EDWARDS A G INC
Form 10-K
April 27, 2007

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

FORM 10-K

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.
For the fiscal year ended February 28, 2007
OR

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

Commission file number 1-8527

State of Incorporation: DELAWARE • I.R.S. Employer Identification No.: 43-1288229
One North Jefferson Avenue, St. Louis, Missouri 63103
Registrant's telephone number, including area code: (314) 955-3000

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

Title of each class	Name of each exchange on which registered
COMMON STOCK, $1 PAR VALUE	*NEW YORK STOCK EXCHANGE*

Securities registered pursuant to Section 12(g) of the Act: NONE

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

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

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. Check one:

Large accelerated filer [X] Accelerated filer [ ] Non-accelerated filer [ ]

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

As of August 31, 2006, the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold was approximately $4.0 billion.

At April 23, 2007, there were 75,995,890 shares of A.G. Edwards, Inc. common stock, $1 par value, outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the A.G. Edwards, Inc. Proxy Statement will be filed with the Securities and Exchange Commission ("SEC") in connection with the Company's Annual Meeting of Stockholders to be held June 21, 2007, (the "Company's 2007 Proxy Statement") are incorporated by reference into Part III hereof, as indicated. Other documents incorporated by reference in this report are listed in the Exhibit Index of this Form 10-K.

A.G. EDWARDS, INC.

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PART I

ITEM 1. BUSINESS.

(a) General Development of Business

A.G. Edwards, Inc., a Delaware corporation, is a financial services holding company incorporated in 1983 whose principal subsidiary, A.G. Edwards & Sons, Inc. (Edwards), is the successor to a partnership founded in 1887. A.G. Edwards, Inc. and its directly owned and indirectly owned subsidiaries (collectively referred to as the Company) provide securities and commodities brokerage, investment banking, trust services, asset management, financial and retirement planning, insurance products, and other related financial services to individual, corporate, governmental, municipal and institutional clients through one of the industrys largest retail branch distribution systems.

Edwards is a securities broker-dealer whose business, primarily with individual clients, is conducted through one of the largest retail branch office networks (based upon number of offices and financial consultants) in the United States. No single client accounts for a significant portion of Edwards business. Edwards is a member, has trading privileges or has access to all major securities exchanges in the United States, and is a member of the National Association of Securities Dealers, Inc. (NASD) and the Securities Investor Protection Corporation (SIPC). In addition, Edwards has memberships on several domestic commodity exchanges and is registered with the Commodity Futures Trading Commission (CFTC) as a futures commission merchant (FCM). In February 2007, Edwards introduced its Federal Depository Insurance Corporation (FDIC)-insured bank deposit program (AGE Bank Deposit Program) to certain clients as part of a multi-stage rollout to all eligible clients.

A.G. Edwards Trust Company FSB (Trust Company) is a federally chartered savings bank that provides investment advisory, portfolio management and trust services. In December 2006, the Trust Company received approval from the Office of Thrift Supervision (the OTS) to expand its powers to be able to accept time and demand deposits so it can participate, along with several other FDIC-insured banks, in the AGE Bank Deposit Program.

A.G. Edwards & Sons (U.K.) Limited is a securities broker-dealer located in London, England, with an office located in Geneva, Switzerland. A.G. Edwards Capital, Inc. serves as general partner to four private equity partnerships that invest in portfolios of venture capital funds, buy-out funds, and direct investments. A.G. Edwards Technology Group, Inc. provides information technology services to the Company. Beaumont Insurance Company is a Vermont captive insurance company that centralizes certain risk management functions and provides access to reinsurance markets. Gallatin Asset Management, Inc. (Gallatin) provides separately managed account and other services to Edwards and markets its investment-management services to unaffiliated mutual-fund firms, pension-fund providers, insurance companies and other financial institutions, including banks and brokerage firms.

(b) Financial Information About Industry Segments

The Company operates and is managed as a single business segment providing investment services to its clients. These services are provided using the same sales and distribution personnel, support services and facilities, and all are provided to meet the needs of its clients. The Company does not identify or manage assets, revenues or expenses resulting from any service, or class of services, as a separate business segment. Financial information related to the Company's single business segment for each of the fiscal years ended February 28, 2007, 2006, and 2005, is included in the consolidated financial statements and notes thereto, such information is hereby incorporated by reference.

(c) Narrative Description of Business

The total amount of revenue by class of products or services that accounted for 10% or more of consolidated net revenues are set forth under Item 6 of this Form 10-K under the caption "Consolidated Five-Year Summary."

Asset Management and Service Fees

Asset management and service fee revenues consist primarily of revenues earned for providing support and services in connection with assets under third-party management, including mutual funds, managed futures funds, money market funds, annuities and insurance contracts, as well as revenues from assets under management by the Company. These revenues include fees based on the amount of client assets under management and transaction-related fees as well as fees related to the administration of custodial and other specialty accounts.

The Company manages client assets through the Trust Company and through Gallatin. The Company offers a non-discretionary advisory program known as Portfolio Advisor and a discretionary advisory program known as FC Advisor. The Company also offers fee-based fund advisory programs that allow clients to select from recommended, established asset allocation models or customize their own models in certain programs. The fund advisory programs are known individually as AGE Allocation Advisors, AGE Pathways, and AGE Professional Fund Advisor. Additionally, the Company offers separately managed accounts and through Gallatin markets its investment-management services to unaffiliated mutual funds, pension-fund providers, insurance companies, and other financial institutions, including banks and brokerage firms.

Edwards has offered clients a fee-based brokerage account known as Client Choice. As a result of a recent court decision, Edwards has stopped opening new Client Choice accounts and is evaluating the status of existing accounts. See Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations" for additional information.

Edwards offers the UltraAsset Account and the Cash Convenience Account, which combine a full-service brokerage account with a bank depository account. These programs provide for the automatic investment of customer free credit balances in the AGE Bank Deposit Program or, if a client elects, in one of several tax-exempt money market funds. Interest is not paid on uninvested credit balances held in client accounts. In addition, the UltraAsset Account allows clients access to their margin and depository or money market accounts through the use of debit card and checking account services provided by an unaffiliated major bank. The UltraAsset Account offers additional advanced features and special investment portfolio reports. Clients are provided the opportunity to apply for an A.G. Edwards credit card provided by an unaffiliated major bank.

Edwards also provides custodial services to its clients for the various types of self-directed individual retirement accounts as provided under the Internal Revenue Code of 1986, as amended (the "Internal Revenue Code").

Commissions

Commission revenues arise from activities in transaction-based accounts in listed and over-the-counter securities, mutual funds, insurance products, futures, and options. As commissions are transaction-based revenues, they are influenced by the number, size, and market value of client transactions and by product mix.

Equities. A significant portion of the Company’s net revenue is derived from commissions generated on securities transactions executed by Edwards, as a broker, in common and preferred stocks and debt instruments on exchanges or in the over-the-counter markets. Edwards’ brokerage clients are primarily individual investors. Edwards’ commission rates for brokerage transactions vary with the size and complexity of the transactions, among other factors.

Mutual Funds. Edwards distributes mutual fund shares in continuous offerings of open-end funds. Income from the sale of mutual funds is derived significantly from the standard dealer’s discount, which varies as a percentage of the client’s purchase price depending on the size of the transaction and terms of the selling agreement. Revenues derived from mutual fund sales continue to be a significant portion of net revenues. Edwards does not sponsor its own mutual fund products.

Insurance. As agent for several unaffiliated life insurance companies, Edwards distributes life insurance and tax-deferred annuities.

Futures and Options. Edwards acts as broker in the purchase and sale of managed futures, futures contracts, options on futures contracts and option contracts to buy and sell securities, primarily common stock and stock indexes. These contracts cover agricultural products, precious metals, currency, interest rate, energy and stock index futures.

Principal Transactions

Client transactions in the equity and fixed-income over-the-counter markets may be effected by Edwards acting as principal. Principal transactions, including market making, require maintaining inventories of securities to satisfy customer order flow. These securities are valued in the Company’s consolidated financial statements at fair value, and unrealized gains or losses are included in the Company’s results of operations.

Investment Banking

Edwards is an underwriter for public offerings of corporate and municipal securities as well as corporate and municipal unit investment trusts and closed-end investment companies. Corporate finance activities are focused on three industry groups: financial institutions and real estate, energy, and emerging growth. Edwards’ public finance activities include areas of specialization for municipal and governmental entities in primary and secondary schools, sports and entertainment, municipal finance, housing, higher education, health care, and public utilities. As an underwriter, usually in conjunction with other broker-dealers, Edwards purchases securities for resale to its clients. Edwards acts as an adviser to corporations and municipal entities in reviewing capital needs and determining the most advantageous means for raising capital. It also advises clients in merger and acquisition activities and acts as agent in private placements.

Net Interest Revenue

Interest revenue is derived primarily from financing clients’ margin transactions. These revenues are based largely on the amount of client margin balances and the rate of interest charged on these balances. Edwards utilizes a variety of sources to finance client margin accounts, including its stockholders’ equity, customer free credit balances and, to the extent permitted by regulations, cash received from net loans of the clients’ collateral to other brokers and borrowings from banks, either unsecured or secured by the clients’ collateral. The Company also earns revenue from interest and dividend payments on inventory held for sale to clients and short-term investments.

Private Client Services

Edwards’ Private Client Services group assists individuals and businesses with a wide range of financial and investment needs. Individual investors can receive tailored asset allocation; tax- and risk-reduction strategies; portfolio reviews of stocks, bonds and mutual funds (including concentrated equity strategies); and

comprehensive financial and estate planning recommendations. Closely held and publicly traded business clients can access services for business insurance, employee benefit programs (retirement plans and key employee compensation), and ownership succession.

Investment Activities

The Company's investment activities primarily include investing in equity and equity-related securities in connection with private investment transactions, either for the accounts of Company-sponsored private equity partnerships or for its own account. These activities include mutual fund investments, including those made in connection with its deferred compensation plan, venture capital investments, and investments in portfolio and operating companies. A.G. Edwards Capital, Inc. is a general partner to the Company-sponsored private equity partnerships and provides them with investment advisory and administrative services. The fair value of the private investments is subject to a higher degree of volatility and management's judgment and may include significant risks of loss while attempting to obtain higher returns than those available from publicly traded securities.

Research

Edwards provides both technical market and fundamental analysis of numerous industries and individual securities for use by its financial consultants and clients. In addition, review and analysis of general economic conditions, along with asset allocation recommendations, are available. These services are provided by Edwards' research analysts, economists, and market strategists.

