UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

(Mark One)

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

For the quarterly period ended August 3, 2018

or

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

For the transition period from _____ to _____

Commission File Number: 001-37748

SecureWorks Corp.

(Exact name of registrant as specified in its charter)

Delaware	**27-0463349**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
One Concourse Parkway NE Suite 500 **Atlanta, Georgia**	**30328**
(Address of principal executive offices)	(Zip Code)

(404) 327-6339
(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically 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 ☑ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

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

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

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

As of August 31, 2018, there were 81,796,515 shares of the registrant's common stock outstanding, consisting of 11,796,515 outstanding shares of Class A common stock and 70,000,000 outstanding shares of Class B common stock.

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Except where the content otherwise requires or where otherwise indicated, all references in this report to "Secureworks," "we," "us," "our" and "our Company" to refer to SecureWorks Corp. and our subsidiaries on a consolidated basis.

Part I. Financial Information

Item 1. Financial Statements

SECUREWORKS CORP.

CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL POSITION (Unaudited)
(in thousands)

	August 3, 2018	February 2, 2018*
ASSETS		
Current assets:		
Cash and cash equivalents	$ 103,316	$ 101,539
Accounts receivable, net of allowances of $7,388 and $8,246, respectively	133,344	157,764
Inventories, net	623	1,030
Other current assets	40,814	40,551
Total current assets	278,097	300,884
Property and equipment, net	32,611	33,457
Goodwill	416,487	416,487
Purchased intangible assets, net	220,316	234,184
Other non-current assets	79,638	72,069
Total assets	$ 1,027,149	$ 1,057,081
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 21,417	$ 23,266
Accrued and other	65,321	81,625
Short-term deferred revenue	151,828	137,697
Total current liabilities	238,566	242,588
Long-term deferred revenue	13,435	14,948
Other non-current liabilities	62,878	68,455
Total liabilities	314,879	325,991
Commitments and contingencies (Note 6)		
Stockholders' equity:		
Preferred stock - $0.01 par value: 200,000 shares authorized; 0 shares issued	—	—
Common stock - Class A of $.01 par value: 2,500,000 shares authorized; 11,797 and 11,085 issued and outstanding as of August 3, 2018 and February 2, 2018, respectively.	118	111
Common stock - Class B of $.01 par value: 500,000 shares authorized; 70,000 shares issued and outstanding as of August 3, 2018 and February 2, 2018	700	700
Additional paid in capital	874,907	867,411
Accumulated deficit	(160,750)	(137,162)
Accumulated other comprehensive (loss) income	(2,705)	30
Total stockholders' equity	712,270	731,090
Total liabilities and stockholders' equity	$ 1,027,149	$ 1,057,081

* Certain prior period amounts have been adjusted as a result of the adoption of the accounting standard for revenue recognition set forth in ASC 606.

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

SECUREWORKS CORP.

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

	Three Months Ended		Six Months Ended	
	August 3, 2018	August 4, 2017*	August 3, 2018	August 4, 2017*
Net revenue	$ 128,778	$ 116,240	$ 254,939	$ 229,918
Cost of revenue	62,548	55,907	123,078	109,520
Gross margin	66,230	60,333	131,861	120,398
Research and development	22,453	19,693	44,807	39,172
Sales and marketing	35,521	35,433	71,191	71,611
General and administrative	22,419	21,138	47,616	44,542
Total operating expenses	80,393	76,264	163,614	155,325
Operating loss	(14,163)	(15,931)	(31,753)	(34,927)
Interest and other, net	1,003	(420)	1,508	(1,069)
Loss before income taxes	(13,160)	(16,351)	(30,245)	(35,996)
Income tax benefit	(3,391)	(6,080)	(6,657)	(12,448)
Net loss	$ (9,769)	$ (10,271)	$ (23,588)	$ (23,548)
Net loss per common share (basic and diluted)	$ (0.12)	$ (0.13)	$ (0.29)	$ (0.29)
Weighted-average common shares outstanding (basic and diluted)	80,839	80,353	80,680	80,205

* Certain prior period amounts have been adjusted as a result of the adoption of the accounting standard for revenue recognition set forth in ASC 606.

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

SECUREWORKS CORP.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS (Unaudited)

(in thousands)

	Three Months Ended		Six Months Ended	
	August 3, 2018	**August 4, 2017***	**August 3, 2018**	**August 4, 2017***
Net loss	$ (9,769)	$ (10,271)	$ (23,588)	$ (23,548)
Foreign currency translation adjustments, net of tax	(1,165)	784	(2,735)	1,519
Comprehensive loss	$ (10,934)	$ (9,487)	$ (26,323)	$ (22,029)

* Certain prior period amounts have been adjusted as a result of the adoption of the accounting standard for revenue recognition set forth in ASC 606.

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

SECUREWORKS CORP.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)
(in thousands)

	Six Months Ended	
	August 3, 2018	August 4, 2017*
Cash flows from operating activities:		
Net loss	$ (23,588)	$ (23,548)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	20,512	20,666
Stock-based compensation expense	9,642	7,158
Effects of exchange rate changes on monetary assets and liabilities denominated in foreign currencies	(1,275)	1,449
Income tax benefit	(6,657)	(12,448)
Provision for doubtful accounts	1,571	2,591
Changes in assets and liabilities:		
Accounts receivable	22,542	(12,491)
Due to / from parent	(1,334)	7,653
Inventories	407	778
Other assets	(5,162)	(4,014)
Accounts payable	(1,392)	428
Deferred revenue	12,240	13,617
Accrued and other liabilities	(16,620)	(10,254)
Net cash provided by (used in) operating activities	10,886	(8,415)
Cash flows from investing activities:		
Capital expenditures	(5,366)	(8,376)
Net cash provided by (used in) investing activities	(5,366)	(8,376)
Cash flows from financing activities:		
Principal payments on financing arrangement with Dell Financial Services	(1,104)	(800)
Taxes paid on vested restricted shares	(2,139)	(1,224)
Other financing activities	(500)	—
Net cash provided by (used in) financing activities	(3,743)	(2,024)
Net increase (decrease) in cash and cash equivalents	1,777	(18,815)
Cash and cash equivalents at beginning of the period	101,539	116,595
Cash and cash equivalents at end of the period	$ 103,316	$ 97,780

* Certain prior period amounts have been adjusted as a result of the adoption of the accounting standard for revenue recognition set forth in ASC 606.

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

SECUREWORKS CORP.

CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (Unaudited)

(in thousands, except per share data)

	Common Stock - Class A		Common Stock - Class B					
	Outstanding Shares	Amount	Outstanding Shares	Amount	Additional Paid in Capital	Accumulated Deficit	Accumulated Other Comprehensive (Loss) Income	Total Stockholders' Equity
Balances, February 2, 2018*	**11,085**	**$ 111**	**70,000**	**$ 700**	**$ 867,411**	**$ (137,162)**	**$ 30**	**$ 731,090**
Net loss	—	—	—	—	—	(23,588)	—	(23,588)
Other comprehensive loss	—	—	—	—	—	—	(2,735)	(2,735)
Vesting of restricted stock units	545	5	—	—	(5)	—	—	—
Grant of restricted stock awards	386	4	—	—	(4)	—	—	—
Common stock withheld as payment for withholding taxes upon the vesting of restricted shares	(219)	(2)	—	—	(2,137)	—	—	(2,139)
Stock-based compensation	—	—	—	—	9,642	—	—	9,642
Balances, August 3, 2018	**11,797**	**$ 118**	**70,000**	**$ 700**	**$ 874,907**	**$ (160,750)**	**$ (2,705)**	**$ 712,270**

* Certain prior period amounts have been adjusted as a result of the adoption of the accounting standard for revenue recognition set forth in ASC 606.

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

NOTE 1 — DESCRIPTION OF THE BUSINESS AND BASIS OF PRESENTATION

Description of the Business

SecureWorks Corp. (individually and collectively with its consolidated subsidiaries, "Secureworks" or the "Company") is a leading global provider of intelligence-driven information security solutions singularly focused on protecting the Company's clients from cyber attacks. The Company's solutions enable organizations of varying size and complexity to fortify their cyber defenses to prevent security breaches, detect malicious activity in near real time, prioritize and respond rapidly to security incidents and predict emerging threats.

On February 8, 2011, the Company was acquired by Dell Inc. (individually and collectively with its consolidated subsidiaries, "Dell" or "Parent"). On October 29, 2013, Dell was acquired by Dell Technologies Inc., formerly known as Denali Holding Inc. ("Dell Technologies"), a parent holding corporation. For the purposes of the accompanying financial statements, the Company elected to utilize pushdown accounting for the acquisition of Dell by Dell Technologies. On April 27, 2016, the Company completed its initial public offering ("IPO"). Upon the closing of the IPO, Dell Technologies owned, indirectly through Dell Inc. and Dell Inc.'s subsidiaries, no shares of the Company's outstanding Class A common stock and all outstanding shares of the Company's outstanding Class B common stock, which as of August 3, 2018 represented approximately 85.6% of the Company's total outstanding shares of common stock and approximately 98.3% of the combined voting power of both classes of the Company's outstanding common stock.

The Company has one primary business activity, which is to provide clients with intelligence-driven information security solutions. The Company's chief operating decision maker, who is the President and Chief Executive Officer, makes operating decisions, assesses performance, and allocates resources on a consolidated basis. Accordingly, Secureworks operates its business as a single reportable segment.

Basis of Presentation and Consolidation

The Company's condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP"). The preparation of financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the amounts reported in the Company's financial statements. The condensed consolidated financial statements include assets, liabilities, revenue and expenses of all majority-owned subsidiaries. Intercompany transactions and balances are eliminated in consolidation.

For the periods presented, Dell has provided various corporate services to the Company in the ordinary course of business, including finance, tax, human resources, legal, insurance, IT, procurement and facilities-related services. The costs of these services are charged in accordance with a shared services agreement that went into effect on August 1, 2015. For more information regarding the charges for these services and related party transactions, see "Note 9—Related Party Transactions."

During the periods presented in the financial statements, Secureworks did not file separate federal tax returns, as the Company is generally included in the tax grouping of other Dell entities within the respective entity's tax jurisdiction. The income tax benefit has been calculated using the separate return method, modified to apply the benefits for loss approach. Under the benefits for loss approach, net operating losses or other tax attributes are characterized as realized or as realizable by Secureworks when those attributes are utilized or expected to be utilized by other members of the Dell consolidated group. See "Note 8—Income and Other Taxes" for more information.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with GAAP for interim financial information and the requirements of the Securities and Exchange Commission ("SEC"). Accordingly, they do not include all of the information and disclosures required by GAAP for complete financial statement presentation. The year-end condensed consolidated balance sheet data was derived from audited financial statements, but does not include all disclosures required by GAAP. In the opinion of management, all adjustments consisting of normal recurring accruals and disclosures considered necessary for a fair statement have been included. All inter-company accounts and transactions have been eliminated in consolidation. The accompanying condensed consolidated financial statements and related financial information should be read in conjunction with the audited financial statements and the related notes thereto for the year ended February 2, 2018 included in Part II, Item 8 of the Company's Annual Report on Form 10-K filed with the SEC on March 28, 2018 (the "Annual Report").

Fiscal Year

The Company’s fiscal year is the 52- or 53-week period ending on the Friday closest to January 31. The Company refers to the fiscal year ending February 1, 2019 and the fiscal year ended February 2, 2018 as fiscal 2019 and fiscal 2018, respectively. Both fiscal 2019 and fiscal 2018 have 52 weeks, and each quarter has 13 weeks.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting periods. Estimates are revised as additional information becomes available. In the Condensed Consolidated Statements of Operations, estimates are used when accounting for revenue arrangements, determining the cost of revenue, allocating costs and estimating the impact of contingencies. In the Condensed Consolidated Statements of Financial Position, estimates are used in determining the valuation and recoverability of assets, such as accounts receivables, inventories, fixed assets, goodwill and other identifiable intangible assets, and estimates are used in determining the reported amounts of liabilities, such as taxes payable and the impact of contingencies, all of which also impact the Condensed Consolidated Statements of Operations. Actual results could differ from these estimates.

Revision of Previously Issued Financial Statements

During the fiscal year ended February 2, 2018, the Company revised its balance sheet as of and for the period ended February 3, 2017 as a result of the correction of an error related to prepaid expenses for which the Company had been invoiced, but for which cash had not been remitted. This error resulted in an overstatement of other current assets and accounts payable balances in the Consolidated Statements of Financial Position and had a corresponding impact to the changes in the balances in the Consolidated Statements of Cash Flows, with no impact on the cash used in operating activities, for the period ended February 3, 2017. The error had no impact on the Consolidated Statements of Operations. Management has concluded that the impact of the misstatement was not material to the previously issued financial statements. Additional information concerning the effect of this revision on the previously issued consolidated financial statements is provided in Note 1 to Consolidated Financial Statements included in Part II, Item 8 of the Annual Report.

Recently Adopted Accounting Pronouncements

Compensation - Stock Compensation—In May 2017, the Financial Accounting Standards Board (the "FASB") issued Accounting Standards Update ("ASU") No. 2017-09, "Compensation – Stock Compensation (Topic 718): Scope of Modification Accounting." The amendments in this update provide guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting under Topic 718. The Company adopted this guidance during the three months ended May 4, 2018 with no material impact on its condensed consolidated financial statements.

