratably over the renewal term.

Security Services

Following the revenue recognition criteria above, revenues from Security Services are usually deferred and recognized over the service term, generally one to two years. These revenues are not significant in relation to our consolidated revenues.

Deferred Revenues

As payment for domain name registrations and renewals are due in advance of our performance, we record these amounts as deferred revenue. The increase in the deferred revenue balance for the three months ended March 31, 2018 is primarily driven by cash payments received or due for domain name registrations and renewals, offset by $269.1 million of revenues recognized that were included in the deferred revenue balance at the beginning of the period. The balance of deferred revenue as of March 31, 2018 represents our aggregate remaining performance obligations. Amounts included in current deferred revenue are all expected to be recognized in revenue within 12 months, while long-term deferred revenue amounts will be recognized in revenue over several years and in some cases up to ten years.

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Historically, we have experienced higher domain name growth in the first quarter of the year compared to other quarters. Our quarterly revenue does not reflect these seasonal patterns because the preponderance of our revenue for each quarterly period is provided by the ratable recognition of our deferred revenue balance. The effect of this seasonality has historically resulted in the largest amount of growth in our deferred revenue balance occurring during the first quarter of the year compared to the other quarters.

Costs Incurred to Obtain a Contract

As discussed above, we recognize the fees that we pay to ICANN for each annual increment of domain name registrations and renewals, as an asset which will be amortized on a straight-line basis over the related registration term. These assets are included in Other current assets and Other long-term assets on the condensed consolidated balance sheet.

Practical Expedients and Exemptions

We recognize sales commissions for our Security Services contracts as expense when incurred because the amortization period for the majority of commissions would have been one year or less. These costs are not material for any period presented and are recorded within sales and marketing expenses.

Note 3. Financial Instruments

Cash, Cash Equivalents, and Marketable Securities

The following table summarizes the Company’s cash, cash equivalents, and marketable securities and the fair value categorization of the financial instruments measured at fair value on a recurring basis:

	March 31, 2018	December 31, 2017
	(In thousands)	
Cash	$51,876	$135,092
Time deposits	5,759	3,682
Money market funds (Level 1)	1,031,051	116,068
Debt securities issued by the U.S. Treasury (Level 1)	1,277,071	2,169,197
Total	$2,365,757	$2,424,039
Cash and cash equivalents	$1,703,722	$465,851
Restricted cash (included in Other long-term assets)	9,295	9,288
Total Cash, cash equivalents, and restricted cash	1,713,017	475,139
Marketable Securities	652,740	1,948,900
Total	$2,365,757	$2,424,039

The fair value of the debt securities held as of March 31, 2018 was $1.3 billion, including less than $0.1 million of gross and net unrealized gains. All of the debt securities held as of March 31, 2018 are scheduled to mature in less than one year. The higher Cash and cash equivalents balance and lower Marketable securities balance at March 31, 2018 reflects the short-term liquidity needed to settle the principal amount of the Subordinated Convertible Debentures in cash, upon redemption on May 1, 2018, as previously disclosed.

Fair Value Measurements

The fair value of the Company’s investments in money market funds approximates their face value. Such instruments are included in Cash and cash equivalents. The fair value of the debt securities consisting of U.S. Treasury bills is based on their quoted market prices. Debt securities purchased with original maturities in excess of three months are included in Marketable securities. The fair value of all of these financial instruments are classified as Level 1 in the fair value hierarchy.

The Company’s other financial instruments include cash, accounts receivable, restricted cash, and accounts payable. As of March 31, 2018, the carrying value of these financial instruments approximated their fair value. The fair value of the Company’s Subordinated Convertible Debentures was $4.3 billion as of March 31, 2018. The fair values of the senior notes due 2023 (the “2023 Senior Notes”), the senior notes due 2025 (the “2025 Senior Notes”), and the senior notes due 2027 (the “2027 Senior Notes”) were $751.9 million, $509.3 million, and $527.3 million, respectively, as of March 31, 2018. The fair values of these debt instruments are based on available market information from public data sources and are classified as Level 2.