Competition

All aspects of the Company's business are highly competitive. The Company competes with large, well capitalized providers of financial services. Those companies include other securities firms and affiliates of banks and insurance companies. The Company also competes with a number of discount brokerage firms that offer lower levels of services. The Company believes its competitive advantages lie in its client-first philosophy, service, product offerings, quality of employees and strong reputation.

The Company's success is largely dependent on its ability to attract and retain qualified employees. These employees, particularly financial consultants, in turn bring new assets and capital management opportunities to the Company.

Employees

At February 28, 2007, the Company had 744 locations in 50 states, the District of Columbia, London, England, and Geneva, Switzerland and 15,338 full-time employees, including 6,618 financial consultants providing services for approximately 3,200,000 active client accounts.

Regulation

The Company as a participant in the financial services business is regulated by federal and state regulatory agencies, self-regulatory organizations and securities exchanges and by foreign governmental agencies and regulatory bodies. Most of these regulations are designed to protect customers and their assets together with integrity of the markets rather than protecting the Company, its shareholders or creditors. Under certain circumstances, these rules may limit the ability of the Company to make withdrawals of capital from subsidiaries or for the subsidiaries to pay dividends to the Company. In addition, the Company because its stock is publicly traded, is subject to the Sarbanes-Oxley Act of 2002 and other laws together with regulations of the SEC and the New York Stock Exchange ("NYSE") governing public disclosure, corporate governance, internal controls and the roles of internal and external auditors and legal counsel.

Edwards, as a broker-dealer and a FCM, is subject to various federal and state laws that regulate virtually all of its activities as a broker-dealer in securities and commodities, as an investment advisor, and as an insurance agent. Edwards is also subject to various regulatory requirements imposed by the securities and commodities exchanges, the NASD and the NYSE. These laws and regulatory requirements generally subject Edwards to standards of solvency with respect to capital requirements, financial reporting requirements, approval of qualifications of personnel engaged in various aspects of its business, record-keeping and business practices, the handling of its clients funds resulting from securities and commodities transactions, and the extension of credit to clients on margin transactions. Violations of these laws, rules and regulations may result in limitations on certain aspects of Edwards regulated activities, as well as proceedings of a civil or criminal nature against the firm or employees that could result in the issuance of cease and desist orders, censures, fines or other monetary penalties or the suspension or expulsion from the securities business of the firm, its officers or its employees.

Margin lending by Edwards and other broker-dealers is regulated by the Federal Reserve Board which restricts lending in connection with customer and proprietary purchases and short sales of securities as well as securities borrowing and lending activities. The NASD and NYSE also by rule require minimum maintenance requirements on the value of securities contained in margin accounts. Edwards margin policies are generally more stringent than these rules.

The commodity futures and commodity options industry in the United States is subject to regulation under the Commodity Exchange Act and by the CFTC charged with administering the act. Edwards is registered with the CFTC. In addition, various self-regulatory organizations including the Chicago Board of Trade (CBOT) and the Chicago Mercantile Exchange (CME), other futures exchanges and the National Futures Association govern the commodity futures and commodity options businesses.

As a registered broker-dealer, Edwards is subject to net capital rules administered by the SEC and the NYSE. Under such rules, this subsidiary must maintain net capital of not less than 2 percent of aggregate debit items, as defined, arising from customer transactions and would be restricted from expanding its business or paying cash dividends or advancing loans to affiliates if its net capital were less than 5 percent of such items. These rules also require Edwards to notify and sometimes obtain approval of the SEC and other regulatory organizations for substantial withdrawals of capital or loans to affiliates. See Note 6 (Net Capital Requirements) of the Notes to the Consolidated Financial Statements for a discussion of Edwards net capital at February 28, 2007.

The Trust Company and certain other subsidiaries are also subject to minimum capital requirements that may restrict the payment of cash dividends and advances to the Company. The only restriction with regard to the payment of cash dividends by the Company is its ability to obtain cash through dividends and advances from its subsidiaries or borrowings, if needed.

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The Trust Company is a federal savings bank and as such is regulated by the OTS and the FDIC. The OTS imposes minimum capital requirements upon the Trust Company. Until December 2006, the Trust Company was authorized only to accept trust and custodian accounts and not to accept deposits or make loans. In December 2006, the Trust Company received authorization to accept time and demand deposits. The Trust Company currently plans to begin accepting demand deposits in mid-calendar 2007. The acceptance of time and demand deposits will subject the Trust Company to increased regulatory requirements including for additional capital and those governing accepting demand deposits and investing the funds received. A.G. Edwards, Inc. is registered as a holding company with the OTS as a result of owning the Trust Company.

A.G. Edwards & Sons (U.K.) Limited is registered under the laws of the United Kingdom and Switzerland and is regulated as a securities broker-dealer by the Financial Services Authority. A.G. Edwards Capital, Inc. and Gallatin are each registered with the SEC as an investment advisor. Beaumont Insurance Company is regulated by the Vermont Department of Banking, Insurance, Securities and Health Care Administration.

The USA PATRIOT Act of 2001 imposes obligations to detect and deter money laundering and for transparency of financial transactions on broker-dealers and other financial services companies including Edwards and the Trust Company. The obligations include requirements to verify client identification at account opening and to monitor client transactions and report suspicious activities. Anti-money laundering laws outside the United States

impose similar requirements and particularly affect A.G. Edwards & Sons (U.K.) Limited. The anti-money laundering requirements have required the development of extensive internal practices, procedures and controls and any failure could subject the Company, its employees or both to substantial liabilities and fines.

(d) Financial Information About Geographic Areas

Revenues from the Company's non-U.S. operations are currently not material. See Note 12 (Enterprise Wide Disclosure) of the Notes to Consolidated Financial Statements.

(e) Available Information

The Company files annual, quarterly, and current reports, proxy statements, and other information with the SEC.

The public may read and copy the Company's annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, proxy statements and any amendments to these reports filed with the SEC at the SEC's Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. This information may also be obtained from the SEC's web site at *www.sec.gov*.

The Company's web site is *www.agedwards.com*. The public can access the Company's Investor Relations' web page by clicking on About A.G. Edwards and the Investor Relations link. The public can also access the Investor Relations web page directly at *www.agedwards.com/public/content/sc/aboutage/ir/index.html*. The Company makes available free of charge its most recent annual reports on Form 10-K, its quarterly reports on Form 10-Q for the current fiscal year, and its most recent proxy statement on its Investor Relations web page. In some cases, these documents may not be available on the Company's web site as soon as they are available on the SEC's web site. The Company also makes available, through its Investor Relations web page, via a link to the SEC's web site, current reports on Form 8-K and statements of beneficial ownership of the Company's equity securities filed by its directors, officers and others under Section 16 of the Securities Exchange Act of 1934 (the "Exchange Act").

ITEM 1A. RISK FACTORS.

In the course of conducting business, the Company faces a variety of risks that are inherent to the financial services business. The following is a summary of the risks that management believes are the most significant and could affect the Company's financial condition.

Developments in market and economic conditions could adversely affect the Company's business operations and profitability.

Overall market and economic conditions, which are beyond the Company's control and cannot be predicted with great certainty, generally have a direct impact on client asset valuations and trading activity. In an environment of adverse or uncertain market or economic conditions, the Company could experience decreased trading volumes, decreased fee-based and commission revenue, and decreased profitability.

The Company may not be able to successfully compete against the other companies within the financial services industry.

The financial services industry has been, and will likely continue to be, intensely competitive. The Company generally competes on the basis of its strong reputation, client-first philosophy and superior service, quality of employees, and range of product and service offerings. The Company competes for business with financial services firms that have greater financial resources and global operations, allowing them to potentially take on more risk and earn higher returns. The Company also competes with companies offering online and discount brokerage services and with banks and bank-affiliated brokerage companies that increasingly are using

brokerage services, sometimes at reduced or no cost to customers, to attract clients for bank services. In the event that the Company cannot successfully compete with these financial services firms on one or more of the previously mentioned factors, it may face a reduction in market share, a reduction in revenues, and/or a reduction in profitability.

The Company may not be able to attract, develop, and retain highly qualified and productive employees.

The Company's employees are its most important assets, and competition for qualified employees is fiercely competitive, especially for successful financial consultants. If the Company cannot continue to attract and retain high quality employees, or if the costs to attract and retain high quality employees rise due to competition, the Company's business operations and financial performance could be adversely impacted.

The Company's business may be adversely affected if its reputation is damaged.

As a participant in the financial services industry, the Company must maintain a high quality reputation in order to attract and retain clients and employees. If the Company fails, or appears to fail, to conduct its business activities in a fair and ethical manner or to associate with appropriate clients and counterparties, the Company could experience adverse effects to its business operations and financial results.

The Company's business operations and financial condition could be adversely affected if it is unable to access funds in a timely or cost-effective manner.

Efficient access to funds is critical to the Company's business operations, particularly margin lending and trading activities. The Company's funding needs are primarily met through cash generated from operations and cash obtained from external sources (e.g., bank lending and securities lending). The Company's access to this financing could be impaired by Company-specific factors, such as weakened opinion of the Company by external financing sources, or by factors affecting the financial services industry in general, such as a severe market disruption. An inability to access the necessary funds at a reasonable cost could negatively impact the Company's business activities and financial condition.

External events and failures in technology or in operational processes could expose the Company to business disruptions, reduced financial results, litigation, and regulatory actions.

The Company relies on its systems and operational processes to process numerous transactions on a daily basis across various different markets. In addition, the Company relies on third-party vendors to conduct significant portions of its trade processing and back office processing. In the event of a breakdown in an operational process (e.g., human error or employee misconduct), a malfunction of the Company's systems or the third-party vendors' systems, or an inability to recover from external events beyond the Company's control, such as a natural disaster, the Company could suffer business and financial losses and be subject to litigation and regulatory actions.

The Company's financial performance could be adversely impacted by fluctuations in interest rates and/or equity prices.

The Company is exposed to variability in the value of financial instruments caused by volatility in interest rates and/or equity prices. The primary source of this exposure is in the inventories of fixed-income and equity securities that the Company maintains in order to facilitate customer securities transactions. The Company could experience financial losses if adverse movements in interest rates and/or equity prices cause a decline in the valuations of its securities inventories.

The Company's financial performance could be adversely impacted by credit exposures.

The Company is exposed to the possibility that a client or counterparty is unable to meet its obligations to the Company, or that the value of collateral supporting an obligation to the firm declines such that the collateral is no longer sufficient to support the obligation. The Company's exposure primarily results from its activities relating to

margin lending, to its role as a counterparty to financial transactions, and to its securities inventories. The lack of performance by clients and/or counterparties could adversely impact the Company's profitability.