Statement of Cash Flows—In August 2016, the FASB issued ASU No. 2016-15, “Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments - A consensus of the FASB Emerging Issues Task Force.” The update was issued with the objective of reducing the existing diversity in practice in how certain cash receipts and cash payments are presented and classified in the statement of cash flows under Topic 230 and other topics. The adoption of this standard had no impact on the Condensed Consolidated Statements of Cash Flows.

Revenue from Contracts with Customers—The Company adopted ASU 2014-09, "Revenue From Contracts With Customers" ("ASC 606") effective February 3, 2018 using the full retrospective method. The cumulative effect of the adoption was recognized as a decrease to accumulated deficit of $51.8 million on February 2, 2018 and impacted certain other prior period amounts. Certain amounts and disclosures set forth in this Quarterly Report on Form 10-Q have been updated to comply with the new ASC 606 standard.

Summary of Significant Accounting Policies

Except for the accounting policies for revenue, deferred revenue, deferred commissions and deferred installation costs updated as a result of adopting ASC 606 (including Subtopic 340-40), there have been no significant changes to the Company's significant accounting policies as of and for the three and six months ended August 3, 2018, as compared to the significant accounting policies described in the Annual Report.

Revenue Recognition—Secureworks derives revenue primarily from two sources: (1) subscription revenue related to managed security and threat intelligence solutions; and (2) professional services, including security and risk consulting and incident response solutions.

Subscription-based arrangements typically include security solutions, the associated hardware appliance, up-front installation fees and maintenance agreements, which are all typically recognized over the life of the related agreement. The Company has determined that hardware appliances and the related maintenance agreement included in the subscription-based solutions arrangements are incapable of being distinct within the context of the contract as they are required to access the Company's Counter Threat Platform. Moreover, any related installation fees are non-refundable and also incapable of being distinct within the context of the contract. Therefore, the Company has deemed these arrangements as a single performance obligation within the context of a typical subscription-based arrangement. The revenue and any related costs for these deliverables are recognized ratably over the contract term, beginning on the date on which service is made available to clients. Amounts that have been invoiced, but for which the above revenue recognition criteria have not been met, are included in deferred revenue.

Professional services consist primarily of fixed-fee and retainer-based contracts. Revenue from these engagements is recognized using an input method over the contract term.

The Company reports revenue net of any revenue-based taxes assessed by governmental authorities that are imposed on, and concurrently with, specific revenue-producing transactions.

The Company recognizes revenue when all of the following criteria are met:

- ***Identification of the contract, or contracts, with a customer***—A contract with a customer exists when (i) the Company enters into an enforceable contract with a customer, (ii) the contract has commercial substance and the parties are committed to perform and, (iii) payment terms can be identified and collection of substantially all consideration to which the Company will be entitled in exchange for goods or services that will be transferred is deemed probable based on the customer's intent and ability to pay. Contracts entered into for professional services and subscription-based solutions near or at the same time are generally not combined as a single contract for accounting purposes, since neither the pricing nor the services are interrelated.
- ***Identification of the performance obligations in the contract***—Performance obligations promised in a contract are identified based on the goods or services that will be transferred to the customer that are both (i) capable of being distinct, whereby the customer can benefit from the goods or service either on its own or together with other resources that are readily available from third parties or from the Company, and (ii) distinct in the context of the contract, whereby the transfer of the goods or services is separately identifiable from other promises in the contract. When promised goods or services are incapable of being distinct, the Company accounts for them as a combined performance obligation. With regard to a typical contract for subscription-based solutions, the performance obligation represents a series of distinct services that will be accounted for as a single performance obligation. In a typical professional services contract, the Company has a separate performance obligation associated with each service. The Company is generally acting as a principal in each subscription-based and professional services arrangement and, thus, recognizes revenue on a gross basis.
- ***Determination of the transaction price***—The total transaction price is primarily fixed in nature as the consideration is tied to the specific services purchased by the customer, which constitutes a series for delivery of the solutions over the duration of the contract. For professional services contracts, variable consideration exists in the form of rescheduling penalties and expense reimbursements; no estimation is required at contract inception, since variable consideration is allocated to the applicable period.
- ***Allocation of the transaction price to the performance obligations in the contract***—The Company allocates the transaction price to each performance obligation based on the performance obligation's standalone selling price. Standalone selling price is determined by considering all information available to the Company, such as historical selling prices of the performance obligation, geographic location, overall strategic pricing objective, market conditions and internally approved pricing guidelines related to the performance obligations.
- ***Recognition of revenue when, or as, the Company satisfies performance obligation***—The Company recognizes revenue over time using a time-elapsed output method to measure progress (i.e., ratable recognition) for the subscription-based performance obligation over the contract term. For any upgraded installation services, which the Company has determined represent a performance obligation separate from its subscription-based arrangements, revenue is recognized over time using hours elapsed over the service term as an appropriate method to measure progress. For the performance obligation pertaining to professional services arrangements, the Company recognizes revenue over time using an input method based on time (hours or days) incurred to measure progress over the contract term.

As indicated above, the Company has one primary business activity, which is to provide clients with intelligence-driven information security solutions. The Company's chief operating decision maker, who is the President and Chief Executive Officer, makes operating decisions, assesses performance, and allocates resources on a consolidated basis. There are no segment managers who are held accountable for operations and operating results below the consolidated unit level. Accordingly, the Company is considered to be in a single reportable segment and operating unit structure.

The following table presents revenue by service type (in thousands):

	Three Months Ended August 3, 2018	Three Months Ended August 4, 2017	Six Months Ended August 3, 2018	Six Months Ended August 4, 2017
Managed Security Services revenue	$ 98,435	$ 91,511	$ 197,135	$ 180,420
Security and Risk Consulting revenue	30,343	24,729	57,804	49,498
Total revenue	$ 128,778	$ 116,240	$ 254,939	$ 229,918

Deferred Revenue (Contract Liabilities)—Deferred revenue represents amounts contractually billed to customers or payments received from customers for which revenue has not yet been recognized. Deferred revenue that is expected to be recognized within one year is recorded as short-term deferred revenue and the remaining portion is recorded as long-term deferred revenue.

The Company has determined that its contracts generally do not include a significant financing component. The primary purpose of the Company's invoicing terms is to provide customers with simplified and predictable ways of purchasing its solutions, not to receive financing from customers or to provide customers with financing. Examples of such terms include invoicing at the beginning of a subscription term with revenue recognized ratably over the contract period.

Deferred Commissions and Deferred Fulfillment Costs—The Company accounts for both costs to obtain a contract for a customer, which are defined as costs that the Company would not have incurred if the contract had not been obtained, and contract costs by capitalizing and systematically amortizing the assets on a basis that is consistent with the transfer to the customer of the goods or services to which the assets relate. These costs generate or enhance resources used in satisfying performance obligations that directly relate to contracts. Applying the practical expedient guidance, the Company recognizes the incremental costs of obtaining contracts as an expense when incurred if the amortization period of the incremental costs of obtaining contracts that the Company otherwise would have recognized is one year or less.

The Company's customer acquisition costs are primarily attributable to sales commissions and related fringe benefits earned by the Company's sales force and such costs are considered incremental costs to obtain a contract. Sales commissions for initial contracts are deferred and amortized taking into consideration the pattern of transfer to which assets relate and may include expected renewal periods where renewal commissions are not commensurate with the initial commission period. The Company recognizes the deferred commissions on a straight-line basis over the life of the customer relationship (estimated to be seven years) in sales and marketing expenses. These assets are classified as non-current, and included in other non-current assets in the Condensed Consolidated Statements of Financial Position. As of August 3, 2018 and February 2, 2018, the amount of deferred commissions included in other non-current assets was $59.6 million and $57.2 million, respectively.

Additionally, the Company incurs certain costs to install and activate hardware and software used in its managed security services, primarily related to a portion of the compensation for the personnel who perform the installation activities. The Company makes judgments regarding the fulfillment costs to be capitalized. Specifically, the Company capitalizes direct labor and associated fringe benefits using standards developed from actual costs and applicable operational data. The Company updates the information quarterly for items such as the estimated amount of time required to perform such activity. The Company capitalizes and amortizes these fulfillment costs on a straight-line basis over the economic life of the services, or approximately four years, in cost of revenue. As of August 3, 2018 and February 2, 2018, the amount of deferred fulfillment costs included in other non-current assets was $11.0 million and $10.2 million, respectively.

ASC 606 Adoption and Revision Impact to Previously Reported Results

The Company adjusted its condensed consolidated financial statements from amounts previously reported due to the retrospective adoption of ASC 606 and the revision discussed above.

Select unaudited condensed consolidated statements of financial position line items which reflect the adoption of ASC 606 are as follows (in thousands):

	February 2, 2018 (as reported)	Adjustments for Adoption of ASC 606	February 2, 2018 (as adjusted)
Current assets:			
Other current assets	$ 42,163	$ (1,612)	$ 40,551
Total current assets	302,496	(1,612)	300,884
Other non-current assets	4,677	67,392	72,069
Total assets	$ 991,301	$ 65,780	$ 1,057,081
Current liabilities:			
Deferred revenue	$ 139,632	$ (1,935)	$ 137,697
Total current liabilities	244,523	(1,935)	242,588
Other non-current liabilities	52,681	15,774	68,455
Total liabilities	312,152	13,839	325,991
Stockholders' equity:			
Accumulated deficit	(188,936)	51,774	(137,162)
Accumulated other comprehensive (loss) income	(137)	167	30
Total stockholders' equity	$ 679,149	$ 51,941	$ 731,090

Select unaudited condensed consolidated statements of operations line items which reflect the retrospective adoption of ASC 606 are as follows (in thousands):

	Three Months Ended August 4, 2017 (as reported)	Adjustments for Adoption of ASC 606	Three Months Ended August 4, 2017 (as adjusted)
Net revenue	$ 116,123	$ 117	$ 116,240
Cost of revenue	56,325	(418)	55,907
Gross margin	59,798	535	60,333
Total operating expenses	78,451	(2,187)	76,264
Operating loss	(18,653)	2,722	(15,931)
Interest and other, net	(425)	5	(420)
Income tax benefit	(6,960)	880	(6,080)
Net loss	$ (12,118)	$ 1,847	$ (10,271)
Net loss per common share (basic and diluted)	$ (0.15)	$ 0.02	$ (0.13)

	Six Months Ended August 4, 2017 (as reported)	Adjustments for Adoption of ASC 606	Six Months Ended August 4, 2017 (as adjusted)
Net revenue	$ 229,716	$ 202	$ 229,918
Cost of revenue	110,267	(747)	109,520
Gross margin	119,449	949	120,398
Total operating expenses	158,503	(3,178)	155,325
Operating loss	(39,054)	4,127	(34,927)
Interest and other, net	(1,074)	5	(1,069)
Income tax benefit	(13,774)	1,326	(12,448)
Net loss	$ (26,354)	$ 2,806	$ (23,548)
Net loss per common share (basic and diluted)	$ (0.33)	$ 0.04	$ (0.29)

Select unaudited condensed consolidated statement of cash flows line items which reflect the retrospective adoption of ASC 606 and the impact of the revision discussed above are as follows (in thousands):

	Six Months Ended August 4, 2017 (as reported)	Adjustments for Adoption of ASC 606	Adjustments for Revision	Six Months Ended August 4, 2017 (as adjusted)
Cash flows from operating activities:				
Net loss	$ (26,354)	$ 2,806	$ —	$ (23,548)
Adjustments to reconcile net loss to net cash used in operating activities:				
Effects of exchange rate changes on monetary assets and liabilities denominated in foreign currencies	1,456	(7)	—	1,449
Income tax benefit	(15,098)	2,650	—	(12,448)
Changes in assets and liabilities:				
Other assets	606	(3,923)	(697)	(4,014)
Accounts payable	(269)	—	697	428
Deferred revenue	13,819	(202)	—	13,617
Accrued and other liabilities	(8,930)	(1,324)	—	(10,254)
Net cash provided by (used in) operating activities	$ (8,415)	$ —	$ —	$ (8,415)

Recently Issued Accounting Pronouncements

Intangibles - Goodwill and Other—In January 2017, the FASB issued ASU No. 2017-04, "Intangibles-Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment." ASU 2017-04 eliminates Step 2 of the goodwill impairment test, which required the Company to determine the implied fair value of goodwill by allocating the reporting unit's fair value to each of its assets and liabilities as if the reporting unit was acquired in a business acquisition. Instead, the updated guidance requires an entity to perform its annual or interim goodwill impairment test by comparing the fair value of the reporting unit to its carrying value, and recognizing a non-cash impairment charge for the amount by which the carrying value exceeds the reporting unit's fair value, with the loss not exceeding the total amount of goodwill allocated to that reporting unit. The updated guidance is effective for the Company for annual and interim periods beginning in the Company's 2021 fiscal year, with early adoption permitted, and will be applied on a prospective basis. The Company does not expect that the adoption of this standard will have a material impact on its consolidated financial statements.

Financial Instruments—Credit Losses—In June 2016, the FASB issued ASU No. 2016-13, "Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments." The amendments in this update replace the incurred loss impairment methodology in current GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. The update is effective for the Company for fiscal years beginning with the Company's 2021 fiscal year, including interim periods within those fiscal years. The Company is currently evaluating the impact of this guidance on its consolidated financial statements.