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Note 4. Other Balance Sheet Items

Other Current Assets

Other current assets consist of the following:

	March 31, 2018	December 31, 2017
	(In thousands)	
Prepaid registry fees	$20,450	$ —
Prepaid expenses	17,296	15,787
Accounts receivable, net	6,117	5,111
Income taxes receivable	3,996	6,347
Other	4,207	4,157
Total other current assets	$52,066	$ 31,402

Other Long-Term Assets

Other long-term assets consist of the following:

	March 31, 2018	December 31, 2017
	(In thousands)	
Prepaid registry fees	$7,730	$ —
Restricted cash	9,295	9,288
Other tax receivable	5,673	5,673
Other	3,609	3,642
Total other long-term assets	$26,307	$ 18,603

The current and long-term prepaid registry fees in the tables above relate to the fees the Company pays to ICANN for each annual increment of .com domain name registrations and renewals which are capitalized and amortized over the domain name registration term, upon adoption of ASU 2014-09 as discussed in Note 1. The amount of prepaid registry fees as of March 31, 2018 reflects amortization of $8.1 million during the three months ended March 31, 2018 which was recorded in Cost of Revenues.

Accounts Payable and Accrued Liabilities

Accounts payable and accrued liabilities consist of the following:

	March 31, 2018	December 31, 2017
	(In thousands)	
Accounts payable	$8,921	$20,923
Accrued employee compensation	25,935	51,481
Customer deposits, net	58,190	63,617
Interest payable	40,895	47,357
Income taxes payable and other tax liabilities	16,119	13,477
Other accrued liabilities	31,507	22,748
Total accounts payable and accrued liabilities	$181,567	$219,603

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Accrued employee compensation primarily consists of liabilities for employee leave, salaries, payroll taxes, employee contributions to the employee stock purchase plan, and incentive compensation. Accrued employee incentive compensation as of December 31, 2017, was paid during the three months ended March 31, 2018. Interest payable includes coupon and contingent interest on the Subordinated Convertible Debentures, and interest payable on the 2023 Senior Notes the 2025 Senior Notes, and the 2027 Senior Notes. Income taxes payable and other tax liabilities as of December 31, 2017 primarily consisted of foreign income taxes payable, which were paid during the three months ended March 31, 2018. Income taxes payable and other tax liabilities as of March 31, 2018 includes the current portion of taxes payable on accumulated foreign earnings triggered by the 2017 Tax Cuts and Jobs Act (“Tax Act”), which was included in Deferred tax liabilities as of December 31, 2017.

Note 5. Stockholders’ Deficit

On February 8, 2018, the Company’s Board of Directors authorized the repurchase of approximately $585.8 million of its common stock, in addition to the $414.2 million remaining available for repurchase under the previous share repurchase program for a total repurchase authorization of up to $1.0 billion of its common stock. The share repurchase program has no expiration date. Purchases made under the program can be made through open market transactions, block purchases, accelerated share repurchase agreements or other negotiated transactions. During the three months ended March 31, 2018 the Company repurchased 1.1 million shares of its common stock at an average stock price of $114.81. The aggregate cost of the repurchases in the three months ended March 31, 2018 was $124.9 million. As of March 31, 2018, $938.3 million remained available for further repurchases under the share repurchase program.

During the three months ended March 31, 2018, the Company placed 0.2 million shares, at an average stock price of $117.89, and for an aggregate cost of $27.8 million, into treasury stock for purposes related to tax withholding upon vesting of Restricted Stock Units (“RSUs”).

Since inception the Company has repurchased 229.0 million shares of its common stock for an aggregate cost of $8.9 billion, which is presented as a reduction of Additional paid-in capital.

Note 6. Calculation of Earnings per Share

The following table presents the computation of weighted-average shares used in the calculation of basic and diluted earnings per share:

	Three Months Ended March 31,	
	2018	2017
	(In thousands)	
Weighted-average shares of common stock outstanding	97,250	102,467
Weighted-average potential shares of common stock outstanding:		
Conversion spread related to Subordinated Convertible Debentures	25,579	21,327
Unvested RSUs and ESPP	677	670
Shares used to compute diluted earnings per share	123,506	124,464

The calculation of diluted weighted average shares outstanding, excludes potentially dilutive securities, the effect of which would have been anti-dilutive, as well as performance-based RSUs granted by the Company for which the relevant performance criteria have not been achieved. The number of potential shares excluded from the calculation was not significant in any period presented.