The Company's reputation and business performance could be adversely impacted if it is unable to sufficiently protect the critical information of its clients.

In order to provide effective service to clients, the Company gathers clients' personal information in the normal course of business. If clients perceive that the Company does not maintain this personal information in a secure manner they may not be willing to do business with the Company. If there is a breach in the Company's protection of clients' personal information through a breach in the information technology network or otherwise, the Company could suffer significant damage to its reputation and be subject to litigation and regulatory actions.

The Company could suffer adverse impacts to its business activities, financial performance, and reputation if it is subject to one or more significant regulatory actions.

As a member of the financial services industry, the Company's activities are subject to extensive regulation by federal and state regulatory bodies, securities exchanges, and other self-regulatory organizations. This regulation has been increasing and becoming more complex in recent years. One or more significant regulatory actions brought against the Company could result in censures, fines, civil or criminal liability, or temporary or permanent prohibition from participating in certain types of business activities, any of which could have material adverse impacts on the Company's business operations, financial results, and reputation. New laws or regulations or changes to existing laws or regulations could also adversely impact the Company's business.

The Company could be negatively impacted as a result of litigation.

In the ordinary course of business, the Company is subjected to various legal actions. These include claims of recommending unsuitable investments to clients, unauthorized or excessive trading on behalf of clients, or human resource related claims by current or former employees. In the event that the Company is liable for significant settlements or awards, the Company's business operations, financial performance, and reputation could be adversely affected.

ITEM 1B. UNRESOLVED STAFF COMMENTS.

None.

ITEM 2. PROPERTIES.

The Company's headquarters are located at One North Jefferson Avenue, St. Louis, Missouri, 63103. It consists of several buildings owned by the Company, which contain approximately 2,600,000 square feet of general office space as well as underground and surface parking and two parking garages. In addition, the Company owns an office building in the St. Louis area, which is used primarily as a contingency planning facility. The Company also leases 35,700 square feet in lower Manhattan and 7,000 square feet in downtown Chicago for the Company's security and commodity trade-processing activities. The Company occupies 744 locations, which are, with a few exceptions, leased premises, throughout the United States as well as in London, England, and Geneva, Switzerland.

ITEM 3. LEGAL PROCEEDINGS.

(a) Litigation

The Company is a defendant in a number of lawsuits, in some of which plaintiffs claim substantial amounts, relating primarily to its securities and commodities business. Management has determined that it is likely that ultimate resolution in favor of the plaintiffs will result in losses to the Company on certain of these claims and as a result, establishes accruals for potential litigation losses. The Company also is involved, from time to time, in investigations and proceedings by governmental and self-regulatory agencies, certain of which may result in

adverse judgments, fines or penalties. Factors considered by management in estimating the Company's reserves for these matters are the loss and damages sought by the plaintiffs, the merits of the claims, the total cost of defending the litigation, the likelihood of a successful defense against the claims, and the potential for fines and penalties from regulatory agencies. The Company establishes reserves for potential losses to the extent that such matters are probable and can be estimated, in accordance with Statement of Financial Accounting Standards No. 5, "Accounting for Contingencies." As litigation and the resolution of regulatory matters are inherently unpredictable, the Company cannot predict with certainty the ultimate loss or range of loss where there is only a reasonable possibility that a loss may be incurred. The Company believes, based on current knowledge and after consultation with legal counsel, that the resolution of loss contingencies will not have a material adverse effect on the consolidated balance sheet, statement of earnings or statement of cash flows of the Company. However, the outcome of such matters could be material to the Company's operating results and cash flows for a future or interim periods, depending, among other things, on the results of operations for these periods.

Edwards has received information requests or subpoenas from the SEC, the NASD, the NYSE, several states and the United States Department of Justice with respect to mutual fund transactions that involve market timing, late trading or both. The SEC, the NASD and certain states have examined certain branch offices and have or will take statements from employees of Edwards in connection with such mutual fund transactions. In addition, Edwards has received requests for information concerning timing of mutual fund transactions in variable annuity sub accounts. The staff of the SEC has informed Edwards that it intends to recommend that a civil injunctive action be brought against Edwards with respect to mutual fund transactions occurring prior to October 2003 and alleged to involve market timing.

The Commonwealth of Massachusetts filed in February 2005 an administrative complaint against Edwards concerning certain mutual fund transactions in Edwards' Boston-Back Bay office. The complaint alleges violations of securities laws by mutual fund market timing transactions and seeks a cease and desist order, an administrative fine in an unspecified amount, compensation to mutual fund holders for losses alleged to have resulted from market timing, and other relief.

The State of Illinois Secretary of State Securities Department sent a Notice of Hearing dated December 1, 2006 that alleges, among other matters, that Edwards engaged in activities to facilitate mutual fund market timing on behalf of certain clients from January 2001 to October 2003 and had inadequate procedures to detect and prevent late trading of mutual funds in violation of the Illinois Securities Law of 1953. The matter is set for hearing in May 2007. Other regulatory actions or claims may occur related to market timing or other mutual fund activities.

Edwards has been named as a defendant in a lawsuit that seeks class-action status filed in the state of Missouri that alleges, among other matters, that mutual fund transactions with certain customers were influenced by undisclosed shared revenue payments. Edwards is defending itself against the suit.

The NASD in fiscal year 2006 advised Edwards that it has made a preliminary determination to recommend that disciplinary action be brought against Edwards concerning the sale of mutual fund class-B shares and class-C shares based upon, it is believed, the grounds for recommending such sales, suitability violations, and Edwards supervisory procedures. The NASD orally proposed a settlement, including a fine, the offer to customers to switch to class-A shares and reimbursement for any disadvantage based on actual performance and the retention of an independent consultant to review supervisory procedures. Edwards did not accept the settlement.

The NASD filed in November 2005 an administrative complaint against Edwards concerning the sale of certain mutual funds to IRA accounts in 2001 and 2002 for which certain mutual fund companies made additional cash payments alleged to total $630,958 to Edwards for sales. The complaint seeks unspecified sanctions and restitution. Edwards is defending itself against the charges. The matter is currently being tried before a hearing panel under the procedures of the NASD.

The Attorney General of South Carolina, Securities Division, filed an administrative proceeding in August 2005 against Edwards and two former employees in connection with actions taken from 1995 until 2002 involving securities transactions with residents of South Carolina by financial consultants in Edwards' Augusta, Georgia branch. Edwards has reached oral agreement to resolve this matter and matters relating to an Edwards branch in South Carolina by payment of $575,000. In March 2004, Edwards agreed under a consent order with the Georgia

Secretary of State□s Securities and Business Regulation Division to make certain payments to the State of Georgia and to customers related to transactions in the Augusta, Georgia branch. Edwards has made payments in excess of $38.2 million to customers and to the State of Georgia related to these matters. Edwards believes the actions involved in these matters were isolated to one branch and a limited number of financial consultants formerly with Edwards and had no connection with any other Edwards office.

On August 7, 2006, NYSE Regulation, Inc. censured and fined Edwards $900,000 (with a previous payment to another regulator deemed to satisfy $400,000 of the fine) for improperly maintaining customers in non-managed fee-based accounts, for failing to supervise a branch manager and for failing to properly report certain statistical information concerning customer complaints. Edwards made restitution to certain clients of fees previously charged in the amount of $830,000. The issues from the examinations include alleged failure to supervise charges related to the firm□s Augusta, Georgia branch related to the matters described above, alleged failure to properly report customer complaints, and alleged failures to supervise Edwards□ Client Choice accounts, including supervision of accounts with limited trading activity and accounts with concentrations of mutual funds. Client Choice accounts are brokerage accounts for which a fee, rather than commissions, is charged.

Edwards and other financial services firms were asked by the SEC to voluntarily review the supervision and operation of certain auction rate securities transactions. Thereafter, on May 31, 2006, the SEC instituted proceedings against Edwards and 14 other financial firms alleging that each of the firms had violated Section 17(a)(2) of the Securities Act of 1933 in connection with transactions involving auction rate securities. Simultaneously with the institution of such proceedings, each of the firms, without admitting or denying the findings of the SEC, consented to censure, undertakings and monetary penalties. Edwards was required to pay $125,000.

Edwards and other financial services firms have received and responded to information requests from the NYSE with respect to delivery of prospectuses to customers. Regulatory actions or claims may result from the information developed during the review by the NYSE.

The Division of Enforcement of the NASD had informed Edwards that it was considering recommending disciplinary action against the firm in connection with what was alleged to be the failure to establish adequate supervisory procedures related to the suitability of variable annuity products. In April 2007, Edwards was informed that the Division of Enforcement of the NASD closed their investigation of this matter and will not recommend the commencement of disciplinary action.

Edwards and other firms in the industry were asked by a number of regulators and exchanges to assess their policies, procedures and filings in response to electronic □blue sheet□ inquiries. Blue sheet inquiries are inquiries concerning trading in particular securities. Edwards has filed its assessment. Regulatory actions or claims may result from information developed during the assessment.

A former employee filed an action in September 2005 against the Company seeking class certification alleging, among other matters, violations of the Employee Retirement Income Security Act by allegedly failing to minimize fees paid in connection with investments in the Company□s Retirement and Profit Sharing Plan and by the selection of mutual funds for investments in the plan. The Company is defending itself against the suit.

Edwards is a defendant in a complaint filed in the United States District Court for the Southern District of California that seeks to be a class action on behalf of all financial consultants and trainees who worked for Edwards in California after June 30, 2000. The action, among other relief, seeks overtime pay for financial consultants, including trainees, on the basis that the financial consultants should be classified as non-exempt

employees under California law, restitution of amounts that were deducted from commissions owed to financial consultants to repay advances made in prior months, payment for meal rest breaks to which financial consultants are claimed to be entitled, and reimbursement for certain alleged business-related expenses paid by financial consultants. Several other financial services firms have been sued in California in similar actions, some of which have settled the actions for substantial amounts. Other financial firms have announced changes in compensation for and charges to financial consultants as the result of such litigation. Edwards is evaluating whether changes will be made to compensation for and charges to financial consultants. Any such changes might increase

expenses for Edwards.

In addition, Edwards has been named as defendants in separate lawsuits filed in the United States District Court for the Northern District of New York, the United States District Court of New Jersey, the United States District Court for the District of Oregon, the United States District Court for the Western District of Pennsylvania, and the Court of Common Pleas of Allegheny County Pennsylvania. Each of the suits seeks to be a class action on behalf of defined groups of financial consultants or employees being trained to be financial consultants during specified periods that vary in each lawsuit. Each of the suits seeks, among other relief, overtime pay for the purported class members and two of the suits seek reimbursement of certain amounts deducted from commissions allegedly owed the employees or paid by the employees.