Leases—In February 2016, the FASB issued ASU No. 2016-02, "Leases (Topic 842)," which requires lessees to recognize most lease liabilities on their balance sheets but recognize the expenses on their income statements in a manner similar to current practice. The update states that a lessee would recognize a lease liability for the obligation to make lease payments and a right-to-use asset for the right to use the underlying asset for the lease term. Companies are required to use a modified retrospective approach for leases that exist or are entered into after the beginning of the earliest comparative period in the financial statements. The update is effective for the Company for annual and interim periods beginning with the Company's 2020 fiscal year, and early adoption is permitted. The Company continues to evaluate the impact of this guidance on its consolidated financial statements and related disclosures, but expects that most of its operating lease commitments will be subject to the new standard and recognized as operating lease liabilities and right-to-use assets upon adoption.

NOTE 2 — NET LOSS PER SHARE

Net loss per share is calculated by dividing net loss for the periods presented by the respective weighted-average number of common shares outstanding, and excludes any dilutive effects of share-based awards as they would be anti-dilutive. Diluted net loss per common share is computed by giving effect to all potentially dilutive common shares, including common stock issuable upon the exercise of stock options and unvested restricted common stock and restricted stock units. The Company applies the two-class method to calculate earnings per share. Because the Class A common stock and the Class B common stock share the same rights in dividends and earnings, earnings per share (basic and diluted) are the same for both classes. Since losses were incurred in all periods presented, all potential common shares were determined to be anti-dilutive.

The following table sets forth the computation of net loss per common share (in thousands, except per share amounts):

	Three Months Ended		Six Months Ended	
	August 3, 2018	**August 4, 2017***	**August 3, 2018**	**August 4, 2017***
Numerator:				
Net loss	$ (9,769)	$ (10,271)	$ (23,588)	$ (23,548)
Denominator:				
Weighted-average number of shares outstanding:				
Basic and Diluted	80,839	80,353	80,680	80,205
Loss per common share:				
Basic and Diluted	$ (0.12)	$ (0.13)	$ (0.29)	$ (0.29)
Weighted-average anti-dilutive stock options, non-vested restricted stock and restricted stock units	5,285	4,750	5,390	4,900

* Certain prior period amounts have been adjusted as a result of the adoption of the accounting standard for revenue recognition set forth in ASC 606.

NOTE 3 — CONTRACT BALANCES AND CONTRACT COSTS

Promises to provide services related to the Company's subscription-based solutions are accounted for as a single performance obligation over an average period of two years. Performance obligations related to the Company's professional service contracts are separate obligations associated with each service. Although the Company has many multi-year customer relationships for its professional service solutions, the contractual period is typically structured as a separate performance obligation and recognized over a duration of less than one year. The Company invoices its clients based on a variety of billing schedules. During the six months ended August 3, 2018, on average, approximately half of the Company's recurring revenue was billed in advance. In addition, many of the Company's strategic risk consulting engagements are billed in advance of service commencement. Deferred revenue represents the aggregate amount of billing in advance of service delivery.

Changes to the Company's deferred revenue during the six months ended August 3, 2018 are as follows (in thousands):

	As of February 2, 2018*	Upfront payments received and billings during the six months ended August 3, 2018	Revenue recognized during the six months ended August 3, 2018	As of August 3, 2018
Deferred revenue	$ 152,645	$ 133,910	$ (121,292)	$ 165,263

* Certain prior period amounts have been adjusted as a result of the adoption of the accounting standard for revenue recognition set forth in ASC 606.

Remaining Performance Obligation

The remaining performance obligation represents the transaction price allocated to contracted revenue that has not yet been recognized, which includes deferred revenue and non-cancellable contracts that will be invoiced and recognized as revenue in future periods. The remaining performance obligation is comprised of two elements: (i) the value of remaining services to be provided through the contract term for client's whose services have been activated ("active"); and (ii) the value of services contracted with clients that have not yet been installed ("backlog"). Backlog is not recorded in revenue, deferred revenue or elsewhere in the condensed consolidated financial statements until the Company establishes a contractual right to invoice at which point it is recorded as revenue or deferred revenue as appropriate. The Company applies the practical expedient in ASC paragraph 606-10-50-14(a) and does not disclose information about remaining performance obligations that are part of a contract that has an original expected duration of one year or less. Additionally, the Company has elected to use the practical expedient to not disclose backlog related to the comparative period under ASC 606-10-65.

The Company expects that the amount of backlog relative to the total value of its contracts will change from year to year due to several factors, including the amount invoiced at the beginning of the contract term, the timing and duration of the Company's customer agreements, varying invoicing cycles of agreements and changes in customer financial circumstances. Accordingly, any fluctuations in backlog are not always a reliable indicator of future revenues.

As of August 3, 2018 the Company expects to recognize remaining performance obligations as follows (in thousands):

	Total	Expected to be recognized in the next 12 months	Expected to be recognized in 12-24 months	Expected to be recognized in 24-36 months	Expected to be recognized thereafter
Performance obligation - active	$ 236,239	$ 131,456	$ 71,910	$ 28,211	$ 4,662
Performance obligation - backlog	$ 41,381	$ 13,920	$ 13,920	$ 12,277	$ 1,264
Total	$ 277,620	$ 145,376	$ 85,830	$ 40,488	$ 5,926

Deferred Commissions and Fulfillment Costs

The Company capitalizes a significant portion of its commission expense and related fringe benefits earned by its sales personnel. Additionally, the Company capitalizes certain costs to install and activate hardware and software used in its managed security services, primarily related to a portion of the compensation for the personnel who perform the installation activities. These deferred costs are amortized on a systematic basis that is consistent with the transfer to the customer of the goods or services to which the assets relate.

Changes in the balance of total deferred commission and total deferred fulfillment costs during the six months ended August 3, 2018 are as follows (in thousands):

	As of February 2, 2018	Amount capitalized	Amount recognized	As of August 3, 2018
Deferred commissions	$ 57,229	$ 9,479	$ (7,089)	$ 59,619
Deferred fulfillment costs	10,163	3,281	(2,460)	10,984

The Company did not record any impairment losses on the deferred commissions or deferred fulfillment costs during the three and six months ended August 3, 2018.

NOTE 4 — GOODWILL AND INTANGIBLE ASSETS

Goodwill relates to the acquisition of Dell by Dell Technologies and represents the excess of the purchase price attributable to Secureworks over the fair value of the assets acquired and liabilities assumed. There were no additions, adjustments or impairments to goodwill during the periods presented. Accordingly, goodwill totaled $416.5 million as of August 3, 2018 and February 2, 2018.

Goodwill and indefinite-lived intangible assets are tested for impairment on an annual basis during the third fiscal quarter, or earlier if an indicator of impairment occurs. The Company completed its most recent annual impairment test by performing a qualitative assessment of goodwill at the reporting unit level. In performing this qualitative assessment, the Company evaluated events and circumstances since the date of the last quantitative impairment test including the results of that test, macroeconomic conditions, industry and market conditions, key financial metrics and the overall financial performance of the Company. After assessing the totality of the events and circumstances, the Company determined that it was not more likely than not that the fair value of the Secureworks reporting unit was less than its carrying amount and, therefore, that the first and second steps of the quantitative goodwill impairment test were unnecessary. Further, no triggering events have subsequently transpired that would indicate a potential impairment as of August 3, 2018.

Intangible Assets

The Company's intangible assets as of August 3, 2018 and February 2, 2018 were as follows:

	August 3, 2018			February 2, 2018		
	Gross	Accumulated Amortization	Net	Gross	Accumulated Amortization	Net
			(in thousands)			
Customer relationships	$ 189,518	$ (70,105)	$ 119,413	$ 189,518	$ (63,058)	$ 126,460
Technology	135,584	(64,799)	70,785	135,584	(57,978)	77,606
Finite-lived intangible assets	325,102	(134,904)	190,198	325,102	(121,036)	204,066
Trade name	30,118	—	30,118	30,118	—	30,118
Total intangible assets	$ 355,220	$ (134,904)	$ 220,316	$ 355,220	$ (121,036)	$ 234,184

Amortization expense related to finite-lived intangible assets was approximately $6.9 million and $13.9 million for each of the three and six months ended August 3, 2018 and August 4, 2017, respectively. Amortization expense is included within cost of revenue and general and administrative in the Condensed Consolidated Statements of Operations. There were no impairment charges related to intangible assets during the three and six months ended August 3, 2018 and August 4, 2017.

NOTE 5 — DEBT

Revolving Credit Facility

On November 2, 2015, SecureWorks, Inc., a wholly-owned subsidiary of SecureWorks Corp., entered into a revolving credit agreement with a wholly-owned subsidiary of Dell Inc. under which the Company obtained a $30 million senior unsecured revolving credit facility. This facility was initially available for a one-year term beginning on April 21, 2016 and was extended on the same terms for an additional one-year term ending on April 21, 2018. During the three months ended May 4, 2018, the facility was amended and restated to extend the maturity date to March 27, 2019 and to reduce the annual rate at which interest accrues to the applicable London Interbank Offered Rate plus 1.15%.

Under the facility, up to $30 million principal amount of borrowings may be outstanding at any time. Amounts under the facility may be borrowed, repaid, and reborrowed from time to time during the term of the facility. The proceeds from loans made under the facility may be used for general corporate purposes. The credit agreement contains customary representations, warranties, covenants and events of default. The unused portion of the facility is subject to a commitment fee of 0.35%, which is due upon expiration of the facility.

The maximum amount of borrowings may be increased by up to an additional $30 million by mutual agreement of the lender and borrower. The borrower will be required to repay, in full, all of the loans outstanding, including all accrued interest, and the facility will terminate upon a change of control of SecureWorks Corp. or following a transaction in which SecureWorks, Inc. ceases to be a direct or indirect wholly-owned subsidiary of SecureWorks Corp. The facility is not guaranteed by SecureWorks Corp. or its subsidiaries. There was no outstanding balance under the credit facility as of August 3, 2018 or February 2, 2018.

NOTE 6 — COMMITMENTS AND CONTINGENCIES

Legal Contingencies—From time to time, the Company is involved in claims and legal proceedings that arise in the ordinary course of business. The Company accrues a liability when it believes that it is both probable that a liability has been incurred and that it can reasonably estimate the amount of the loss. The Company reviews the status of such matters at least quarterly and adjusts its liabilities as necessary to reflect ongoing negotiations, settlements, rulings, advice of legal counsel and other relevant information. Whether the outcome of any claim, suit, assessment, investigation or legal proceeding, individually or collectively, could have a material adverse effect on the Company's business, financial condition, results of operations or cash flows will depend on a number of factors, including the nature, timing and amount of any associated expenses, amounts paid in settlement, damages or other remedies or consequences. To the extent new information is obtained and the Company's views on the probable outcomes of claims, suits, assessments, investigations or legal proceedings change, changes in accrued liabilities would be recorded in the period in which such a determination is made. As of August 3, 2018, the Company does not believe that there were any such matters that, individually or in the aggregate, would have a material adverse effect on its business, financial condition, results of operations or cash flows.

Client-based Taxation Contingencies—Various government entities ("taxing authorities") require the Company to bill its clients for the taxes they owe based on the services they purchase from the Company. The application of the rules of each taxing authority concerning which services are subject to each tax and how those services should be taxed involves the application of judgment. Taxing authorities periodically perform audits to verify compliance and include all periods that remain open under applicable statutes, which generally range from three to four years. These audits could result in significant assessments of past taxes, fines and interest if the Company were found to be non-compliant. During the course of an audit, a taxing authority may question the Company's application of its rules in a manner that, if the Company were not successful in substantiating its position, could result in a significant financial impact to the Company. In the course of preparing its financial statements and disclosures, the Company considers whether information exists that would warrant disclosure or an accrual with respect to such a contingency.

Indemnifications—In the ordinary course of business, the Company enters into contractual arrangements under which it agrees to indemnify its clients from certain losses incurred by the client as to third-party claims relating to the services performed on behalf of the Company or for certain losses incurred by the client as to third-party claims arising from certain events as defined within the particular contract. Such indemnification obligations may not be subject to maximum loss clauses. Historically, payments related to these indemnifications have been immaterial.

Concentrations—The Company sells solutions to clients of all sizes primarily through its direct sales organization, supplemented by sales through channel partners. The Company had no client that represented 10% or more of its net revenue for the three and six months ended August 3, 2018 or August 4, 2017.

NOTE 7 — STOCK-BASED COMPENSATION AND OTHER LONG-TERM PERFORMANCE INCENTIVES

The Company's board of directors adopted the SecureWorks Corp. 2016 Long-Term Incentive Plan (the "2016 Plan") effective April 18, 2016. The 2016 Plan provides for the grant of options, stock appreciation rights, restricted stock, restricted stock units, deferred stock units, unrestricted stock, dividend equivalent rights, other equity-based awards, and cash bonus awards. Awards may be granted under the 2016 Plan to individuals who are employees, officers, or non-employee directors of the Company or any of its affiliates, consultants and advisors who perform services for the Company or any of its affiliates, and any other individual whose participation in the 2016 Plan is determined to be in the best interests of the Company by the compensation committee of the board of directors. During the three months ended August 3, 2018, the 2016 Plan was amended to increase the total shares of Class A common stock available for issuance by an additional 4,000,000 shares, which are now available for grants under the 2016 Plan.