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Note 7. Stock-based Compensation

Stock-based compensation is classified in the Condensed Consolidated Statements of Comprehensive Income in the same expense line items as cash compensation. The following table presents the classification of stock-based compensation:

	Three Months Ended March 31,	
	2018	2017
	(In thousands)	
Cost of revenues	$1,609	$1,735
Sales and marketing	1,448	1,429
Research and development	1,721	1,496
General and administrative	8,200	7,903
Total stock-based compensation expense	$12,978	$12,563

The following table presents the nature of the Company’s total stock-based compensation:

	Three Months Ended March 31,	
	2018	2017
	(In thousands)	
RSUs	$9,287	$9,154
Performance-based RSUs	3,113	3,088
ESPP	1,049	981
Capitalization (included in Property and equipment, net)	(471)	(660)
Total stock-based compensation expense	$12,978	$12,563

Note 8. Debt and Interest Expense

The following table presents the components of the Company’s interest expense:

	Three Months Ended March 31,	
	2018	2017
	(In thousands)	
Contractual interest on Subordinated Convertible Debentures	$14,948	$10,156
Contractual interest on Senior Notes	21,766	15,235
Amortization of debt discount on Subordinated Convertible Debentures	3,161	2,911
Amortization of debt issuance costs and other interest expense	913	721
Total interest expense	$40,788	$29,023

On February 15, 2018, the Company called for the redemption of all of the outstanding Subordinated Convertible Debentures. The debentures will be redeemed on May 1, 2018 at a redemption price equal to 100% of the principal, plus accrued but unpaid interest up to, but not including, the redemption date. The Subordinated Convertible Debentures called for redemption may be converted at any time before the close of business on Monday, April 30, 2018. If holders elect to convert their debentures, the Company will settle the principal value, up to $1.25 billion, in cash, and the remaining value through the issuance of shares of the Company’s stock. In the second quarter of 2018, the Company will recognize any gain or loss upon extinguishment for the difference between the carrying value and the fair value of the liability component of the Subordinated Convertible Debentures on the redemption date.

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Note 9. Non-operating Income, Net

The following table presents the components of Non-operating income, net:

	Three Months Ended March 31,	
	2018	2017
	(In thousands)	
Interest income	$7,489	$2,245
Other, net	315	(944)
Total non-operating income, net	$7,804	$1,301

Note 10. Income Taxes

The following table presents income tax expense and the effective tax rate:

	Three Months Ended March 31,	
	2018	2017
	(Dollars in thousands)	
Income tax expense	$18,172	$31,137
Effective tax rate	12 %	21 %

The effective tax rate for the three months ended March 31, 2018 was lower than the statutory federal rate of 21% primarily due to foreign income taxed at lower rates, $12.1 million of tax benefits recognized related to changes to provisional amounts previously recognized for the impact of the Tax Act, and $5.5 million of excess tax benefits related to stock-based compensation, partially offset by state income taxes. The effective tax rate for the three months ended March 31, 2017 was lower than the statutory federal rate of 35% primarily due to tax benefits from foreign income taxed at lower rates and $6.2 million of excess tax benefits related to stock-based compensation, partially offset by state income taxes.

The Tax Act was enacted on December 22, 2017, most provisions of which became effective starting in 2018. The Company recorded provisional amounts of deferred taxes for the impact of various parts of the Tax Act in 2017. These provisional amounts were adjusted in the three months ended March 31, 2018, primarily due to new IRS guidance, resulting in an income tax benefit of $12.1 million, and a reduction in the amount of foreign tax credit carryforwards reported as of December 31, 2017 to $67.9 million. The Company has not completed its accounting for the tax effects of the enactment of the Tax Act. Specifically, the amounts recorded for the U.S. tax on accumulated foreign earnings, net of foreign tax credits, the amounts recorded for foreign tax credits related to the foreign withholding tax on unremitted foreign earnings, and the state income tax effects of these items are provisional amounts based on the Company's estimates. The Company expects to complete the accounting for these impacts of the Tax Act in the fourth quarter of 2018 as it finalizes its cumulative earnings and profits of its foreign subsidiaries and receives additional guidance from the IRS pertaining to the Tax Act. The impacts of additional guidance and changes in estimates related to the effects of the Tax Act, if any, will be recorded in the period the additional guidance or information is available.

As a result of the Tax Act, the Company no longer intends to indefinitely reinvest the earnings of its foreign subsidiaries offshore, and accordingly, during the three months ended March 31, 2018 the Company completed the previously disclosed repatriation of $1.15 billion of cash held by foreign subsidiaries, net of $60.7 million of foreign withholding taxes which was recorded in deferred tax liabilities in 2017.