The Division of Enforcement of the NYSE has informed Edwards that it is considering bringing a formal disciplinary action against Edwards relating to Edwards stock loan business. The disciplinary action being considered is stated, among other matters, to relate to alleged failures to detect and prevent stock loan personnel from engaging in away-from-market stock loan transactions and from engaging in business dealings with finders in violation of firm policy, failing to detect and prevent conflicts of interest between stock loan personnel and their counterparties, failing to ensure adequate review of electronic communications and to retain facsimile transmissions related to the stock loan business and failing to review certain employee trades. Edwards has been offered the opportunity to make a Wells-type submission.

(b) Proceedings Terminated During the Fourth Quarter of the Fiscal Year Covered by This Report

Not Applicable.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.

There were no matters submitted to a vote of security holders during the fourth quarter of the fiscal year ended February 28, 2007.

EXECUTIVE OFFICERS OF THE COMPANY

The following table sets forth the executive officers of the Company as of April 27, 2007, as determined by the Board of Directors.

Name	Age	Office and Title	Year First Appointed Executive Officer of the Company
Robert L. Bagby	63	Chairman of the Board and Chief Executive Officer of the Company and Edwards since 2001. Vice Chairman of the Board, Executive Vice President and Director of the Branch Division of Edwards prior to 2001. Employee of Edwards for 32 years. Director of Edwards since 1979.	1991
Ronald J. Kessler	59	Vice Chairman of the Board of the Company and Edwards since 2001. Executive Vice President and Director of the Operations Division of Edwards. Employee of Edwards for 39 years. Director of Edwards since 1989.	1996
Mary V. Atkin	52	Director of the Staff Division of Edwards since 2005. Executive Vice President of Edwards since 2001.	1999

		Director of Corporate Strategy from November 2003 to February 2005. President of A.G. Edwards Technology Group, Inc. from 2001 to 2003. Director of A.G. Edwards Technology Group Inc. since 1999. Employee of Edwards for 29 years. Director of Edwards since 1993.	

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Name	Age	Office and Title	Year First Appointed Executive Officer of the Company
Gene M. Diederich	48	Executive Vice President of Edwards since 2005. Director of the Branch Division of Edwards since March 2005. Regional Manager of Edwards from 2002 to 2005. Branch Manager of Edwards from 1996 to 2002. Employee of Edwards for 22 years. Director of Edwards since 2003.	2005
Charles J. Galli	66	Senior Vice President of Edwards. Regional Manager. Employee of Edwards for 28 years. Director of Edwards since 1990.	2001
Alfred E. Goldman	73	Corporate Vice President of Edwards, Director of Market Analysis of Edwards. Employee of Edwards for 47 years. Director of Edwards since 1967.	1991
Richard F. Grabish	58	Chairman and Chief Executive Officer of A.G. Edwards Trust Company since 2001. President of A.G. Edwards Trust Company since 2005 and from 1987 to 2001. Senior Vice President of Edwards. Assistant Director of the Sales and Marketing Division of Edwards. Employee of Edwards for 26 years. Director of Edwards since 1988.	2001
Douglas L. Kelly	58	Vice President, Secretary, Chief Financial Officer and Treasurer of the Company since 2001. Executive Vice President, Secretary, Director of the Law and Compliance Division of Edwards since 1994. Chief Financial Officer, Treasurer and Director of the Administration Division of Edwards since 2001. Employee of Edwards for 13 years. Director of Edwards since 1994.	1994
Peter M. Miller	49	Executive Vice President and Director of the Sales and Marketing Division of	2002

		Edwards since 2002. Regional Manager of Edwards from 1995 to 2002. Employee of Edwards for 18 years. Director of Edwards since 1997.	
John C. Parker	47	Executive Vice President of Edwards since 2003. Director and President of A.G. Edwards Technology Group, Inc. since November 2003. Senior Vice President of A.G. Edwards Technology Group, Inc. from 2001 to 2003. Employee of Edwards for five years. Director of Edwards since 2002.	2003
Paul F. Pautler	61	Executive Vice President and Director of the Capital Markets Division of Edwards since 2001. Senior Vice President and Director of the Investment Banking Division of Edwards from 2000 to 2001. Director of Corporate Finance of Edwards from 1999 to 2001. Employee of Edwards for nine years. Director of Edwards since 2000.	2000
Joseph G. Porter	46	Assistant Treasurer and Assistant Secretary of the Company since 1999. Vice President of the Company since 2002. Principal Accounting Officer of the Company and Edwards. Senior Vice President and Assistant Director of the Administration Division of Edwards. Employee of Edwards for 24 years. Director of Edwards since 2001.	1999

PART II

ITEM 5. MARKET FOR THE REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES.

Quarterly Information
(Unaudited)

	Dividends Declared per Share	Stock Price Sales Price High-Low	Net Revenues (In millions)	Earnings Before Tax (In millions)	Net Earnings (In millions)	Earnings Per Share Diluted	Basi
Fiscal 2007 by Quarter							
First	$0.20	$54.56 - $43.17	$764.7	$ 122.4	$ 77.6	$1.01	$1.0
Second	$0.20	$56.17 - $47.77	$713.3	$ 104.4	$ 66.3	$0.86	$0.8
Third	$0.20	$59.93 - $51.55	$767.5	$ 124.0	$ 78.3	$1.03	$1.0
Fourth	$0.20	$69.04 - $56.70	$865.0	$ 169.8	$ 109.2	$1.44	$1.4

Fiscal 2006* by Quarter							
First	$0.16	$45.70 - $38.66	$652.9	$ 75.9	$ 51.8	$0.67	$0.6
Second	$0.16	$47.00 - $40.94	$672.5	$ 74.3	$ 47.2	$0.61	$0.6
Third	$0.20	$46.73 - $38.41	$674.1	$ 75.8	$ 51.7	$0.67	$0.6
Fourth	$0.20	$48.04 - $43.86	$740.6	$ 115.0	$ 75.4	$0.99	$0.9

See Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations for additional information on the components presented above.

*Fiscal 2006 amounts have been adjusted due to a change in accounting method. See Note 2 (Employee Stock Plans) of the Notes to Consolidated Financial Statements for a detailed discussion of the Companys Stock-Based Compensation plan.

Issuer Purchases of Equity Securities

The following table presents the number of shares purchased monthly under the Companys stock repurchase programs for the three-month period ended February 28, 2007.

Period	**Total Number of Shares Purchased**	**Average Price Paid Per Share**	**Total Number of Shares Purchased as Part of Publicly Announced Plans**	**Maximum Number of Shares That May Yet Be Purchased Under the Plans**
December (12/1/06 12/31/06)	361,356	$61.15	361,356	4,577,210
January (1/1/07 1/31/07)	354,590	$66.26	354,590	14,222,620
February (2/1/07 2/28/07)	288,246	$66.99	288,246	13,934,374
Total	1,004,192	$64.63	1,004,192	

In November 2004, the Companys Board of Directors authorized the repurchase of up to 10,000,000 shares of the Companys outstanding common stock during the period November 19, 2004, through December 31, 2006. The Company purchased 6,203,611 shares under the November 19, 2004 authorization. In November 2006, the Companys Board of Directors authorized the repurchase of up to 10,000,000 shares of the Companys outstanding stock during the period January 1, 2007 through December 31, 2008. At February 28, 2007, the Company had up to 9,419,832 shares available for repurchase under the January 2007 authorization.

In May 2005, the Board of Directors authorized the repurchase of up to 5,000,000 shares of the Companys outstanding common stock solely to effect employee stock transactions in the Companys Retirement and Profit Sharing Plan during the period May 24, 2005, through May 31, 2008. At February 28, 2007, the Company had up to 4,514,542 shares available to repurchase under this authorization.

Annual Meeting

The 2007 Annual Meeting of Stockholders (the Annual Meeting) will be held at the Companys headquarters, One North Jefferson, St. Louis, Missouri, on Thursday, June 21, 2007, at 10 a.m. CDT. The Notice of Annual Meeting, Proxy Statement and Proxy Voting Card will be mailed on or around May 15, 2007, to each stockholder

of record at the close of business on May 1, 2007. The Proxy Statement describes the items of business to be voted on at the Annual Meeting and provides information on the Board of Directors nominees for director and their principal affiliations with other organizations as well as other information about the Company.

Dividend Payment

The next four anticipated dividend payment dates are July 2 and October 1, 2007, and January 2 and April 1, 2008. However, the payment and rate of dividends on the Companys common stock is subject to several factors including operating results, financial requirements of the Company, and the availability of funds from the Companys subsidiaries, which may be subject to restrictions under the net capital rules of the SEC and NYSE and the capital adequacy requirements of the OTS. Such restrictions have never become applicable with respect to the Companys dividend payments. See Note 6 (Net Capital Requirements) of the Notes to Consolidated Financial Statements for more information on the capital restrictions placed on the Company and its subsidiaries.

Stock Exchange Listing

The Companys common stock is listed on the NYSE under the symbol AGE. The approximate number of stockholders on February 28, 2007, was 19,300. The approximate number of stock holders of record includes customers who hold the Companys stock in their accounts on the books of Edwards.

Registrar/Transfer Agent

The Bank of New York
1-800-524-4458
1-212-815-3700 (Outside the U.S. and Canada)
1-888-269-5221 (Hearing Impaired TTY Phone)

e-mail: shareowners@bankofny.com
website: https://www.stockbny.com

Address Shareholder Inquiries to:
The Bank of New York
Investor Services Department
P.O. Box 11258
New York, New York 10286-1258

Send Certificates for Transfer and Address Changes to:
Receive and Deliver Department
P.O. Box 11002
New York, NY 10286-1002

ITEM 6. SELECTED FINANCIAL DATA.