In March 2017, the Company began granting long-term performance cash awards to certain employees under the 2016 Plan. The employees who receive these performance cash awards do not receive equity awards as part of the long-term incentive program. The long-term performance cash awards are subject to various performance conditions and vest in equal annual installments over a three-year period. The Company made no grants of such cash awards for the three months ended August 3, 2018 and granted $15.7 million of such cash awards for the six months ended August 3, 2018. The Company granted $0.8 million and $11.6 million of such cash awards for the three and six months ended August 4, 2017, respectively. The Company recognized compensation expense of $2.0 million and $3.5 million for the three and six months ended August 3, 2018, respectively, and compensation expense of $0.6 million and $1.1 million for the three and six months ended August 4, 2017, respectively, related to the long-term performance cash awards under the plan.

Under the 2016 Plan, the Company granted 115,455 and 1,718,408 restricted stock units, for three and six months ended August 3, 2018 respectively, and 132,574 and 753,738 restricted stock units for the three and six months ended August 4, 2017, respectively. The Company granted no restricted stock awards during the three months ended August 3, 2018 and August 4, 2017, and 405,000 and 283,988 restricted stock awards during the six months ended August 3, 2018 and August 4, 2017, respectively. The annual restricted stock unit and restricted stock awards granted during fiscal 2019 and 2018 vest over a three-year period and approximately 50% of such awards are subject to performance conditions.

NOTE 8 — INCOME AND OTHER TAXES

The Company's effective income tax rate for the three and six months ended August 3, 2018 and August 4, 2017 was as follows:

	Three Months Ended		Six Months Ended	
	August 3, 2018	August 4, 2017	August 3, 2018	August 4, 2017
Loss before income taxes	$ (13,160)	$ (16,351)	$ (30,245)	$ (35,996)
Income tax benefit	$ (3,391)	$ (6,080)	$ (6,657)	$ (12,448)
Effective tax rate	25.8%	37.2%	22.0%	34.6%

During the periods presented in the accompanying condensed consolidated financial statements, the Company did not file separate federal tax returns as the Company generally was included in the tax grouping of other Dell entities within the respective entity's tax jurisdiction. The income tax benefit has been calculated using the separate return method, modified to apply the benefits-for-loss approach. Under the benefits-for-loss approach, net operating losses or other tax attributes are characterized as realized by the Company when those attributes are utilized by other members of the Dell consolidated group.

The change in the Company's effective income tax rate for the three and six months ended August 3, 2018 compared to the effective income tax rate for the three and six months ended August 4, 2017 was primarily driven by lower U.S. corporate income tax rate from 35% to 21% and the impact of the minimum tax on foreign earnings from the enactment of the U.S. Tax Cuts and Jobs Act ("U.S. Tax Reform Act" or the "Act") The Company’s effective tax rate for the six months ended August 3, 2018 also includes the discrete impact of approximately $0.3 million relating to the impact of the vesting of certain equity awards for which the fair value on the vesting date was lower than the fair value on the date the equity awards were originally granted. This change in fair value, which is measured by the price of the Class A common stock as reported on the NASDAQ Global Select Market, resulted in a lower actual tax deduction than was deducted for financial reporting purposes.

The U.S. Tax Reform Act was enacted in December 2017. GAAP requires the effect of changes in tax laws to be recognized in the period that includes enactment date. Among other things, the U.S. Tax Reform Act decreases the U.S. corporate income tax, establishes a modified territorial system by requiring a mandatory deemed repatriation tax on undistributed earnings of foreign subsidiaries (the "Transition Tax") and requires a minimum tax on certain future earnings generated by foreign subsidiaries. Due to the complexities involved in accounting for the enactment of the Act, SEC Staff Accounting Bulletin No. 118 ("SAB 118") allows companies to record provisional amounts in earnings for the first year following the Act's enactment, with those provisional amounts required to be finalized by the end of that year.

In accordance with GAAP and SAB 118, the Company recognized a provisional tax benefit in the fourth quarter of fiscal 2018 of $27.0 million primarily attributable to the remeasurement of deferred tax assets and liabilities at the lower statutory rate. This tax benefit was net of an expense estimate of approximately $0.6 million for the impact of the Transition Tax. The provisional estimates were made based on the Company's initial analysis using available information and estimates. During the six months ended August 3, 2018, the Company recorded an adjustment to the provisional benefit recognized in fiscal 2018 of approximately $0.4 million due to a change in the remeasurement of a deferred tax liability. No other adjustments have been made to the provisional amounts recorded in the fourth quarter of fiscal 2018. The Company is continuing to gather additional information and refine its analysis to more precisely compute the amount of the Transition Tax and, as a result, the Company's accounting for this item is not yet complete. As the Company refines its provisional estimate calculation, further analyzes provisions of the Act and considers any subsequent guidance in accordance with SAB 118, these provisional estimates could be adjusted during the measurement period, which ends during the fourth quarter of fiscal 2019. As indicated above, the Company is included in the tax groupings of other Dell entities and recognized a tax benefit when its tax attributes are utilized by other members of the Dell consolidated group. Adjustments to these provisional estimates could have an impact on the Company's future financial results. Additionally, further regulatory or GAAP accounting guidance regarding the U.S. Tax Reform Act also could impact the Company's future financial results.

As of August 3, 2018 and February 2, 2018, the Company had $4.2 million and $4.0 million, respectively, of deferred tax assets related to net operating loss carryforwards for state tax returns that are not included with those of other Dell entities. These net operating loss carryforwards began expiring in the fiscal year ended February 2, 2018. Due to the uncertainty surrounding the realization of these net operating loss carryforwards, the Company has provided valuation allowances for the full amount as of August 3, 2018 and February 2, 2018. Because the Company is included in the tax filings of certain other Dell entities, management has determined that it will be able to realize the remainder of its deferred tax assets. If the Company's tax provision had been prepared using the separate return method, the unaudited pro forma pre-tax loss, tax benefit and net loss for the six months ended August 3, 2018 would have been $30.2 million, $2.8 million and $27.5 million, respectively, as a result of the recognition of a valuation allowance that would have been recorded on certain deferred tax assets as well as certain attributes from the U.S. Tax Reform Act that would be lost if not utilized by the Dell consolidated group.

Net deferred tax balances are included in other non-current assets and other non-current liabilities in the Condensed Consolidated Statements of Financial Position.

As of August 3, 2018 and February 2, 2018, the Company had $23.9 million and $21.4 million, respectively, of a net operating loss tax receivable from Dell. The Company had $1.0 million and $0.8 million of unrecognized tax benefits as of August 3, 2018 and February 2, 2018, respectively.

NOTE 9 — RELATED PARTY TRANSACTIONS

Allocated Expenses

For the periods presented, Dell has provided various corporate services to Secureworks in the ordinary course of business. The costs of services provided to Secureworks by Dell are governed by a shared services agreement between Secureworks and Dell Inc. or its wholly-owned subsidiaries. The total amounts of the charges under the shared services agreement with Dell were $0.9 million and $2.0 million for the three and six months ended August 3, 2018, respectively, and $1.2 million and $2.5 million for the three and six months ended August 4, 2017, respectively. Management believes that the basis on which the expenses have been allocated is a reasonable reflection of the utilization of services provided to or the benefit received by the Company during the periods presented.

Related Party Arrangements

For the periods presented, related party transactions and activities involving Dell Inc. and its wholly-owned subsidiaries were not always consummated on terms equivalent to those that would prevail in an arm's-length transaction where conditions of competitive, free-market dealing may exist.

The Company purchases computer equipment for internal use from Dell that is capitalized within property and equipment in the Condensed Consolidated Statements of Financial Position. These purchases were made at pricing that is intended to approximate arm's-length pricing. Purchases of computer equipment from Dell and EMC Corporation, a wholly-owned subsidiary of Dell ("EMC"), totaled $0.6 million and $1.4 million for the three and six months ended August 3, 2018, respectively, and $0.8 million and $1.5 million for the three and six months ended August 4, 2017, respectively.

EMC, a company that provides enterprise software and storage, maintains a majority ownership interest in a subsidiary, VMware, Inc. ("VMware"), that provides cloud and virtualization software and services. The Company's purchases of annual maintenance services, software licenses and hardware systems for internal use from EMC and VMware totaled $0.2 million and $0.5 million for the three and six months ended August 3, 2018, respectively, and $0.2 million and $0.4 million for the three and six months ended August 4, 2017, respectively. Approximately $3.0 million of the purchases from VMware prior to the three months ended August 3, 2018 were financed through Dell Financial Services, of which approximately $1.1 million of such purchases were included in intercompany liabilities as of August 3, 2018.

The Company recognized revenue related to solutions provided to other subsidiaries of Dell, consisting of RSA Security LLC, and Pivotal Software, Inc. The revenue recognized by the Company for security solutions provided to these entities totaled $0.1 million and $0.2 million for the three and six months ended August 3, 2018, respectively, and $0.1 million and $0.1 million for the three and six months ended August 4, 2017, respectively. Purchases by the Company from these subsidiaries totaled $0.5 million for the three and six months ended August 3, 2018. The Company had purchases from these subsidiaries of $34.0 thousand for the three and six months ended August 4, 2017.

The Company recognized revenue related to solutions provided to principal stockholders of Dell Technologies consisting of Michael S. Dell, Chairman and Chief Executive Officer of Dell Technologies and Dell Inc., the Susan Lieberman Dell Separate Property Trust (a separate property trust for the benefit of Mr. Dell's wife) and MSD Capital, L.P. (a firm founded for the purposes of managing investments of Mr. Dell and his family). The revenues recognized by the Company from solutions provided to Mr. Dell, the Susan Lieberman Dell Separate Property Trust and MSD Capital, L.P. totaled $19 thousand and $38 thousand for the three and six months ended August 3, 2018, respectively, and $23 thousand and $46 thousand for the three and six months ended and August 4, 2017, respectively.

The Company provides solutions to certain clients whose contractual relationship has historically been with Dell rather than Secureworks, although the Company is the primary obligor and carries credit and inventory risk in these arrangements. Effective August 1, 2015, upon the creation of new subsidiaries to segregate some of the Company's operations from Dell's operations, as described in "Note 1—Description of the Business and Basis of Presentation," many of such client contracts were transferred from Dell to the Company, forming a direct contractual relationship between the Company and the end client. For clients whose contracts have not yet been transferred and for contracts subsequently originated through Dell under a reseller agreement, the Company recognized revenues of approximately $16.4 million and $29.1 million for the three and six months ended August 3, 2018, respectively, and approximately $10.2 million and $20.4 million for the three and six months ended August 4, 2017, respectively.

As the Company's client and on behalf of certain of its own clients, Dell also purchases solutions from the Company at pricing that is intended to approximate arm's-length pricing. Such revenues totaled approximately $5.1 million and $10.1 million for the three and six months ended August 3, 2018, respectively, and $6.7 million and $12.6 million for the three and six months ended August 4, 2017, respectively.

As a result of the foregoing related party arrangements, the Company has recorded the following related party balances in the Condensed Consolidated Statements of Financial Position as of August 3, 2018 and February 2, 2018. During the third quarter of fiscal 2017, the Company began settling in cash its related party balances with Dell on a quarterly basis.

	August 3, 2018	February 2, 2018
	(in thousands)	
Intercompany receivable	$ —	$ —
Intercompany payable	(17,467)	(19,580)
Net intercompany payable (in accrued and other)	$ (17,467)	$ (19,580)
Accounts receivable from clients under reseller agreements with Dell (included in accounts receivable, net)	$ 23,697	$ 25,229
Net operating loss tax sharing receivable under agreement with Dell (included in "Other current assets" and "Other non-current assets" at August 3, 2018 and in "Other current assets" at February 2, 2018)	$ 23,895	$ 21,380

NOTE 10 — FAIR VALUE MEASUREMENTS

The Company measures fair value within the guidance of the three-level valuation hierarchy. This hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The categorization of a measurement within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement. The three levels are defined as follows:

- Level 1 - Quoted market prices in active markets for identical assets or liabilities
- Level 2 - Other observable market-based inputs or unobservable inputs that are corroborated by market data
- Level 3 - Significant unobservable inputs

Assets and Liabilities Measured at Fair Value on a Recurring Basis

The assets and liabilities of the Company that are measured at fair value on a recurring basis using the respective input levels as of August 3, 2018 and February 2, 2018 were as follows:

	August 3, 2018	February 2, 2018
	Level 1	Level 1
	(in thousands)	
Cash equivalents - Money Market Funds	$ 34,275	$ 58,967

Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

The carrying amounts of the Company's accounts receivable, accounts payable and accrued expenses approximate their respective fair value due to their short-term nature.

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

This management's discussion and analysis is based upon the financial statements of Secureworks which have been prepared in accordance with accounting principles generally accepted in the United States, or GAAP, and should be read in conjunction with our audited financial statements and related notes for the year ended February 2, 2018 included in Part II, Item 8 of our Annual Report on Form 10-K as filed with the SEC on March 28, 2018, which we refer to as the Annual Report. In addition to historical financial information, the following discussion contains forward-looking statements that reflect our plans, estimates and beliefs. Our actual results could differ materially from those discussed or implied in our forward-looking statements. Factors that could cause or contribute to these differences include those discussed in "Risk Factors" in Part I, Item 1A of our Annual Report.