The Company's deferred tax liabilities as of March 31, 2018 reflect the reclassification of the $93.6 million noncurrent liability for U.S. income taxes on accumulated foreign earnings, net of applicable foreign tax credits, to Other long-term tax liabilities and the reclassification of the $8.1 million current portion of the liability to Accounts payable and accrued liabilities. Other long-term tax liabilities as of March 31, 2018 also reflects the reclassification of deferred tax assets related to tax credits and loss carryforwards which are no longer available to offset unrecognized tax benefits.

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ITEM 2. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

You should read the following discussion in conjunction with the interim unaudited Condensed Consolidated Financial Statements and related notes.

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). These forward-looking statements involve risks and uncertainties, including, among other things, statements regarding our anticipated costs and expenses and revenue mix. Forward-looking statements include, among others, those statements including the words “expects,” “anticipates,” “intends,” “believes” and similar language. Our actual results may differ significantly from those projected in the forward-looking statements. Factors that might cause or contribute to such differences include, but are not limited to, those discussed in the section titled “Risk Factors” in Part II, Item 1A of this Quarterly Report on Form 10-Q. You should also carefully review the risks described in other documents we file from time to time with the Securities and Exchange Commission, including the Quarterly Reports on Form 10-Q or Current Reports on Form 8-K that we file in 2018 and our 2017 Form 10-K, which was filed on February 16, 2018, which discuss our business in greater detail. You are cautioned not to place undue reliance on the forward-looking statements, which speak only as of the date of this Quarterly Report on Form 10-Q. We undertake no obligation to publicly release any revisions to the forward-looking statements or reflect events or circumstances after the date of this document.

Overview

We are a global provider of domain name registry services and internet security, enabling internet navigation for many of the world’s most recognized domain names and providing protection for websites and enterprises around the world. Our Registry Services ensure the security, stability and resiliency of key internet infrastructure and services, including the .com and .net domains, two of the internet’s root servers, and the operation of the Root Zone Maintainer function for the core of the internet’s DNS. Our product suite also includes Security Services, consisting of DDoS Protection Services and Managed DNS Services. Revenues from Security Services are not significant in relation to our consolidated revenues.

As of March 31, 2018, we had approximately 148.3 million .com and .net registrations in the domain name base. The number of domain names registered is largely driven by continued growth in online advertising, e-commerce, and the number of internet users, which is partially driven by greater availability of internet access, as well as marketing activities carried out by us and our registrars. Growth in the number of domain name registrations under our management may be hindered by certain factors, including overall economic conditions, competition from ccTLDs, the introduction of new gTLDs, and ongoing changes in the internet practices and behaviors of consumers and businesses. Factors such as the evolving practices and preferences of internet users, and how they navigate the internet, as well as the motivation of domain name registrants and how they will manage their investment in domain names, can negatively impact our business and the demand for new domain name registrations and renewals.

Business Highlights and Trends

- We recorded revenues of $299.3 million during the three months ended March 31, 2018, an increase of 4% compared to the same period in 2017.
- We recorded operating income of $185.4 million during the three months ended March 31, 2018. This represents an increase of 6% compared to the same period in 2017.
- During the first quarter we repatriated $1.15 billion of cash held by foreign subsidiaries, net of foreign withholding taxes.
- On February 15, 2018 we called for the redemption of all the outstanding Subordinated Convertible Debentures, with a redemption date of May 1, 2018. If holders elect to convert their debentures, we will settle the principal amount, up to $1.25 billion in cash and settle the remaining value through the issuance of shares of Verisign’s common stock.
- We finished the first quarter with 148.3 million .com and .net registrations in the domain name base, which represents a 3% increase from March 31, 2017, and a net increase of 1.9 million domain name registrations from December 31, 2017.
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During the three months ended March 31, 2018, we processed 9.6 million new domain name registrations for .com and .net compared to 9.5 million for the same period in 2017.

- The final .com and .net renewal rate for the fourth quarter of 2017 was 72.2% compared with 67.6% for the same quarter in 2016. Renewal rates are not fully measurable until 45 days after the end of the quarter.

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- During the three months ended March 31, 2018, we repurchased 1.1 million shares of our common stock under the share repurchase program for $124.9 million. As of March 31, 2018, $938.3 million remained available for further repurchases under our share repurchase program.
- We generated cash flows from operating activities of $90.0 million during the three months ended March 31, 2018, compared to $148.2 million in the same period last year.