Consolidated Five-Year Summary

Year Ended	February 28, 2007	February 28, 2006 (As Adjusted)*	February 28, 2005	February 29, 2004	February 28, 2003
	(In thousands, except per share amounts)				
Revenues					
Asset management and service fees:					
Distribution fees	$ 684,290	$ 571,573	$ 498,026	$ 366,735	$ 336,636
Fee-based accounts	474,532	386,585	323,769	246,943	225,888

Service fees	107,240	104,714	97,282	109,708	90,493
Total	1,266,062	1,062,872	919,077	723,386	653,017
Commissions:					
Equities	539,208	530,052	530,654	543,462	453,231
Mutual funds	244,031	242,883	259,179	260,518	201,567
Insurance	200,956	195,476	192,019	205,622	185,249
Futures and options	46,689	48,411	47,810	51,427	42,816
Other	1,073	894	4,504	19,998	5,116
Total	1,031,957	1,017,716	1,034,166	1,081,027	887,979
Principal transactions:					
Debt securities	127,720	131,284	178,395	217,224	252,688
Equities	87,410	78,826	75,504	79,662	58,436
Total	215,130	210,110	253,899	296,886	311,124
Investment banking:					
Underwriting fees and selling concessions	196,593	168,963	174,555	240,094	184,220
Management fees	93,295	65,434	71,067	81,767	66,960
Total	289,888	234,397	245,622	321,861	251,180
Interest:					
Margin account balances	146,194	138,466	107,611	74,662	86,189
Securities owned and deposits	85,103	42,871	21,132	21,470	20,474
Total	231,297	181,337	128,743	96,132	106,663
Other	91,743	44,334	30,288	6,384	10,239
Total Revenues	3,126,077	2,750,766	2,611,795	2,525,676	2,220,202
Interest expense	15,617	10,653	4,114	2,859	5,850
Net Revenues	3,110,460	2,740,113	2,607,681	2,522,817	2,214,352
Non-Interest Expenses					
Compensation and benefits	1,931,870	1,761,199	1,699,156	1,642,999	1,448,199
Communication and technology	257,838	236,379	241,830	272,047	282,603
Occupancy and equipment	150,464	144,114	151,426	137,617	134,149
Marketing and business development	76,950	71,635	65,682	53,262	45,649
Floor brokerage and clearance	19,101	21,073	21,341	22,495	22,464
Other	153,644	164,705	133,839	149,123	109,854
Total Non-Interest Expenses	2,589,867	2,399,105	2,313,274	2,277,543	2,042,918
Earnings Before Income Taxes	520,593	341,008	294,407	245,274	171,434
Income Taxes	189,240	117,684	107,933	85,789	52,606
Earnings before cumulative effect of accounting change	331,353	223,324	186,474	159,485	118,828
Cumulative effect of accounting change, net of $1,655 of income taxes	—	2,768	—	—	—
Net earnings	$ 331,353	$ 226,092	$ 186,474	$ 159,485	$ 118,828

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Year Ended	February 28, 2007	February 28, 2006 (As Adjusted)*	February 28, 2005	February 29, 2004	February 28, 2003
	(In thousands, except per share amounts)				
Earnings per diluted share:					

Earnings before cumulative effect of accounting change	$ 4.34	$ 2.89	$ 2.37	$ 1.97	$ 1.46
Cumulative effect of accounting change, net of income taxes*	—	0.04	—	—	—
Earnings per diluted share	$ 4.34	$ 2.93	$ 2.37	$ 1.97	$ 1.46
Per Share Data:					
Dividends Declared	$ 0.80	$ 0.72	$ 0.64	$ 0.64	$ 0.64
Book Value	$ 27.91	$ 24.96	$ 23.21	$ 22.08	$ 20.92
Other Data:					
Total Assets	$ 5,312,118	$ 4,671,643	$ 4,687,797	$ 4,436,085	$ 3,980,094
Stockholders’ Equity	$ 2,102,039	$ 1,887,012	$ 1,787,691	$ 1,778,319	$ 1,688,537
Dividends Declared	$ 60,664	$ 54,894	$ 49,392	$ 51,007	$ 51,034
Pre-tax Return on Average Equity	26.1%	18.6%	16.5%	14.1%	10.3%
Return on Average Equity	16.6%	12.3%	10.5%	9.2%	7.1%
Pre-tax Net Earnings as a Percent of Net Revenues	16.7%	12.4%	11.3%	9.7%	7.7%
Average Common and Common Equivalent Shares Outstanding (Diluted)	76,431	77,204	78,766	80,990	81,177

*Fiscal 2006 amounts have been adjusted due to a change in accounting method. See Note 2 (Employee Stock Plans) of the Notes to Consolidated Financial Statements for a detailed discussion of the Company’s Stock-Based Compensation plan.

ITEM 7. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

(Year references, including those in charts, are to fiscal years ended February 28 unless otherwise specified)

Introduction

Headquartered in St. Louis, Missouri, A.G. Edwards, Inc. is a financial services holding company whose principal operating subsidiary is the national investment firm of A.G. Edwards & Sons, Inc. (“Edwards”), which is a successor to a partnership formed in 1887. A.G. Edwards, Inc. and its operating subsidiaries (collectively, the “Company”), provide securities and commodities brokerage, investment banking, trust services, asset management, retirement and financial planning, insurance products, and other related financial services.

The Company’s client base is comprised mostly of individual investors and includes corporations, governments, municipalities and financial institutions. Total client assets at the end of 2007 were $374 billion, an increase of $31 billion (9 percent) when compared to the end of 2006.

The Company serves its clients through one of the securities industry’s largest branch-office networks with locations in all 50 states, the District of Columbia, London, England and Geneva, Switzerland. The Company added six locations during 2007, increasing its total to 744. The total number of full-time employees decreased by 142 (1 percent) to end the year at 15,338. The number of the Company’s financial consultants declined 206 (3 percent) to end the year at 6,618. Average client assets per financial consultant at the end of 2007 were $56.5 million, an increase of $6.2 million (12 percent).

Executive Summary

Economic/Market Conditions

As the fiscal year progressed and the economic data turned more positive, the actions of investors suggested they were becoming more comfortable with the economic and market environments. While the first four months of the fiscal year were largely dominated by rising interest rates and rising oil prices, along with economic data that provided no clear indication of the economy's direction, the last eight months displayed much of the opposite.

After raising the Federal Funds rate from 4.75 percent to 5.25 percent from March to June, the Federal Reserve held the rate steady from June through the end of February. Crude oil prices, which peaked at more than $77 per barrel in July, hovered in the $58-$63 range for much of the fiscal third quarter, fell as low as $50 per barrel in the fourth quarter, and closed the year at $62 per barrel. Consumer price inflation increased at its smallest monthly rates during the last six months of the year, and Gross Domestic Product growth maintained slower, steadier progress from April to December, further relaxing concerns of additional Federal Funds rate increases.

The positive economic news later in the year was reflected in the equity markets. While the major stock market indexes posted modest gains through the first six months, their fiscal-year highs and the bulk of the overall gains came within the last six months. It should be noted that the fiscal-year results for these indexes were adversely affected by heavy stock-selling in the last week of the fiscal year. The Standard & Poor's 500 Index increased 126 points (10 percent), gaining 103 of those points (8 percent) in the last six months, to finish the year at 1,407. Similarly, the Dow Jones Industrial Average increased 1,275 points (12 percent), gaining 888 points (8 percent) in the last six months, to finish at 12,269. The Nasdaq Composite Index, meanwhile, was at a 4 percent loss through the first six months before ending the year with a 135-point (6 percent) increase to finish at 2,416.

Regulatory Environment

The enactment of new or changes in existing laws or regulations, new or changed interpretations or enforcement of such laws or regulations, or court decisions concerning them in the U.S. or in other jurisdictions could materially affect the Company's business, financial condition or results of operations in one or more periods. Recent changes include the New York Stock Exchange ("NYSE") and the National Association of Securities Dealers, Inc. ("NASD"), which have regulatory authority over the business of Edwards as a broker-dealer, announcing that they intend to merge their regulatory operations into a single regulatory body that is expected to begin operations in the second quarter of calendar 2007. Recent regulatory changes concerning the trading of securities under Regulation NMS issued by the SEC and related actions are affecting how Edwards and other broker-dealers handle transactions. The Chairman and the Director of the Division of Investment Management of the SEC have stated that the SEC will be reviewing the fees paid by mutual fund companies to broker dealers and other entities under rule 12b-1 of the Securities and Exchange Act of 1934. Edwards receives significant payments of 12b-1 fees and changes in the rule governing such fees could have a material adverse affect on the receipt of such payments by Edwards. The United States Court of Appeals for the District of Columbia Circuit in March 2007 invalidated a final rule adopted by the SEC that exempted broker-dealers including Edwards from the requirements of the Investment Advisers Act in connection with certain activities and accounts. As a result of this ruling Edwards has stopped opening new fee-based brokerage accounts known as Client Choice and is reviewing the status of existing accounts and other business activities. The impact of this court ruling cannot be determined with certainty but, unless changed, will affect how brokerage activities are performed by Edwards and other broker-dealers.

As with most other publicly held companies, the Company was subject to the ongoing implementation of the Sarbanes-Oxley Act of 2002, particularly as it pertained to internal control over financial reporting. (See the "Controls and Procedures" section, Part II, Item 9A, for a detailed discussion of the Company's report on internal control over financial reporting).

Company Performance Summary

Overall for 2007, the Company set a record for annual net revenues at $3.1 billion and experienced its fourth consecutive year of increased net revenues. The Company also posted its fifth consecutive year of increased net earnings, earnings per diluted share, pre-tax profit margin and return on average equity:

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Additionally, results for 2006 have been adjusted to reflect a change in accounting method related to stock options and restricted stock (collectively referred to as Stock Awards) granted to retirement-eligible employees under Statement of Financial Accounting Standards No. 123 (Revised 2004) Share Based Payment (SFAS No. 123R).

In reviewing its results for 2007, the Companys asset-management and service-fee revenues for the second consecutive year accounted for the largest percentage of net revenues, at 41 percent in 2007 and 39 percent last year. Higher client-asset levels in fee-based programs, mutual funds and other individual investments helped this revenue line grow to $1.3 billion, a 19 percent increase for the year. The Company continues to believe this trend reflects a natural migration by clients toward fee-based programs and services to diversify their portfolios. In response to this client demand, the Company continues to expand its lineup of fee-based programs and services, including additional portfolio choices in its fund advisory programs and the introduction of its Unified Managed Portfolios, a program that allows investments in mutual funds and exchange traded funds and by professional money managers.

Helped by asset-management and service-fee revenue, net revenues for 2007 increased $370 million (14 percent) as the Company posted increases in every major revenue category. Of note, the $55 million (24 percent) increase in investment banking revenues largely reflected a significant increase in underwriting volume of closed-end funds and equity offerings. Additionally, the $45 million (26 percent) increase in net interest revenues reflected an increased prime rate resulting in higher interest rates charged on margin balances, higher interest rates earned on the fixed-income inventory held for sale to clients and higher balances and rates earned on short-term investments partially offset by decreased margin loan balances.

During 2007, total client assets grew more than $31 billion (9 percent), while client assets in fee-based accounts grew $7 billion (18 percent).