Our fiscal year is the 52- or 53-week period ending on the Friday closest to January 31. We refer to the fiscal year ending February 1, 2019 and the fiscal year ended February 2, 2018 as fiscal 2019 and fiscal 2018, respectively. Fiscal 2019 and fiscal 2018 each have 52 weeks, and each quarter has 13 weeks. All percentage amounts and ratios presented in this management's discussion and analysis were calculated using the underlying data in thousands. Unless otherwise indicated, all changes identified for the current-period results represent comparisons to results for the prior corresponding fiscal periods.

Except where the context otherwise requires or where otherwise indicated, (1) all references to "Secureworks" "we," "us," "our," and "our Company" in this management's discussion and analysis refer to SecureWorks Corp. and our subsidiaries on a consolidated basis, (2) all references to "Dell" refer to Dell Inc. and its subsidiaries on a consolidated basis and (3) all references to "Dell Technologies" refer to Dell Technologies Inc., the ultimate parent company of Dell Inc.

Overview

We are a leading global cybersecurity company that protects organizations in the digitally connected world. We combine visibility from thousands of clients, machine learning and automation from our industry-leading SecureWorks Counter Threat Platform™, and actionable insights from our team of elite researchers and analysts to create a powerful network effect that provides increasingly strong protection for our clients. By aggregating and analyzing data from various sources around the world, we prevent security breaches, detect malicious activity in real time, respond rapidly and predict emerging threats.

Our mission is to unlock the value of our clients' security investments by simplifying their complex security operations and amplifying their defenses. Through our vendor-neutral approach, we create integrated and comprehensive solutions by proactively managing the collection of "point" products deployed by our clients to address specific security issues and provide supplemental solutions where gaps exist in our clients' defenses. We customize the right level of security for each client's unique situation, which evolves as the client's organization grows and changes.

We have pioneered an integrated approach that delivers a broad portfolio of information security solutions to organizations of varying size and complexity. Our flexible and scalable solutions support the evolving needs of the largest, most sophisticated enterprises staffed with in-house security experts, as well as small and medium-sized businesses and government agencies with limited in-house capabilities and resources.

Our solutions enable organizations to:

- prevent security breaches by fortifying their cyber defenses,
- detect malicious activity,
- respond rapidly to security breaches, and
- predict emerging threats.

The solutions leverage our proprietary technologies, processes and extensive expertise in the information security industry, which we have developed over more than 18 years. Key elements of our strategy include:

- maintain and extend our technology leadership,
- expand and diversify our client base,
- deepen our existing client relationships, and
- attract and retain top talent.

Our intelligence-driven information security solutions offer an innovative approach to prevent, detect, respond to and predict cybersecurity breaches. Through our *managed security offerings*, which are sold on a subscription basis, we provide global visibility and insight into malicious activity, enabling our clients to detect and effectively remediate threats quickly. *Threat intelligence*, which is typically deployed as part of our managed security offerings, delivers early warnings of vulnerabilities and threats along with actionable information to help prevent any adverse impact. In addition to these solutions, we also offer a variety of professional services, which include security and risk consulting and incident response. Through *security and risk consulting*, we advise clients on a broad range of security and risk-related matters. *Incident response* minimizes the impact and duration of security breaches through proactive client preparation, rapid containment and thorough event analysis followed by effective remediation. We continuously evaluate potential investments and acquisitions of businesses, services and technologies that could complement our existing offerings. We have a single organization responsible for the delivery of our security solutions, which enables us to respond quickly to our clients' evolving needs and help them secure themselves against cyber attacks.

The fees we charge for our solutions vary based on a number of factors, including the solutions selected, the number of client devices covered by the selected solutions, and the level of management we provide for the solutions. Approximately 77% of our revenue is derived from subscription-based solutions, attributable to managed security contracts, while approximately 23% is derived from professional services engagements. As we respond to the evolving needs of our clients, the relative mix of subscription-based solutions and professional services we provide our clients may fluctuate.

Key Operating Metrics

In recent years, we have experienced broad growth across our portfolio of intelligence-driven information security solutions being provided to all sizes of clients. We have achieved much of this growth by providing solutions to large enterprise clients, which generate substantially more average revenue than our small and medium-sized business, or SMB, clients and by continually expanding the volume and breadth of the security solutions that we provide to all clients. This has resulted in steady growth in our average revenue per client. This growth has required continuous investment in our business, resulting in net losses. We believe these investments are critical to our success, although they may continue to impact our profitability.

We believe the operating metrics described below provide further insight into the long-term value of our subscription agreements and our ability to maintain and grow our client relationships. Relevant key operating metrics are presented below as of the dates indicated and for the quarterly periods then ended:

	August 3, 2018	August 4, 2017
Client base	4,300	4,400
Average revenue per client (in thousands)	$ 100.4	$ 89.2
Monthly recurring revenue (in millions)	$ 36.2	$ 32.3
Revenue retention rate	98%	96%

Client Base. We define our client base as the number of clients who subscribe to our managed security solutions as of a particular date. We believe that our ability to grow our average revenue per client represents significant future revenue opportunities for us. The increase in average revenue per client is primarily related to the persistence of cyber threats and the results of our sales and marketing efforts to increase the awareness of our solutions. Additionally, our client composition of both enterprise and SMB companies provides us with an opportunity to expand our professional services revenue.

Monthly Recurring Revenue. We define monthly recurring revenue as the monthly value of our subscription contracts as of a particular date. Because we use monthly recurring revenue as a leading indicator of future annual revenue, we include operational backlog. We define operational backlog as the monthly recurring revenue associated with pending contracts, which are contracts that have been sold but for which the service period has not yet commenced. Our increase in monthly recurring revenue has been driven primarily by our continuing ability to expand our offerings and sell additional solutions to existing clients, as well as by growth in our client base. Overall, we expect monthly recurring revenue to continue to grow as we retain and expand our client base, and as our clients extend the use of our solutions over time.

Revenue Retention Rate. Our revenue retention rate is an important measure of our success in retaining and growing revenue from our subscription-based clients. To calculate our revenue retention rate for any period, we compare the monthly recurring revenue excluding operational backlog of our subscription-based client base at the beginning of the fiscal year, which we call our base recurring revenue, to the monthly recurring revenue excluding operational backlog from that same cohort of clients at the end of the period, which we call our retained recurring revenue. By dividing the retained recurring revenue by the base recurring revenue, we measure our success in retaining and growing installed revenue from the specific cohort of clients we served at the beginning of the period. Our calculation includes the positive revenue impacts of selling and installing additional solutions to this cohort of clients and the negative revenue impacts of client or service attrition during the period. However, the calculation does not include the positive impact on revenue from sales of solutions to any clients acquired during the period. Our revenue retention rates may decline or increase from period to period as a result of several factors, including the timing of solution installations and client renewal rates.

Non-GAAP Financial Measures

We use supplemental measures of our performance, which are derived from our financial information, but which are not presented in our financial statements prepared in accordance with GAAP. Non-GAAP financial measures presented in this management's discussion and analysis include non-GAAP revenue, non-GAAP gross margin, non-GAAP research and development expenses, non-GAAP sales and marketing expenses, non-GAAP general and administrative expenses, non-GAAP operating loss, non-GAAP net loss, non-GAAP net loss per share and adjusted EBITDA. We use non-GAAP financial measures to supplement financial information presented on a GAAP basis. We believe these non-GAAP financial measures provide useful information to help evaluate our operating results by facilitating an enhanced understanding of our operating performance and enabling more meaningful period-to-period comparisons.

In particular, we have excluded the impact of certain purchase accounting adjustments related to a change in the basis of deferred revenue for the acquisition of Dell by Dell Technologies in fiscal 2014. We believe it is useful to exclude such purchase accounting adjustments related to the foregoing transactions as this deferred revenue generally results from multi-year service contracts under which deferred revenue is established upon sale and revenue is recognized over the term of the contract. Pursuant to the fair value provisions applicable to the accounting for business combinations, GAAP requires this deferred revenue to be recorded at its fair value, which is typically less than the book value. In presenting non-GAAP earnings, we add back the reduction in revenue that results from this revaluation on the expectation that a significant majority of these service contracts will be renewed in the future and therefore the revaluation is not helpful in predicting our ongoing revenue trends. We believe that this non-GAAP financial adjustment is useful to investors because it allows investors to (1) evaluate the effectiveness of the methodology and information used by management in its financial and operational decision-making, and (2) compare past and future reports of financial results of our Company as the revenue reduction related to acquired deferred revenue will not recur when related service contracts are renewed in future periods.

There are limitations to the use of the non-GAAP financial measures presented in this management's discussion and analysis. Our non-GAAP financial measures may not be comparable to similarly titled measures of other companies. Other companies, including companies in our industry, may calculate non-GAAP financial measures differently than we do, limiting the usefulness of those measures for comparative purposes.

Non-GAAP revenue, non-GAAP gross margin, non-GAAP research and development expenses, non-GAAP sales and marketing expenses, non-GAAP general and administrative expenses, non-GAAP operating loss, non-GAAP net loss and non-GAAP net loss per share, as defined by us, exclude the items described in the reconciliation below. As the excluded items can have a material impact on earnings, our management compensates for this limitation by relying primarily on GAAP results and using non-GAAP financial measures supplementally. The non-GAAP financial measures are not meant to be considered as indicators of performance in isolation from or as a substitute for revenue, gross margin, research and development expenses, sales and marketing expenses, general and administrative expenses, operating loss or net loss prepared in accordance with GAAP, and should be read only in conjunction with financial information presented on a GAAP basis.

Reconciliation of Non-GAAP Financial Measures

The table below presents a reconciliation of each non-GAAP financial measure to its most directly comparable GAAP financial measure. We encourage you to review the reconciliations in conjunction with the presentation of the non-GAAP financial measures for each of the periods presented. In future fiscal periods, we may exclude such items and may incur income and expenses similar to these excluded items. Accordingly, the exclusion of these items and other similar items in our non-GAAP presentation should not be interpreted as implying that these items are non-recurring, infrequent or unusual.

The following is a summary of the items excluded from the most comparable GAAP financial measures to calculate our non-GAAP financial measures:

- *Impact of Purchase Accounting.* The impact of purchase accounting consists primarily of purchase accounting adjustments related to a change in the basis of deferred revenue related to the acquisition of Dell by Dell Technologies in fiscal 2014.
- *Amortization of Intangible Assets.* Amortization of intangible assets consists of amortization of customer relationships and acquired technology. In connection with the acquisition of Dell by Dell Technologies in fiscal 2014, all of our tangible and intangible assets and liabilities were accounted for and recognized at fair value on the transaction date.

Accordingly, amortization of intangible assets consists of amortization associated with intangible assets recognized in connection with this transaction.

- *Stock-based Compensation Expense.* Non-cash stock-based compensation relates to both the Dell Technologies and Secureworks equity plans. We exclude such expenses when assessing the effectiveness of our operating performance since stock-based compensation does not necessarily correlate with the underlying operating performance of the business.
- *Aggregate Adjustment for Income Taxes.* The aggregate adjustment for income taxes is the estimated combined income tax effect for the adjustments mentioned above. The tax effects are determined based on the tax jurisdictions where the above items were incurred.

	Three Months Ended		Six Months Ended	
	August 3, 2018	**August 4, 2017***	**August 3, 2018**	**August 4, 2017***
	(in thousands)			
GAAP revenue	$ 128,778	$ 116,240	$ 254,939	$ 229,918
Impact of purchase accounting	—	146	—	292
Non-GAAP revenue	$ 128,778	$ 116,386	$ 254,939	$ 230,210
GAAP gross margin	$ 66,230	$ 60,333	$ 131,861	$ 120,398
Amortization of intangibles	3,411	3,411	6,821	6,821
Impact of purchase accounting	—	156	—	312
Stock-based compensation expense	275	217	544	441
Non-GAAP gross margin	$ 69,916	$ 64,117	$ 139,226	$ 127,972
GAAP research and development expenses	$ 22,453	$ 19,693	$ 44,807	$ 39,172
Stock-based compensation expense	(1,006)	(759)	(2,037)	(1,573)
Non-GAAP research and development expenses	$ 21,447	$ 18,934	$ 42,770	$ 37,599
GAAP sales and marketing expenses	$ 35,521	$ 35,433	$ 71,191	$ 71,611
Stock-based compensation expense	(720)	(411)	(1,341)	(625)
Non-GAAP sales and marketing expenses	$ 34,801	$ 35,022	$ 69,850	$ 70,986
GAAP general and administrative expenses	$ 22,419	$ 21,138	$ 47,616	$ 44,542
Amortization of intangibles	(3,523)	(3,523)	(7,047)	(7,047)
Impact of purchase accounting	—	(256)	—	(512)
Stock-based compensation expense	(2,911)	(2,143)	(5,720)	(4,519)
Non-GAAP general and administrative expenses	$ 15,985	$ 15,216	$ 34,849	$ 32,464
GAAP operating loss	$ (14,163)	$ (15,931)	$ (31,753)	$ (34,927)
Amortization of intangibles	6,934	6,934	13,868	13,868
Impact of purchase accounting	—	412	—	824
Stock-based compensation expense	4,912	3,530	9,642	7,158
Non-GAAP operating loss	$ (2,317)	$ (5,055)	$ (8,243)	$ (13,077)
GAAP net loss	$ (9,769)	$ (10,271)	$ (23,588)	$ (23,548)
Amortization of intangibles	6,934	6,934	13,868	13,868
Impact of purchase accounting	—	412	—	824
Stock-based compensation expense	4,912	3,530	9,642	7,158
Aggregate adjustment for income taxes	(2,938)	(4,122)	(5,329)	(7,356)
Non-GAAP net loss	$ (861)	$ (3,517)	$ (5,407)	$ (9,054)

GAAP net loss per share	$ (0.12)	$ (0.13)	$ (0.29)	$ (0.29)
Amortization of intangibles	0.09	0.09	0.17	0.17
Impact of purchase accounting	—	0.01	—	0.01
Stock-based compensation expense	0.06	0.04	0.12	0.09
Aggregate adjustment for income taxes	(0.04)	(0.05)	(0.07)	(0.09)
Non-GAAP net loss per share *	$ (0.01)	$ (0.04)	$ (0.07)	$ (0.11)
** Sum of reconciling items may differ from total due to rounding of individual components*				

GAAP net loss	$ (9,769)	$ (10,271)	$ (23,588)	$ (23,548)
Interest and other, net	(1,003)	420	(1,508)	1,069
Income tax benefit	(3,391)	(6,080)	(6,657)	(12,448)
Depreciation and amortization	10,225	10,405	20,512	20,666
Stock-based compensation expense	4,912	3,530	9,642	7,158
Impact of purchase accounting	—	146	—	292
Adjusted EBITDA	$ 974	$ (1,850)	$ (1,599)	$ (6,811)

* Certain prior period amounts have been adjusted as a result of the adoption of the accounting standard for revenue recognition set forth in ASC 606.