Pursuant to our agreements with ICANN, we make available on our website (at https://www.Verisign.com/zone) files containing all active domain names registered in the .com and .net registries. At the same website address, we make available a summary of the active zone count registered in the .com and .net registries and the number of .com and .net domain name registrations in the domain name base. The domain name base is the active zone plus the number of domain name registrations that are registered but not configured for use in the respective top level domain zone file plus the number of domain name registrations that are in a client or server hold status. These files and the related summary data are updated at least once per day. The update times may vary each day. The number of domain name registrations provided in this Form 10-Q are as of midnight of the date reported. Information available on, or accessible through, our website is not incorporated herein by reference.

Results of Operations

The following table presents information regarding our results of operations as a percentage of revenues:

	Three Months Ended March 31, 2018	2017
Revenues	100.0 %	100.0 %
Costs and expenses:		
Cost of revenues	16.1	17.6
Sales and marketing	5.8	6.3
Research and development	5.1	4.6
General and administrative	11.0	10.8
Total costs and expenses	38.0	39.3
Operating income	62.0	60.7
Interest expense	(13.6)	(10.1)
Non-operating income, net	2.6	0.5
Income before income taxes	51.0	51.1
Income tax expense	(6.1)	(10.8)
Net income	44.9 %	40.3 %

Revenues

Revenues related to our Registry Services are primarily derived from registrations for domain names in the .com and .net domain name registries. We also derive revenues from operating domain name registries for several other TLDs and from providing back-end registry services to a number of TLD registry operators, all of which are not significant in relation to our consolidated revenues. For domain names registered with the .com and .net registries we receive a fee from registrars per annual registration that is fixed pursuant to our agreements with ICANN. Individual customers, called registrants, contract directly with registrars or their resellers, and the registrars in turn register the domain names with Verisign. Changes in revenues are driven largely by changes in the number of new domain name registrations and the renewal rate for existing registrations as well as the impact of new and prior price increases, to the extent permitted by ICANN and the DOC. New registrations and the renewal rate for existing registrations are impacted by continued growth in online advertising, e-commerce, and the number of internet users, as well as marketing activities carried out by us and our registrars. We increased the annual fee for a .net domain name registration from $7.46 to $8.20 on February 1, 2017 and from $8.20 to $9.02 on February 1, 2018. We have the contractual right to increase the fees for .net domain name registrations by up to 10% each year during the term of our agreement with ICANN, through June 30, 2023. The annual fee for a .com domain name registration is $7.85 for the duration of the current .com Registry Agreement through November 30, 2024, except that prices may be raised by up to 7% each year due to the imposition of any new Consensus Policy or documented extraordinary expense resulting from an attack or threat of attack on the Security and Stability (each as defined in the .com Registry Agreement) of the DNS, subject to approval of the DOC. We offer promotional marketing programs for our registrars based upon market conditions and the business environment in which the registrars operate. All fees paid to us for .com and .net registrations are in U.S. dollars. Revenues from Security Services are not significant in relation to our total consolidated revenues.

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A comparison of revenues is presented below:

	Three Months Ended March 31,		
	2018	% Change	2017
	(Dollars in thousands)		
Revenues	$299,288	4 %	$288,614

The following table compares the .com and .net domain name registrations in the domain name base managed by our Registry Services business:

	March 31, 2018	% Change	March 31, 2017
.com and .net domain name registrations in the domain name base	148.3 million	3 %	143.6 million

Revenues increased by $10.7 million during the three months ended March 31, 2018, compared to the same period last year, primarily due to an increase in revenues from the operation of the registries for the .com and .net TLDs, which was driven by a 4% increase in the domain name base for .com and the increase in the .net domain name registration fees in February 2017 and 2018, partially offset by a 5% decline in the domain name base for .net.

Growth in the domain name base has been primarily driven by continued internet growth and marketing activities carried out by us and our registrars. However, competitive pressure from ccTLDs, the introduction of new gTLDs, ongoing changes in internet practices and behaviors of consumers and business, as well as the motivation of existing domain name registrants and how they will manage their investment in domain names, and historical global economic uncertainty, has limited the rate of growth of the domain name base in recent years and may continue to do so in the remainder of 2018 and beyond.

We expect the rate of growth in revenues will remain consistent in the remainder of 2018 compared to the three months ended March 31, 2018, as a result of continued growth in the aggregate number of domain names ending in .com and increases in the .net domain name registration fees in February 2018.

Geographic revenues

We generate revenues in the U.S.; Europe, the Middle East and Africa ("EMEA"); China; and certain other countries, including Canada, Australia, and Japan.

The following table presents a comparison of our geographic revenues:

	Three Months Ended March 31,		
	2018	% Change	2017
	(Dollars in thousands)		
U.S.	$		