The Companys results for 2007 included $23 million in revenue for gains related to the merger of the NYSE and Archipelago Holdings, Inc. to form NYSE Group, Inc. (NYSE Group), including the mark-to-market on NYSE Group shares the Company currently holds. The results also included $18 million in revenue for gains on the sales of shares in the Intercontinental Exchange (ICE) and Chicago Mercantile Exchange (CME) and the mark-to-market on the ICE, CME and New York Mercantile Exchange (NYMEX) shares the Company currently holds.

Non-interest expenses for 2007 increased, albeit at a slower pace than revenue growth. Expenses for compensation and benefits in 2007 increased mainly due to greater revenue produced by the Companys financial consultants, earnings allocated to the Companys incentive compensation and a change in the expense recognition for employee awards of restricted stock and stock options. Communication and technology expenses also increased, largely because of higher depreciation expenses, higher technology-consulting expenses and higher securities-processing costs, which are consistent with greater client activity. The securities-processing costs became more variable in nature after the Company moved its securities-processing operations to an application service provider last year. As a partial offset, other expenses declined during the period as a result of lower expenses for addressing various regulatory changes and legal matters.

When comparing the Companys results for 2007 to those for 2006:

Net earnings Increased $105 million (47 percent) to $331 million.

Diluted earnings per share Increased $1.41 (48 percent) to $4.34.

Net revenues Increased $370 million (14 percent) to $3.1 billion.

Pre-tax profit margin Increased from 12.4 percent to 16.7 percent.

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When comparing the Companys results for 2006* to those for 2005:

Net earnings Increased $40 million (21 percent) to $226 million.

Diluted earnings per share Increased $0.56 (24 percent) to $2.93.

Net revenues Increased $132 million (5 percent) to $2.7 billion.

Pre-tax profit margin Increased from 11.3 percent to 12.4 percent.

*Fiscal 2006 amounts have been adjusted due to a change in accounting method. See Note 2 (Employee Stock Plans) of the Notes to the Consolidated Financial Statements for a detailed discussion of the Companys Stock-Based Compensation plan.

The results for 2006 included $5 million in revenue for gains on the sale of shares in the Chicago Board of Trade (CBOT), $8 million in gains on CME shares, and a $3 million gain on the sale of real estate. The 2006 results also reflected $6 million in tax benefits resulting from the resolution of certain tax matters, including $3 million in tax benefits from the resolution of tax matters related to technology research and development tax credits.

As a result of the Companys March 1, 2005 early adoption of SFAS No. 123R, the Company recognized in the first quarter of 2006 a one-time, $3 million after-tax benefit, as the cumulative effect of a change in accounting method, resulting from the requirement to estimate forfeitures of restricted stock awards at the date of grant instead of recognizing them as incurred. Based on interpretive guidance related to SFAS No. 123R, the Company changed its accounting method such that compensation expense only for Stock Awards to retirement-eligible employees was retroactively recorded in 2006, in accordance with Statement of Financial Accounting Standards No. 154 Accounting Changes and Error Corrections a replacement of APB Opinion No. 20 and FASB Statement No. 3 (SFAS No. 154). Stock Awards to non-retirement eligible employees for 2006 granted in the first quarter of 2007 are being expensed over their service period, generally three years.

In both the 2007 versus 2006 and the 2006 versus 2005 comparisons, the Company experienced a general increase in net revenues paced by record results in asset-management and service-fee revenues, combined with higher compensation expenses based on higher commissionable revenue and the Companys increased profitability. A detailed discussion of the Companys results of operations follows.

Results of Operations

The Company generates revenues primarily through Edwards. These revenues can be categorized into six main components: asset-management and service fees, commissions, principal transactions, investment banking, net interest revenue and other.

Many factors affect the Companys net revenues and profitability, including economic and market conditions, the level and volatility of interest rates, inflation, political events, investor sentiment, legislative and regulatory developments, and competition. Because many of these factors are unpredictable and beyond the Companys control, earnings may fluctuate significantly from year to year.

The following table illustrates the composition of the Companys net revenues for 2007, 2006 and 2005:

	2007	**2006**	**2005**
Asset management and service fees	41%	39%	35%
Commissions	33%	37%	40%
Principal transactions	7%	8%	10%
Investment banking	9%	9%	9%
Net interest	7%	6%	5%
Other	3%	1%	1%

Following are descriptions of the Companys revenue and expense components and its operational results in each:

Asset Management and Service Fees

Revenues from asset-management services are based principally on the amount of certain client assets held through the Company. These assets may be managed by the Company, by Gallatin Asset Management, Inc. (Gallatin) or by third-party investment managers, including third-party portfolio managers, mutual funds, managed futures funds, money market funds, annuities and insurance companies. The Company manages certain client assets through the A.G. Edwards Trust Company FSB (Trust Company), a wholly owned subsidiary and

federally chartered savings bank that provides portfolio management and trust services. In addition, the Company offers a non-discretionary advisory program known as Portfolio Advisor and a discretionary advisory program known as FC Advisor.

The Company also offers fee-based fund advisory programs that allow clients to select from recommended, established asset allocation models or customize their own models in certain programs. The fund advisory programs are known individually as AGE Allocation Advisors, AGE Pathways and AGE Professional Fund Advisor.

Gallatin provides separately managed accounts and other services to Edwards and markets its investment-management services to unaffiliated mutual-fund firms, pension-fund providers, insurance companies and other financial institutions, including banks and brokerage firms. Gallatin receives management fees for its services.

Asset-management and service-fee revenues for 2007 increased $203 million (19 percent) to post an annual record of $1.3 billion. Growth in this revenue category was helped by the Company's fee-based programs, which increased $88 million (23 percent) due in part to an 18 percent increase in the number of client accounts in these programs under third-party management or through the Company's fee-based transaction accounts and trust services.

Fees received from third-party mutual funds, managed futures and insurance providers increased $113 million (20 percent) mainly as a result of increased asset values in these investment products. Service-fee revenues increased $3 million (2 percent) due in part to an increase by Edwards in the postage and handling fee on certain transactions.

Asset-management and service-fee revenues displayed modest volatility throughout the year but generally maintained an upward bias as it established a new annual record. The Company's fund advisory programs again displayed the greatest strength among the Company's fee-based programs, both in terms of client-asset growth (45 percent) and client-account growth (38 percent).

Client assets in fee-based accounts increased $7 billion (18 percent) from February 28, 2006 to February 28, 2007 and increased $7 billion (22 percent) from February 28, 2005 to February 28, 2006. An analysis of changes in assets in fee-based accounts from these time periods is detailed below (dollars in millions):

Assets in fee-based accounts	**February 28, 2007**	**February 28, 2006**	**2007 vs. 2006**	**February 28, 2005**	**2006 vs. 2005**
Fund advisory programs	$20,393	$14,059	45%	$ 9,871	42%
Separately managed accounts	12,853	12,030	7%	11,438	5%
Company-managed and other fee-based accounts	10,922	11,357	(4)%	9,443	20%
Total assets in fee-based accounts	$44,168	$37,446	18%	$30,752	22%

In mid-February 2007, the Company introduced its bank deposit program (AGE Bank Deposit Program) to certain clients as part of a multi-stage rollout to all eligible clients. The AGE Bank Deposit Program offers up to $1 million in FDIC insurance, competitive interest rates and the opportunity to earn higher interest rates based

on household asset values and account type. Also in 2007, the Trust Company received approval from the Office of Thrift Supervision (OTS) to expand its powers to be able to accept time and demand deposits so it can participate, along with several other FDIC-insured banks, in the AGE Bank Deposit Program. The Company expects the Trust Company to begin accepting client deposits in the second quarter of 2008.

The revenue contribution of the AGE Bank Deposit Program was not material to the Companys 2007 results of operations. The revenue impact of this program in 2008 cannot be determined with certainty and will depend, among other things, on the amount of assets that clients move into the AGE Bank Deposit Program, when the Trust Company begins accepting deposits, the amount of deposits placed with the Trust Company, the amount of new assets brought to the Company as a result of this program, and competitive and economic factors. As of April 25, 2007, the Company had average money fund balances of $20 billion that are eligible for conversion to this program.

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Revenue and expenses derived from deposits placed with the Trust Company through the AGE Bank Deposit Program will be reflected in net interest revenue in future periods. Revenue and expenses derived from assets deposited in other FDIC-insured banks through this program will be reflected in asset-management and service fees in future periods.

In 2006 asset-management and service-fee revenues increased $144 million (16 percent). The growth was driven by a $63 million (19 percent) increase in revenue from the Companys fee-based programs, generated in part by a 22 percent increase in the number of client accounts in these programs under third-party management or through the Companys fee-based transaction accounts and trust services.

Fees received from third-party mutual funds, managed futures and insurance providers increased $78 million (21 percent) mainly as a result of increased asset values in these investment products. Service-fee revenues increased $7 million (8 percent) due to greater revenue from the Companys asset accounts and investment-research services. These results were partially offset by a $4 million (3 percent) decline in fees received from the distribution of certain money funds, due mainly to a decrease in client assets in those money funds.

Commissions

The Company generates commission revenues when acting as an agent for client activities in transaction-based accounts in listed and over-the-counter securities, mutual funds, insurance products, futures and options. These revenues can be affected by trading volumes, by the dollar value of individual transactions, by market and economic conditions, and by investor sentiment because the Companys clients are primarily retail-oriented.

Commission revenues increased $14 million (1 percent) in 2007 compared to 2006. Commissions from equity transactions increased $9 million (2 percent), revenues from transactions in insurance products increased $5 million (3 percent) and commissions from individual mutual-fund transactions were essentially flat. As a partial offset to these increases, commission revenues from commodities and financial futures decreased $1 million (5 percent) and commission revenues from options transactions decreased $1 million (2 percent).

Commission revenues from equity transactions were at or near their best performance in May, while they displayed their weakest performance in July, consistent with market declines and seasonally slower activity. The Company benefited modestly from a change in its commission schedule for equity and options transactions, which went into effect March 15, 2006. Commission revenues from individual mutual-fund and insurance-product transactions were strongest in the first and fourth quarters of 2007. The Company believes the essentially flat revenue contribution from individual mutual-fund transactions was partly attributable to the continued client migration toward fee-based fund advisory programs.

Commission revenues for 2006 declined $16 million (2 percent) from 2005. While commissions from listed-stock transactions increased $9 million (2 percent), commissions in over-the-counter equities declined $13 million (14 percent). Meanwhile, commissions from transactions in mutual funds declined $16 million (6 percent) and commissions from commodities and financial futures decreased $1 million (4 percent). These declines were

partially offset by a $2 million (7 percent) increase in revenues from options transactions and a $3 million (2 percent) increase in transaction revenues from insurance products.