Our Relationship with Dell and Dell Technologies

On February 8, 2011, we were acquired by Dell Inc. On October 29, 2013, Dell was acquired by Dell Technologies Inc. (formerly known as Denali Holding Inc.), a parent holding corporation. For the purposes of our condensed consolidated financial statements included in this report, we elected to utilize pushdown accounting for the acquisition of Dell by Dell Technologies. On April 27, 2016, we completed our IPO, as further described below. Upon the closing of our IPO, Dell Technologies owned, indirectly through Dell Inc. and Dell Inc.'s subsidiaries, no shares of our outstanding Class A common stock and all shares of our outstanding Class B common stock, which as of August 3, 2018 represented approximately 85.6% of our total outstanding shares of common stock and approximately 98.3% of the combined voting power of both classes of our outstanding common stock.

Since acquiring us in 2011, Dell has provided us with various corporate services in the ordinary course of business, including finance, tax, human resources, legal, insurance, IT, procurement and facilities related services. The costs of these services have been charged in accordance with a shared services agreement that went into effect on August 1, 2015, the effective date of our carve-out from Dell. For more information regarding the allocated costs and related party transactions, see "Notes to Condensed Consolidated Financial Statements—Note 9—Related Party Transactions" in our condensed consolidated financial statements included in this report.

During the periods presented in the condensed consolidated financial statements included in this report, Secureworks did not file separate federal tax returns, as Secureworks generally was included in the tax grouping of other Dell entities within the respective entity's tax jurisdiction. The income tax benefit has been calculated using the separate return method, modified to apply the benefits for loss approach. Under the benefits for loss approach, net operating losses or other tax attributes are characterized as realized or as realizable by Secureworks when those attributes are utilized or expect to be utilized by other members of the Dell consolidated group. For more information, see "Notes to Condensed Consolidated Financial Statements—Note 8—Income and Other Taxes" in our condensed consolidated financial statements included in this report.

As a majority-owned subsidiary of Dell, we have participated in various commercial arrangements with Dell, under which, for example, we provide information security solutions to third-party clients with which Dell has contracted to provide our solutions, procure hardware, software and services from Dell, and sell our solutions through Dell in the United States and some international jurisdictions. In connection with our IPO, effective August 1, 2015, we entered into agreements with Dell that govern these commercial arrangements. The commercial agreements set the terms and conditions for transactions between Dell and us, while our shared services agreement with Dell sets the terms and conditions for certain administrative functions that continue to be provided by Dell. These agreements generally are effective for up to one to three years and include extension and cancellation options. To the extent that we choose to or are required to transition away from the corporate services currently provided by Dell, we may incur additional non-recurring transition costs to establish our own stand-alone corporate functions. As of August 3, 2018, we have established a substantial portion of our stand-alone corporate functions. For more information regarding the allocated costs and related party transactions, see "Notes to Condensed Consolidated Financial Statements—Note 9—Related Party Transactions" in our condensed consolidated financial statements included in this report.

Initial Public Offering

On April 27, 2016, we completed our IPO in which we issued and sold 8,000,000 shares of Class A common stock at a price to the public of $14.00 per share. We received net proceeds of $99.6 million from the sale of shares of Class A common stock, after deducting $12.4 million of underwriting discounts and commissions and unpaid offering expenses payable by us.

Components of Results of Operations

Revenue

We sell managed security solutions and threat intelligence solutions on a subscription basis and various professional services, including security and risk consulting and incident response solutions. Our managed security subscription contracts typically range from one to three years and, as of August 3, 2018, averaged two years in duration. The revenue and any related costs for these deliverables are recognized ratably over the contract term, beginning on the date on which service is made available to clients. Professional services clients typically purchase solutions pursuant to customized contracts that are shorter in duration. In general, these contracts have terms of less than one year. Professional services consist primarily of fixed-fee and retainer-based contracts. Revenue from these engagements is recognized under the proportional performance method of accounting. Revenue from time-and materials-based contracts is recognized as costs are incurred at amounts represented by the agreed-upon billing rates.

The fees we charge for our solutions vary based on a number of factors, including the solutions selected, the number of client devices covered by the selected solutions, and the level of management we provide for the solutions. Approximately 77% of our revenue is derived from subscription-based solutions, attributable to managed security contracts, while approximately 23% is derived from professional services engagements. International revenue, which we define as revenue contracted through non-U.S. entities, represented approximately 22% of our total net revenue in the second quarter of fiscal 2019 and 16% of our total net revenue in the second quarter of fiscal 2018. Although our international clients are located primarily in the United Kingdom, we provided managed security services to clients across 54 countries as of August 3, 2018.

Over all of the periods presented in this report, our pricing strategy for our various offerings was relatively consistent, and accordingly did not significantly affect our revenue growth. However, we may adjust our pricing to remain competitive and support our strategic initiatives.

During the second quarter of fiscal 2019, a significant portion of the contract with Bank of America, N.A., a large client, was amended and extended for two more years. During the term of the extended contract, the mix of services is expected to be different than it was in historical periods and the total anticipated value of services may be lower in the future.

Gross Margin

We operate in a challenging business environment, where the complexity and number of cyber attacks are constantly increasing. Accordingly, initiatives to drive the efficiency of our Counter Threat Platform and the continued training and development of our employees are critical to our long-term success. Gross margin has been and will continue to be affected by these factors as well as others, including the mix of solutions sold, the mix between large and small clients, timing of revenue recognition and the extent to which we expand our counter threat operations centers.

Cost of revenue consists primarily of personnel expenses, including salaries, benefits and performance-based compensation for employees who maintain our Counter Threat Platform and provide solutions to our clients, as well as perform other critical functions. Also included in cost of revenue are amortization of equipment and costs associated with hardware provided to clients as part of their subscription services, amortization of technology licensing fees, fees paid to contractors who supplement or support our solutions, maintenance fees and overhead allocations. As our business grows, the cost of revenue associated with our solutions may fluctuate.

We operate in a high-growth industry and have experienced significant revenue growth since our inception. Accordingly, we expect our gross margin to increase in absolute dollars. We continue to invest in initiatives to drive the efficiency of our business to increase gross margin as a percentage of total revenue. However, as we balance revenue growth and efficiency initiatives, gross margin as a percentage of total revenue may fluctuate from period to period.

Operating Costs and Expenses

Our operating costs and expenses consist of research and development expenses, sales and marketing expenses and general and administrative expenses.

- *Research and Development, or R&D, Expenses.* Research and development expenses include compensation and related expenses for the continued development of our solutions offerings, including a portion of expenses related to our threat research team, which focuses on the identification of system vulnerabilities, data forensics and malware analysis. R&D expenses also encompass expenses related to the development of prototypes of new solutions offerings and allocated overhead. Our solutions offerings have generally been developed internally. We operate in a competitive and highly technical industry. Therefore, to maintain and extend our technology leadership, we intend to continue to invest in our R&D efforts by hiring more personnel to enhance our existing security solutions and to add complementary solutions.
- *Sales and Marketing, or S&M, Expenses.* Sales and marketing expenses include salaries, sales commissions and performance-based compensation benefits and related expenses for our S&M personnel, travel and entertainment, marketing and advertising programs (including lead generation), client advocacy events, and other brand-building expenses, as well as allocated overhead.
- *General and Administrative, or G&A, Expenses.* General and administrative expenses include primarily the costs of human resources and recruiting, finance and accounting, legal support, information management and information security systems, facilities management, corporate development and other administrative functions, and are partially offset by allocations of information technology and facilities costs to other functions.

As we continue to grow our business, both domestically and internationally, we will invest in our sales capability, which will increase our sales and marketing expenses in absolute dollars. In addition, we expect to incur additional costs as we increase our G&A functions to further support stand-alone public company requirements.

Interest and Other, Net

Interest and other, net consists primarily of the effect of exchange rates on our foreign currency-denominated asset and liability balances and interest income earned on our cash and cash equivalents. All foreign currency transaction adjustments are recorded as foreign currency gains (losses) in the Condensed Consolidated Statements of Operations. To date, we have had minimal interest income.

Income Tax Expense (Benefit)

Our effective tax rate was a benefit of 25.8% and 37.2% for the three months ended August 3, 2018 and August 4, 2017, respectively, and 22.0% and 34.6% for the six months ended August 3, 2018 and August 4, 2017, respectively. The change in the Company's effective income tax rate for the three and six months ended August 3, 2018 compared to the effective income tax rate for the three and six months ended August 4, 2017 was primarily attributable to the impact of the Tax Cuts and Jobs Act of 2017 on the federal statutory rate and the impact of certain discrete adjustments and non-deductible stock compensation expense in fiscal 2019.

We calculate a provision for income taxes using the asset and liability method, under which deferred tax assets and liabilities are recognized by identifying the temporary differences arising from the different treatment of items for tax and accounting purposes. We provide valuation allowances for deferred tax assets, where appropriate. We file U.S. federal returns on a consolidated basis with Dell and we expect to continue doing so until such time (if any) as we are deconsolidated for tax purposes with respect to the Dell consolidated group. According to the terms of the tax matters agreement between Dell Technologies and Secureworks that went into effect on August 1, 2015, Dell Technologies will reimburse us for any amounts by which our tax assets reduce the amount of tax liability owed by the Dell group on an unconsolidated basis. For a further discussion of income tax matters, see "Notes to Condensed Consolidated Financial Statements—Note 8—Income and Other Taxes" in our condensed consolidated financial statements included in this report.

Results of Operations

The following tables summarize our key performance indicators for the three and six months ended August 3, 2018 and August 4, 2017.

	Three Months Ended				
	August 3, 2018			August 4, 2017	
	$	% of Revenue	% Change	$	% of Revenue
	(in thousands, except percentages)				
Net revenue	$ 128,778	100.0 %	10.8 %	$ 116,240	100.0 %
Cost of revenue	$ 62,548	48.6 %	11.9 %	$ 55,907	48.1 %
Total gross margin	$ 66,230	51.4 %	9.8 %	$ 60,333	51.9 %
Operating expenses	$ 80,393	62.4 %	5.4 %	$ 76,264	65.6 %
Operating loss	$ (14,163)	(11.0)%	(11.1)%	$ (15,931)	(13.7)%
Net loss	$ (9,769)	(7.6)%	(4.9)%	$ (10,271)	(8.8)%
Other Financial Information [(1)]					
Non-GAAP net revenue	$ 128,778	100.0 %	10.6 %	$ 116,386	100.0 %
Non-GAAP cost of revenue	$ 58,862	45.7 %	12.6 %	$ 52,269	44.9 %
Non-GAAP gross margin	$ 69,916	54.3 %	9.0 %	$ 64,117	55.1 %
Non-GAAP operating expenses	$ 72,233	56.1 %	4.4 %	$ 69,172	59.4 %
Non-GAAP operating loss	$ (2,317)	(1.8)%	(54.2)%	$ (5,055)	(4.3)%
Non-GAAP net loss	$ (861)	(0.7)%	(75.5)%	$ (3,517)	(3.0)%
Adjusted EBITDA	$ 974	0.8 %	(152.6)%	$ (1,850)	(1.6)%

	Six Months Ended				
	August 3, 2018			August 4, 2017	
	$	% of Revenue	% Change	$	% of Revenue
	(in thousands, except percentages)				
Net revenue	$ 254,939	100.0 %	10.9 %	$ 229,918	100.0 %
Cost of revenue	$ 123,078	48.3 %	12.4 %	$ 109,520	47.6 %
Total gross margin	$ 131,861	51.7 %	9.5 %	$ 120,398	52.4 %
Operating expenses	$ 163,614	64.2 %	5.3 %	$ 155,325	67.6 %
Operating loss	$ (31,753)	(12.5)%	(9.1)%	$ (34,927)	(15.2)%
Net loss	$ (23,588)	(9.3)%	0.2 %	$ (23,548)	(10.2)%
Other Financial Information [(1)]					
Non-GAAP net revenue	$ 254,939	100.0 %	10.7 %	$ 230,210	100.0 %
Non-GAAP cost of revenue	$ 115,713	45.4 %	13.2 %	$ 102,238	44.4 %
Non-GAAP gross margin	$ 139,226	54.6 %	8.8 %	$ 127,972	55.6 %
Non-GAAP operating expenses	$ 147,469	57.8 %	4.6 %	$ 141,049	61.3 %
Non-GAAP operating loss	$ (8,243)	(3.2)%	(37.0)%	$ (13,077)	(5.7)%
Non-GAAP net loss	$ (5,407)	(2.1)%	(40.3)%	$ (9,054)	(3.9)%
Adjusted EBITDA	$ (1,599)	(0.6)%	(76.5)%	$ (6,811)	(3.0)%

(1) See "Non-GAAP Financial Measures" and "Reconciliation of Non-GAAP Financial Measures" for more information about these non-GAAP financial measures, including our reasons for including the measures, material limitations with respect to the usefulness of the measures, and a reconciliation of each non-GAAP financial measure to the most directly comparable GAAP financial measure. Non-GAAP financial measures as a percentage of revenue are calculated based on non-GAAP revenue.

Three and six months ended August 3, 2018 compared to the three and six months ended August 4, 2017

Revenue

Net revenue, which we refer to as revenue, increased $12.5 million, or 10.8%, and $25.0 million, or 10.9% for the three and six months ended August 3, 2018, respectively. These revenue increases resulted primarily from revenue generated by subscription-based solutions, as revenue attributable to these solutions represented approximately 77% of net revenue for the three and six months ended August 3, 2018. Our existing clients continued to increase their contracted subscriptions for our solutions, with average revenue per client increasing 13% year over year.

Revenue for certain services provided to or on behalf of Dell under our commercial agreements with Dell totaled approximately $5.1 million and $10.1 million for the three and six months ended August 3, 2018, respectively, and $6.7 million and $12.6 million for the three and six months ended August 4, 2017, respectively. For more information regarding the commercial agreements, see "Notes to Condensed Consolidated Financial Statements—Note 9—Related Party Transactions" in our condensed consolidated financial statements included in this report.

We primarily generate revenue from sales in the United States. However, for the three months ended August 3, 2018, international revenue, which we define as revenue contracted through non-U.S. entities, increased to $28.4 million, or 50.5%, from the three months ended August 4, 2017. Currently, our international clients are primarily located in Europe, Asia/Pacific and Canada. We are focused on continuing to grow our international client base in future periods.

Gross Margin

Our total gross margin increased $5.9 million, or 9.8%, for the three months ended August 3, 2018, and $11.5 million, or 9.5%, for the six months ended August 3, 2018. As a percentage of revenue, our gross margin decreased 50 basis points to 51.4% and 70 basis points to 51.7% for the three and six months ended August 3, 2018, respectively. Gross margin on a GAAP basis includes amortization of intangible assets, stock compensation expense and purchase accounting adjustments. On a non-GAAP basis, excluding these adjustments, gross margin increased $5.8 million, or 9.0%, for the three months ended August 3, 2018, and $11.3 million, or 8.8%, for the six months ended August 3, 2018. As a percentage of revenue, our non-GAAP gross margin decreased 80 basis points to 54.3% for the three months ended August 3, 2018 and 100 basis points to 54.6% for the six months ended August 3, 2018 compared to the three and six months ended August 4, 2017, respectively. The decrease in gross margin as a percentage of revenue on both a GAAP and non-GAAP basis during the three and six months ended August 3, 2018 was primarily attributable to an increased mix of revenue from large clients, some of which are more price competitive, and the growth of consulting revenue.

Operating Expenses

The following table presents information regarding our operating expenses during the three and six months ended August 3, 2018 and August 4, 2017.

	Three Months Ended				
	August 3, 2018			August 4, 2017*	
	Dollars	% of Revenue	% Change	Dollars	% of Revenue
	(in thousands, except percentages)				
Operating expenses:					
Research and development	$ 22,453	17.4%	14.0 %	$ 19,693	16.9%
Sales and marketing	35,521	27.6%	0.2 %	35,433	30.5%
General and administrative	22,419	17.4%	6.1 %	21,138	18.2%
Total operating expenses	$ 80,393	62.4%	5.4 %	$ 76,264	65.6%
Other Financial Information					
Non-GAAP research and development	$ 21,447	16.7%	13.3 %	$ 18,934	16.3%
Non-GAAP sales and marketing	34,801	27.0%	(0.6)%	35,022	30.1%
Non-GAAP general and administrative	15,985	12.4%	5.1 %	15,216	13.1%
Non-GAAP operating expenses (1)	$ 72,233	56.1%	4.4 %	$ 69,172	59.4%

	Six Months Ended				
	August 3, 2018			August 4, 2017*	
	Dollars	% of Revenue	% Change	Dollars	% of Revenue
	(in thousands, except percentages)				
Operating expenses:					
Research and development	$ 44,807	17.6%	14.4 %	$ 39,172	17.0%
Sales and marketing	71,191	27.9%	(0.6)%	71,611	31.1%
General and administrative	47,616	18.7%	6.9 %	44,542	19.4%
Total operating expenses	$ 163,614	64.2%	5.3 %	$ 155,325	67.6%
Other Financial Information					
Non-GAAP research and development	$ 42,770	16.8%	13.8 %	$ 37,599	16.3%
Non-GAAP sales and marketing	69,850	27.4%	(1.6)%	70,986	30.8%
Non-GAAP general and administrative	34,849	13.7%	7.3 %	32,464	14.1%
Non-GAAP operating expenses (1)	$ 147,469	57.8%	4.6 %	$ 141,049	61.3%

(1) See "Non-GAAP Financial Measures" and "Reconciliation of Non-GAAP Financial Measures" for a reconciliation of each non-GAAP financial measure to the most directly comparable GAAP financial measure.

* Certain prior period amounts have been adjusted as a result of the adoption of the accounting standard for revenue recognition set forth in ASC 606.

Research and Development Expenses. R&D expenses increased $2.8 million, or 14.0%, and $5.6 million, or 14.4%, for the three and six months ended August 3, 2018, respectively. As a percentage of revenue, R&D expenses increased 50 basis points to 17.4% and 60 basis points to 17.6% for the three and six months ended August 3, 2018, respectively. On a non-GAAP basis, R&D expenses as a percentage of revenue increased 40 basis points to 16.7% and 50 basis points to 16.8% for the three and six months ended August 3, 2018, respectively. The increases were primarily attributable to compensation and benefit costs for additional engineers and the use of outside resources associated with strategic initiatives related to the development of a new application framework.

Sales and Marketing Expenses. S&M expenses increased $0.1 million, or 0.2%, for the three months ended August 3, 2018 and decreased $0.4 million, or 0.6%, for the six months ended August 3, 2018. As a percentage of revenue, S&M expenses decreased 290 basis points to 27.6% and 320 basis points to 27.9% for the three and six months ended August 3, 2018, respectively. On a non-GAAP basis, S&M expenses as a percentage of revenue decreased 310 basis points to 27.0% and 340 basis points to 27.4% for the three and six months ended August 3, 2018, respectively. The decreases in S&M expenses as a percentage of revenue were primarily attributable to lower headcount, a decrease in commission expense, and greater leverage on the overall cost base as revenue increased.

General and Administrative Expenses. G&A expenses increased $1.3 million, or 6.1%, and $3.1 million, or 6.9%, for the three and six months ended August 3, 2018, respectively. As a percentage of revenue, G&A expenses decreased 80 basis points to 17.4% and 70 basis points to 18.7% for the three and six months ended August 3, 2018, respectively. On a non-GAAP basis, G&A expenses as a percentage of revenue decreased 70 basis points to 12.4% and 40 basis points to 13.7% for the three and six months ended August 3, 2018, respectively. The increases in G&A expenses on a dollar basis resulted from an overall increase in our long-term incentive and stock compensation expense as these programs ramped up following our IPO.

Operating Loss

Our GAAP operating loss decreased to $14.2 million and $31.8 million for the three and six months ended August 3, 2018, respectively, from $15.9 million and $34.9 million for the three and six months ended August 4, 2017, respectively. As a percentage of revenue, our operating loss decreased to 11.0% and 12.5% for the three and six months ended August 3, 2018, respectively. The decreases in our GAAP operating loss on a dollar basis were primarily attributable to increased gross margin, which was partially offset by research and development investments in our business together with higher G&A expenses relating to costs of long-term compensation programs combined with lower sales and marketing expenses. Operating loss on a GAAP basis includes amortization of intangible assets, purchase accounting adjustments and stock-based compensation expense. On a non-GAAP basis, excluding these charges, our operating loss as a percentage of revenue decreased to 1.8% and 3.2% for the three and six months ended August 3, 2018, respectively. The decrease in our non-GAAP net operating loss as a percentage of revenue during the three and six months ended August 3, 2018 was primarily attributable to improved operating leverage as we grow, which was partially offset by research and development investments in our business, including the addition of personnel.

Interest and Other, Net

Our interest and other, net was $1.0 million and $1.5 million of income for the three and six months ended August 3, 2018, respectively, compared with $0.4 million and $1.1 million of expense for the three and six months ended August 4, 2017, respectively. The changes primarily reflected the effects of foreign currency transactions and related exchange rate fluctuations.

Income Tax Benefit

Our income tax benefit was $3.4 million, or 25.8%, and $6.7 million, or 22.0%, of our pre-tax loss during the three and six months ended August 3, 2018, respectively. Comparatively, our income tax benefit was $6.1 million, or 37.2%, and $12.4 million, or 34.6%, of our pre-tax loss during the three and six months ended August 4, 2017, respectively. The decrease in the effective tax rate is primarily attributable to the decrease in the federal statutory rate from 35% to 21% as a result of the Tax Cuts and Jobs Act of 2017, an overall decrease in our pre-tax losses and the impact of certain discrete adjustments and non-deductible stock-based compensation expense in the periods.

Net Loss

Our net loss of $9.8 million decreased $0.5 million, or 4.9%, for the three months ended August 3, 2018. For the six months ended, our net loss of $23.6 million decreased $40.0 thousand, or 0.2%. Net loss on a non-GAAP basis was $0.9 million, which represented a decrease of $2.7 million, or 75.5%, and $5.4 million, which represented a decrease of $3.6 million, or 40.3%, from the three and six months ended August 4, 2017, respectively. The changes in net loss were attributable to our improved operating loss results offset in part by the lower income tax benefit recognized in the periods.

Liquidity, Capital Commitments and Contractual Cash Obligations

Overview

We believe that our cash and cash equivalents together with our accounts receivable will provide us with sufficient liquidity to fund our business and meet our obligations for at least 12 months. Our future capital requirements will depend on many factors, including our rate of revenue growth, the rate of expansion of our workforce, the timing and extent of our expansion into new markets, the timing of introductions of new functionality and enhancements to our solutions, potential acquisitions of complementary businesses and technologies, continuing market acceptance of our solutions, and general economic conditions. We may need to raise additional capital or incur indebtedness to continue to fund our operations in the future or to fund our needs for less predictable strategic initiatives, such as acquisitions. In addition to our $30 million revolving credit facility from Dell, described below, sources of financing may include arrangements with unaffiliated third parties, depending on the availability of capital, the cost of funds and lender collateral requirements.

Selected Measures of Liquidity and Capital Resources

Selected measures of our liquidity and capital resources are as follows:

	August 3, 2018	February 2, 2018
	(in thousands)	
Cash and cash equivalents	$ 103,316	$ 101,539
Accounts receivable, net	$ 133,344	$ 157,764

As of August 3, 2018, our principal sources of liquidity consisted of cash and cash equivalents of $103.3 million and accounts receivable of $133.3 million. Our cash and cash equivalents balance as of August 3, 2018 included $34.3 million invested in money market funds pending use in our business.

We invoice our clients based on a variety of billing schedules. During the six months ended August 3, 2018, on average, 55% of our recurring revenue was billed in advance and approximately 45% was billed on either a monthly or a quarterly basis. Invoiced accounts receivable generally are collected over a period of 30 to 120 days. The decrease in accounts receivable as of August 3, 2018, reflected increased collection activity, partially offset by an increase in revenue. We regularly monitor our accounts receivable for collectability, particularly in markets where economic conditions remain uncertain and continue to take actions to reduce our exposure to credit losses. As of August 3, 2018 and February 2, 2018, the allowance for doubtful accounts was $7.4 million and $8.2 million, respectively. The decrease in the allowance for doubtful accounts was due to overall improvement in our longer-aged receivables balances as well as the collection of accounts for which we had previously recorded an allowance. Based on our assessment, we believe we are adequately reserved for credit risk.