The 2006 commission revenues generally reflected increased client activity in equities and mutual funds when major market indexes reached various peaks. Revenues from insurance products were generally steady throughout 2006 as clients sought these products to help diversify their portfolios. Additionally, the strong pace of asset growth in fee-based programs suggested greater client interest in these programs versus individual transactions.

Principal Transactions

The Company maintains inventories of fixed-income and equity securities to satisfy client demand and, therefore, effects certain transactions with its clients by acting as a principal. Realized and unrealized gains and losses result from the sale and holding of securities positions for resale to clients and are included in principal-transaction revenues.

In 2007 principal-transaction revenues increased $5 million (2 percent) versus 2006. A $9 million (11 percent) revenue increase from transactions in equity securities held in the Company's inventory overcame decreases of $2 million (6 percent) in revenues from corporate-debt transactions and $2 million (3 percent) in revenues from municipal-debt transactions. Revenue from government-debt transactions was essentially flat.

Client activity in over-the-counter equity securities was generally consistent with equity activity noted above in Commission revenues. Conversely, client activity in municipal- and government-debt securities was strongest in the periods of weakness for the equity markets as clients took more defensive positions in their portfolios.

In 2006 principal-transaction revenues decreased $44 million (17 percent) versus 2005. The overall decline in this revenue category was driven almost entirely by a slowdown in client activity in the fixed-income markets, as evidenced by a $17 million (19 percent) decrease in revenue from municipal-bond transactions, a $17 million (39 percent) decrease in corporate-debt transactions and a $13 million (29 percent) decrease in revenue from government-debt transactions. These decreases were partially offset by $3 million (4 percent) increase in revenues from transactions in equity securities held in the Company's inventory. Investor concerns about interest rates and improving equity markets were the main factors affecting activity in this revenue category during 2006.

Investment Banking

Investment banking revenues result primarily from bringing new issues of securities, both equity-based and fixed income-based, to the market for issuers. The issuers are generally corporate or municipal clients but may be institutional clients of Edwards in the case of exchange-traded funds and related products. Investment banking revenues vary depending on the number and size of transactions successfully completed and generally are received in the form of underwriting fees or selling concessions. Additionally, the Company receives fees for financial advisory services, including advice on mergers and acquisitions, restructurings, and other strategic advisory needs.

Investment banking revenues in 2007 increased $55 million (24 percent), posting their second-best annual performance and their best-ever quarterly performance in the fourth quarter. Underwriting fees and selling concessions from equity products increased $26 million (21 percent). Underwriting fees and selling concessions from corporate-debt products increased $4 million (18 percent). These increases were partially offset by a $3 million (12 percent) decrease in underwriting fees and selling concessions from municipal- and government-debt products.

The Company participated in a significantly greater volume of equity underwritings during 2007, particularly in the area of closed-end funds as several large issues came to market. Related management fees from these underwritings accounted for much of the overall increase in management fees. The Company also had a greater volume of underwritings in its core focus areas of energy, financial and real estate. The increase in corporate-debt activity was primarily due to increased client demand for preferred-debt issues. The revenue decrease from municipal underwritings was mainly due to greatly reduced volume from municipalities issuing

new debt or refinancing existing debt.

In 2006 investment banking revenues decreased $11 million (5 percent). While underwriting fees and selling concessions from corporate-equity products were essentially flat for the year, underwriting fees and selling concessions from corporate-debt products decreased $7 million (23 percent) and government-debt products decreased $4 million (66 percent). Management fees in 2006 decreased $6 million (8 percent). These results were partially offset by a $5 million (28 percent) increase in underwriting fees and selling concessions from municipal-debt products. The underwriting environment in 2006 was largely the opposite experienced in 2007, as the Company had a significantly lower volume of closed-end-fund underwriting partially offset by a greater volume of municipal underwritings as municipalities took advantage of the interest-rate environment.

Net Interest Revenue

Interest revenue is derived primarily from financing clients margin transactions. These revenues are based largely on the amount of client margin balances and the rate of interest charged on these balances. The Company also earns revenue from interest and dividend payments on inventory held for sale to clients and from short-term investments.

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Interest revenue net of interest expense increased $45 million (26 percent) in 2007. A 2 percent increase in the prime rate the base rate the Company uses for charging interest on average margin balances was primarily responsible for the $8 million (6 percent) increase in revenue from margin balances. During the year, average client margin balances declined from $1.9 billion to $1.6 billion. The decline in these balances is believed to be, in part, the by-product of more client assets moving to fee-based programs, most of which do not allow clients to have margin accounts. Higher interest rates also were the primary driver behind a $25 million (153 percent) increase in revenue from the Companys short-term investments. Higher interest rates from fixed-income securities and dividend payments from equity securities held in inventory contributed to a $17 million (65 percent) revenue increase from this inventory.

As noted earlier, net interest revenue in future periods will reflect the impact of client assets deposited in the Trust Company through the AGE Bank Deposit Program.

The following chart details the average client margin balances as of February 28(29) 2004, 2005, 2006 and 2007 and the average rate charged on those balances:

Interest revenue net of interest expense increased $46 million (37 percent) in 2006 for mainly the same reasons as those noted above for the 2007 results. Average client margin balances during 2006 declined from $2.1 billion to $1.9 billion.

Other Revenue

Other revenue is derived primarily from the Companys investment activities in equity and equity-related securities along with four Company-sponsored private equity partnerships.

Other revenue increased $47 million (107 percent) in 2007. These results included $23 million in revenue for gains related to the merger of the NYSE and Archipelago Holdings, Inc. to form NYSE Group, including the mark-to-market on NYSE Group shares the Company currently holds. The results also included $14 million in revenue for gains on the sale of shares in ICE and the mark-to-market on the ICE and NYMEX shares the Company currently holds. Additionally, the results in other revenue reflected a $21 million increase in gains in 2007 versus 2006 on the Companys private-equity investment valuations and dividend payments. The increase was partially offset by a $3 million decrease in gains the Company recorded in 2007 versus 2006 for the sale of shares in the CME and the mark-to-market on other CME shares the Company currently holds. The 2006 and 2007 sales of CME shares occurred after shareholding requirements for CME membership were lowered. The 2007 sale of ICE shares occurred after the merger of ICE and New York Board of Trade (NYBOT) in January 2007.

In 2006 other revenue increased $14 million (46 percent). The 2006 results included a $5 million gain on the sale of shares in the CBOT that the Company was not required to own for CBOT membership. The increase also included a $3 million gain on the sale of real estate and a $13 million increase in revenue from the Company's private-equity investment valuations and dividend payments. The increase was partially offset by a $2 million decrease in gains the Company recorded in 2006 versus 2005 for the sale of shares in the CME and the mark-to-market on other CME shares the Company currently holds. Both the 2005 and 2006 sales of CME shares occurred after the CME lowered shareholding requirements for CME membership.

Expenses

The Company's expenses are categorized into six components: compensation and benefits, communication and technology, occupancy and equipment, marketing and business development, floor brokerage, and other expenses.

Compensation and Benefits

Compensation and benefits expenses comprise the largest components of the Company's overall expenses. Most of these expenses are variable in nature and relate to commissions paid to the Company's financial consultants for transaction-based or asset-management services and to incentive compensation, which is largely based on the profitability of the Company. This expense category also includes employee healthcare insurance costs.

For 2007, compensation and benefits increased $171 million (10 percent). Commission expense increased $55 million (7 percent). Incentive compensation increased $103 million (32 percent), which included $13 million in amortization expense related to stock awards for non-retirement eligible employees and $7 million in accrued expense for Stock Awards to be granted to retirement-eligible employees. Retirement-eligible employees generally are those age 55 and older. See Note 2 (Employee Stock Plans) of the Notes to Consolidated Financial Statements for further discussion of the recent change of accounting method for retirement-eligible employees. Administrative salaries increased $5 million (1 percent), and costs related to healthcare insurance and other benefits increased $13 million (8 percent).

The increase in commission expense was primarily the result of higher commissionable revenue from fee-based programs and individual transactions, partially offset by adjustments Edwards made to the compensation of its financial consultants effective April 3, 2006, lowering the commission payout schedule to its financial consultants on certain transactions. The increase in incentive compensation was due mainly to the Company's 47 percent increase in net earnings during 2007 and an increase in the number of financial consultants qualifying for sales bonuses. The increase in administrative salaries largely reflected general salary increases. The increase in healthcare insurance costs was mainly a reflection of generally higher individual claims during the year.

For 2006, compensation and benefits expenses increased $62 million (4 percent). Commission expense increased $11 million (1 percent) and incentive compensation increased $4 million (1 percent), both due to increased sales and earnings. Administrative salaries increased $6 million (2 percent) as a result of general salary increases and a net increase in salaried employees. Healthcare insurance costs increased $5 million (9 percent) due to higher individual claims.

As a partial offset to other incentive-compensation expenses, the Company's early adoption of SFAS No. 123R additionally resulted in an expense for Stock Awards only for non-retirement eligible employees being recognized in 2006. Stock awards granted at the end of 2006 for non-retirement eligible employees are being expensed over their service period, generally three years, which began in 2007. See Note 2 (Employee Stock Plans) of the Notes to Consolidated Financial Statements for further discussion of the impact of the Company's change in accounting method for Stock Awards to retirement-eligible employees.

Upon the adoption of SFAS No. 123R, the Company recognized the compensation expense related to Stock Awards to retirement-eligible employees on the date of grant. Based on interpretive guidance related to SFAS No. 123R, on March 1, 2006, the Company changed its accounting method for recognizing the cost of Stock Awards

that are granted to retirement-eligible employees. The Company is accruing an expense throughout the fiscal year preceding the date of grant representing an estimate of Stock Awards to be granted to retirement-eligible employees as a result of such fiscal year’s service rather than recognize the expense on grant date, which occurs in the first quarter of the subsequent fiscal year. The accounting for Stock Awards to non-retirement eligible employees did not change and will be recognized over the service period, generally three years from grant date. Following is a table that outlines the actual/projected expense impact for non-retirement eligible employees Stock Awards for the fiscal years 2007 through 2010:

Actual/Projected Expense Impact of Non-Retirement Eligible Employees Stock Awards

For Non-Retirement Eligible Employees Stock Awards Granted For:	**2007 Expense Impact**	**2008 Expense Impact**	**2009 Expense Impact**	**2010 Expense Impact**
2006	$13 million	$11 million	$10 million	$ 2 million
2007	—	$15 million	$14 million	$13 million
Total Actual/Projected Expenses For Non-Retirement Eligible Employees Stock Awards	$13 million	$26 million	$24 million plus expense for Stock Awards to be granted in April 2008	$15 million plus expense for Stock Awards to be granted in April 2008 and 2009

Differences between the projected and actual expenses for non-retirement eligible employees Stock Awards for 2008 and subsequent fiscal years may occur as a result of actual employee forfeitures of non-retirement eligible employees Stock Awards compared to the Company’s estimates and/or future accounting pronouncements by the Financial Accounting Standards Board (“FASB”), SEC or other regulatory authority.