Revolving Credit Facility

SecureWorks, Inc., our wholly-owned subsidiary, has entered into a revolving credit agreement with a wholly-owned subsidiary of Dell Inc. under which we have obtained a $30 million senior unsecured revolving credit facility. During the three months ended May 4, 2018, the facility was amended and restated to extend the maturity date to March 27, 2019 and to reduce the annual rate at which interest accrues to the applicable London Interbank Offered Rate plus 1.15%. Under the facility, up to $30 million principal amount of borrowings may be outstanding at any time. The maximum amount of borrowings may be increased by up to an additional $30 million by mutual agreement of the lender and borrower. The proceeds from loans made under the facility may be used for general corporate purposes. The facility is not guaranteed by us or our subsidiaries. There was no outstanding balance under the facility as of as of August 3, 2018 or February 2, 2018.

The unused portion of the facility is subject to a commitment fee of 0.35%, which is due upon expiration of the facility. For additional information about the facility, see "Notes to Condensed Consolidated Financial Statements—Note 5—Debt" in our condensed consolidated financial statements included in this report.

Cash Flows

The following table presents information concerning our cash flows during the six months ended August 3, 2018 and August 4, 2017.

	Six Months Ended	
	August 3, 2018	August 4, 2017
	(in thousands)	
Net change in cash from:		
Operating activities	$ 10,886	$ (8,415)
Investing activities	(5,366)	(8,376)
Financing activities	(3,743)	(2,024)
Change in cash and cash equivalents	$ 1,777	$ (18,815)

Operating Activities — Cash provided by operating activities totaled $10.9 million and cash used in operating activities totaled $8.4 million for the six months ended August 3, 2018 and August 4, 2017, respectively. The increase in our operating cash flows was primarily driven by the decrease in our net accounts receivable balance due to increased revenues and improved collection rates, partially offset by the overall decrease in our accounts payable and accrued liabilities as well as our net transactions with Dell.

We began fiscal 2019 with a net payable to Dell of $19.6 million. On a continuing basis, we incur liabilities to Dell for charges under our commercial agreements with Dell and for costs Dell continues to pay directly on our behalf, such as the cost of employee benefits for our employees provided under the Dell benefit plans. Offsetting these liabilities, we charge to, or through, Dell for sales to our clients that we make through Dell legal entities or for services we provide directly to Dell. As of August 3, 2018, the amount due to Dell had decreased to approximately $17.5 million. During the third quarter of fiscal 2017, we began settling in cash our related party balances with Dell and will continue doing so on a quarterly basis. We expect that over time our transactions with Dell will not be a use of cash as we anticipate that our charges to Dell will continue to exceed Dell's charges to us, although the timing of charges and settlements may vary from period to period.

Investing Activities — Cash used in investing activities totaled $5.4 million and $8.4 million for the six months ended August 3, 2018 and August 4, 2017, respectively. For the periods presented, investing activities consisted primarily of capital expenditures for property and equipment to support our data center and facility infrastructure. Additionally, during the six months ended August 4, 2017, the Company capitalized costs associated with the implementation of its new ERP system.

Financing Activities — Cash flows used in financing activities totaled $3.7 million and $2.0 million for the six months ended August 3, 2018 and August 4, 2017, respectively. The usage in the six months ended August 3, 2018 reflected employee tax withholding payments of $2.1 million on restricted stock awards paid by us and payments of long-term financing arrangements of $1.6 million, including an intercompany obligation with a Dell subsidiary of $1.1 million. The usage in the six months ended August 4, 2017 reflected employee tax withholding payments of $1.2 million on restricted stock awards paid by us and payment of an intercompany obligation of $0.8 million.

Off-Balance Sheet Arrangements

As of August 3, 2018, we were not subject to any obligations pursuant to any off-balance sheet arrangements that have or are reasonably likely to have a material effect on our financial condition, results of operations or liquidity.

Critical Accounting Policies

The unaudited condensed consolidated financial statements included elsewhere in this report have been prepared in accordance with GAAP for interim financial information and the requirements of the SEC. Accordingly, they do not include all of the information and disclosures required by GAAP for a complete financial statement presentation. The year-end condensed balance sheet data was derived from audited financial statements, but does not include all disclosures required by GAAP. In the opinion of management, all adjustments consisting of normal recurring accruals and disclosures considered necessary for a fair interim presentation have been included. All inter-company accounts and transactions have been eliminated in consolidation.

As described in "Notes to Condensed Consolidated Financial Statements—Note 1—Description of the Business and Basis of Presentation," we have adopted the new revenue recognition accounting guidance set forth in ASC 606. Management assessed the critical accounting policies as disclosed in our Annual Report and determined that, other than the change in accounting for revenue recognition, there were no changes to our critical accounting policies or our estimates associated with those policies during the three and six months ended August 3, 2018.

Recently Issued Accounting Pronouncements

See "Notes to Condensed Consolidated Financial Statements—Note 1—Description of the Business and Basis of Presentation" in our condensed consolidated financial statements included in this report for a description of recently issued accounting pronouncements and our expectation of their impact, if any, on our financial statements.

Item 3. Quantitative and Qualitative Disclosures About Market 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, the British Pound, the Romanian Leu and the Canadian Dollar, the currencies of countries where we currently have our most significant international operations. Our expenses in international locations are generally denominated in the currencies of the countries in which our operations are located.

As our international operations grow, we may begin to use foreign exchange forward contracts to partially mitigate the impact of fluctuations in net monetary assets denominated in foreign currencies.

Item 4. Controls and Procedures

Limitations on Effectiveness of Disclosure Controls and Procedures

In designing and evaluating our disclosure controls and procedures, as defined below under SEC rules, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. In addition, the design of disclosure controls and procedures must reflect the fact that there are resource constraints and that management is required to apply its judgment in evaluating the benefits of possible controls and procedures relative to their costs.

Evaluation of Disclosure Controls and Procedures

Disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange of 1934, or Exchange Act) are designed to ensure that information required to be disclosed in reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms and that such information is accumulated and communicated to management, including the chief executive officer and the chief financial officer, to allow timely decisions regarding required disclosures.

In connection with the preparation of this report, our management, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures as of August 3, 2018. Based on that evaluation, our management has concluded that our disclosure controls and procedures were effective as of August 3, 2018.

Changes in Internal Control over Financial Reporting

Internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) 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. Internal control over financial reporting includes those policies and procedures which (a) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of assets, (b) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, (c) provide reasonable assurance that receipts and expenditures are being made only in accordance with appropriate authorization of management and the board of directors, and (d) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of assets that could have a material effect on the financial statements.

There were no changes in our internal control over financial reporting that occurred during the quarter ended August 3, 2018 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Part II. Other Information

Item 1A. Risk Factors

We have discussed risks affecting us under "Risk Factors" in Part I, Item 1A of our Annual Report on Form 10-K for the fiscal year ended February 2, 2018 filed with the SEC on March 28, 2018 and in our Quarterly Report on Form 10-Q for the quarterly period ended May 4, 2018. The risks described in that Annual Report and that Quarterly Report are not the only risks facing us. There are additional risks and uncertainties not currently known to us or that we currently deem to be immaterial that may also materially adversely affect our business, financial condition or operating results.

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

Proceeds from the Company's April 2016 IPO, net of fees and transaction costs, were approximately $99.6 million. There has been no material change in the use, or planned use, of proceeds from our IPO as described in the prospectus for the offering. As of August 3, 2018, the Company's total cash and cash equivalents balances were $103.3 million, which represents the remaining net proceeds from the IPO and cash flows generated in the normal course of operations. Approximately $34.3 million of the Company's cash and cash equivalents are invested in money market funds pending their use in our business.

Item 6. Exhibits

Secureworks hereby files or furnishes the following exhibits:

Exhibit No.	Description
10.1	SecureWorks Corp. 2016 Long-Term Incentive Plan, as amended and restated as of June 21, 2018 (incorporated by reference to Exhibit 10.1 to SecureWorks Corp.'s Current Report on Form 8-K filed with the Securities and Exchange Commission on June 27, 2018 (Commission File No. 001-37748).
10.2	Amendment #3 to Shared Services Agreement, dated as of July 11, 2018, between SecureWorks Corp. and Dell Inc. Filed herewith.
31.1	Certification of Chief Executive Officer of the Company pursuant to Rule 13a-14(a) or Rule 15d-14(a) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. Filed herewith.
31.2	Certification of Chief Financial Officer of the Company pursuant to Rule 13a-14(a) or Rule 15d-14(a) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. Filed herewith.
32.1	Certifications of Chief Executive Officer and Chief Financial Officer of the Company pursuant to Rule 13a-14(b) or Rule 15d-14(b) under 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. Furnished herewith.
101.INS	XBRL Instance Document.
101.SCH	XBRL Taxonomy Extension Schema Document.
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document.
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document.
101.LAB	XBRL Taxonomy Extension Labels Linkbase Document.
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document.

+ Indicates a management contract or any compensatory plan, contract or arrangement

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

SecureWorks Corp.

By: /s/ R. Wayne Jackson

R. Wayne Jackson
Chief Financial Officer
(Duly Authorized Officer)

Date: September 5, 2018

Amendment #3 to
SHARED SERVICES AGREEMENT

THIS AMENDMENT #3 TO SHARED SERVICES AGREEMENT (this "Amendment"), dated July 11, 2018, is made by and between Dell Inc., for itself and its Subsidiaries ("Dell"), and SecureWorks Corp. (f/k/a SecureWorks Holding Corporation), for itself and its Subsidiaries ("SCWX") (each a "Party" and collectively, the "Parties") and amends the Shared Services Agreement, dated July 20, 2015, that was entered into by and between the Parties (as amended, the "Agreement"). Capitalized terms used herein, but not defined herein, shall have the meanings given to such terms in the Agreement.

RECITALS

WHEREAS, pursuant to the Agreement, Dell is providing to SCWX certain Services set forth on Service Schedules in accordance with the terms and subject to the conditions set forth in the Agreement; and

WHEREAS, the Parties desire to amend Schedule B of the Agreement.

NOW, THEREFORE, in consideration of the mutual agreements, provisions, and covenants contained in this Amendment, the Parties, intending to be legally bound, hereby agree as follows:

a. Schedule B. Schedule B of the Agreement shall be amended by replacing "$750,000 per year" with "$375,000 per year." Such amended pricing shall be effective as of June 1, 2018.

b. Miscellaneous. Except as amended by the terms of this Amendment, the terms and conditions of the Agreement shall remain in full force and effect. In the event of a conflict between the terms of the Agreement and the terms of this Amendment, the terms of this Amendment shall govern and control. This Amendment and the Agreement constitute the sole and entire understanding of the Parties with respect to the matters contemplated hereby and supersede and render null and void all prior negotiations, representations, agreements, and understandings (oral and written) between the Parties with respect to such matters. This Amendment shall inure to the benefit of and be binding upon the Parties and their respective successors and assigns. This Amendment may be executed in counterparts, each of which shall be deemed to be an original but all of which shall constitute one and the same agreement.

[Signature Page Follows]

IN WITNESS WHEREOF, the Parties have executed this Amendment as of the date first set forth above.

DELL INC.

By: /s/ Janet Bawcom
Name: Janet Bawcom
Title: Senior Vice President & Assistant Secretary

SECUREWORKS CORP.

By: /s/ George B. Hanna
Name: George B. Hanna
Title: Chief Legal Officer & Corporate Secretary

EXHIBIT 31.1

**CERTIFICATION OF CHIEF EXECUTIVE OFFICER
OF THE COMPANY PURSUANT TO RULE 13a-14(a)
OR RULE 15d-14(a) UNDER THE SECURITIES EXCHANGE
ACT OF 1934, AS ADOPTED PURSUANT TO SECTION 302
OF THE SARBANES-OXLEY ACT OF 2002**

I, Michael R. Cote, certify that:

1. I have reviewed this quarterly report on Form 10-Q of SecureWorks Corp.;
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(s) 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(s) 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.

September 5, 2018

/s/ Michael R. Cote

Michael R. Cote
President and Chief Executive Officer

EXHIBIT 31.2

**CERTIFICATION OF CHIEF FINANCIAL OFFICER
OF THE COMPANY PURSUANT TO RULE 13a-14(a)
OR RULE 15d-14(a) UNDER THE SECURITIES EXCHANGE
ACT OF 1934, AS ADOPTED PURSUANT TO SECTION 302
OF THE SARBANES-OXLEY ACT OF 2002**

I, R. Wayne Jackson, certify that:

1. I have reviewed this quarterly report on Form 10-Q of SecureWorks Corp.;

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;

1. The registrant's other certifying officer(s) 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

4. The registrant's other certifying officer(s) 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.

September 5, 2018

/s/ R. Wayne Jackson

R. Wayne Jackson
Chief Financial Officer

EXHIBIT 32.1

CERTIFICATIONS OF CHIEF EXECUTIVE OFFICER AND CHIEF FINANCIAL OFFICER OF THE COMPANY PURSUANT TO RULE 13a-14(b) OR RULE 15d-14(b) UNDER 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

Each of the undersigned hereby certifies, in his capacity as an officer of SecureWorks Corp. (the "Company"), for purposes of 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to the best of his knowledge:

1. The quarterly report on Form 10-Q of the Company for the quarter ended August 3, 2018 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 such quarterly report on Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date:	September 5, 2018	/s/ Michael R. Cote
		Michael R. Cote
		President and Chief Executive Officer
Date:	September 5, 2018	/s/ R. Wayne Jackson
		R. Wayne Jackson
		Chief Financial Officer