Communication and Technology

Communication and technology expenses mainly encompass those costs associated with operating the Company’s back-office systems and technology infrastructure, which includes computer software and hardware — and the amortization and depreciation of each — along with data and trade processing. This expense line also includes costs for contract workers assigned to the Company’s various technology projects and needs. Additionally, account-statement printing and mailing, telephone service and technology repairs and maintenance all fall under this expense category.

Communication and technology expenses increased $21 million (9 percent) in 2007. Professional expenses for outside consultants increased by $17 million (93 percent) due to various projects, including the Company’s transition from certain legacy back-office systems. Amortization and depreciation expenses increased $5 million (7 percent) as a result of several new technology projects. Expenses associated with the conversion of securities-processing operations to an application service provider increased $4 million (35 percent) due in part to greater client activity. As partial offsets, expenses related to repairs and maintenance decreased $2 million (14 percent) and expenses for certain telecommunications services decreased $3 million (15 percent).

In 2006 communication and technology expenses declined $5 million (2 percent) as the Company completed several significant projects, resulting in decreased professional expenses for outside consultants. Amortization and depreciation expenses also decreased as several assets became fully depreciated. Partially offsetting these decreases were increases from securities-processing expenses associated with the conversion of securities-processing operations to an application service provider and data-processing expenses associated with data-processing services provided by an outside service provider.

Occupancy and Equipment

Occupancy and equipment expenses relate mainly to the leases for the Company�s branch-office locations and the amortization and depreciation expenses associated with equipment and furniture in those locations.

In 2007 occupancy and equipment expenses increased $6 million (4 percent) primarily due to higher rates associated with renewing certain branch-office leases.

In 2006, occupancy and equipment expenses decreased $7 million (5 percent). The decrease was primarily due to a $10 million charge recorded in 2005 to correct the recognition period for rent-escalation clauses and lease incentive in certain branch-office leases. The decrease was partially offset by increases in amortization expenses for leasehold improvements.

Marketing and Business Development

Marketing and business development expenses are mainly related to the Company�s branding initiative, local-branch advertising and promotional efforts, and travel and entertainment expenses.

In 2007 marketing and business development expenses increased $5 million (7 percent). Expenses associated with the Company�s national sales conference largely accounted for a $6 million (54 percent) increase in travel expenses. Partially offsetting this increase was $2 million (4 percent) in decreased costs associated with the Company�s branding initiative and other business-promotion expenses primarily resulting from timing differences in advertising schedules.

While the amount for 2008 has not been determined with certainty, the Company expects its branding initiative to cost approximately $20 million, with fluctuations from period to period.

In 2006 marketing and business development expenses increased $6 million (9 percent) primarily due to an increase in advertising expenses associated with the Company�s branding initiative and other business-promotion expenses.

All Other Expenses

All remaining operational expenses are largely related to professional expenses for legal, regulatory and audit consulting services, reserves and settlements for legal and regulatory matters, licensing and registration fees, publication and subscription expenses, and floor brokerage expenses.

In 2007 all remaining operational expenses decreased $13 million (7 percent), led by an $11 million (20 percent) decline in professional expenses for legal and regulatory consulting services. Reserves and settlements for various legal and regulatory matters were $3 million (8 percent) lower than the prior year. A $2 million (9 percent) decrease in floor brokerage and clearance expenses resulted from lower fees charged by various securities exchanges. As a partial offset, the Company had a $3 million (15 percent) increase in expenses related to certain media-vendor services.

In 2006 all remaining operational expenses increased $31 million (20 percent) due largely to increases in reserves and settlements for various legal and regulatory matters, professional expenses for legal and regulatory consulting services, and an increase in registration fees due mainly to an $8 million credit recorded in 2005 to correctly recognize state registration fees for the Company�s financial consultants over the registration period.

Income Taxes

The Company�s effective tax rate was 36.4 percent for 2007 compared with 34.5 percent for 2006. The increase in the effective tax rate was due largely to the recognition of $6 million in tax benefits from the resolution of certain tax matters during 2006, including $3 million in tax benefits from the resolution of tax matters related to technology research and development tax credits.

Impact of Stock Exchange Holdings

On March 7, 2006, the NYSE and Archipelago Holdings, Inc. closed a merger agreement and formed a new holding company, NYSE Group. In the merger, NYSE members were entitled, and the Company elected, to receive $404,640 and 78,601 shares of NYSE Group common stock for each NYSE membership seat. The sale of shares are subject to certain restrictions that expire ratably over a three-year period, unless the NYSE Group board of directors removes or reduces the transfer restrictions earlier. The NYSE Group board of directors authorized a secondary distribution, and the Company sold 67,841 shares in the offering, at a price of $60.27 per share in May 2006. In addition, Edwards purchases trading licenses through a modified Dutch auction process every year in order to receive the right to trade securities on the floor of the exchange. In January 2007, Edwards purchased four NYSE trading licenses at a price of $50,000 each.

At February 28, 2006, Edwards had four NYSE membership seats included in other assets on the consolidated balance sheet at a total cost of $492,000. Factoring in the Company’s cost basis for the four seats and the transfer restrictions on the remaining shares, the Company recorded a $23 million gain related to the merger. Subsequent gains or losses will be recorded in future periods as transfer restrictions expire and the share price of NYSE Group stock fluctuates. As of February 28, 2007, the Company owned 246,563 NYSE Group shares.

Edwards currently has two NYMEX membership seats included in other assets at a cost of $10,000. In addition, Edwards owns 196,800 shares of NYMEX common stock, of which 150,000 are required membership holdings and 46,800 are subject to transfer restrictions. Factoring in the Company’s cost basis for the two seats and the transfer restrictions on the remaining shares, the Company recorded a $6 million unrealized gain on the mark to market of the common stock as of February 28, 2007.

Edwards currently has six NYBOT membership seats included in other assets at a cost of $243,000. In January 2007, the NYBOT and the ICE closed a merger agreement that resulted in the issuance of ICE common stock to existing NYBOT membership seat holders. As a result of the merger, Edwards received 66,404 shares of ICE common stock, of which 27,402 shares are required membership holdings and 7,905 shares were available for sale. Edwards sold 31,097 shares during the current year. Factoring in the Company’s cost basis for the six seats and the sales proceeds, the Company recorded an $8 million gain related to the merger and subsequent sale of ICE common stock.

Edwards currently has three CME membership seats included in other assets at a cost of $9,000. As of February 28, 2007, Edwards owned 12,666 shares of CME common stock, of which 8,000 shares were required membership holdings. Edwards sold 2,334 common shares in February 2007. The Company recorded $7 million gain for the sale of stock and a $3 million gain for the mark to market of remaining available for sale shares.

Edwards currently has two CBOT membership seats included in other assets at a cost of $31,000. As of February 28, 2007, Edwards owned 54,676 shares of CBOT common stock, all of which are required membership holdings. The book value of both the CBOT seats and shares are held at cost, and no gain was recognized in the current year.

As a result of the changes noted above at various securities exchanges of which the Company is a member, has trading privileges or has access to, portions of the Company’s shareholdings in these exchanges will impact the Company’s results of operations. Subsequent gains or losses will be recorded in future periods as transfer restrictions expire, as the share prices of these stocks fluctuate, and if any or all of these exchanges change shareholding requirements for membership. Shares required for exchange membership do not impact results of operations and are included in other assets on the consolidated balance sheet.

Following is a table that illustrates the exchanges in which the Company owned shares:

Securities Exchange	**Shares Impacting Results of Operations**	**Shares Required for Exchange Membership**

			Total Shares Held
NYSE Euronext(2)	246,563(1)	—	246,563
NYMEX	46,800(1)	150,000	196,800
ICE	7,905	27,402	35,307
CME	4,666(1)	8,000	12,666
CBOT		54,676	54,676
Other exchanges	1,100		1,100

(1) Includes certain sales restrictions as set forth by the various exchanges.

(2) NYSE Group, Inc. and Euronext N.V. merged to create NYSE Euronext on April 4, 2007.

Impact of Change in Accounting Principle for Stock Awards to Retirement Eligible Employees

Effective March 1, 2006, the Company changed its accounting for restricted-stock and stock-options awards (collectively referred to as the "Stock Awards") granted to retirement-eligible employees from expense recognition on grant date to expense recognition over the fiscal-year the Stock Awards are earned. As a result of this accounting change in 2007, the Company accrued an expense throughout the fiscal year for Stock Awards granted to retirement-eligible employees as a result of service during the fiscal year rather than recognize the expense on grant date, which occurred in April 2008. The accounting for awards to non-retirement eligible employees did not change and continues to be recognized over the service period, generally three years from grant date.

Due to this change in the Company's accounting method, Stock Awards to retirement-eligible employees for 2006 totaling $20 million were accounted for in accordance with SFAS No. 154. This amount, net of taxes, was retrospectively applied to 2006 financial statements, including interim financial statements. In 2007, an adjustment was made to the opening balances as if the change in accounting for Stock Awards to retirement-eligible employees had been in effect in prior periods. The result was that the opening balance of retained earnings were reduced by the amount of the Stock Awards, net of taxes, for retirement-eligible employees for 2006.

Employees, including retirement-eligible employees, were granted 1,030,024 restricted shares with a market value of approximately $53 million, and 308,170 options on April 17, 2006.

Litigation and Regulatory Matters

The Company is a defendant in a number of lawsuits, in some of which plaintiffs claim substantial amounts, relating primarily to its securities and commodities business. Management has determined that it is likely that ultimate resolution in favor of the plaintiffs will result in losses to the Company on certain of these claims and as a result, establishes accruals for potential litigation losses. The Company also is involved, from time to time, in investigations and proceedings by governmental and self-regulatory agencies, certain of which may result in adverse judgments, fines or penalties. Factors considered by management in estimating the Company's reserves for these matters are the loss and damages sought by the plaintiffs, the merits of the claims, the total cost of defending the litigation, the likelihood of a successful defense against the claims, and the potential for fines and penalties from regulatory agencies. The Company establishes reserves for potential losses to the extent that such matters are probable and can be estimated, in accordance with Statement of Financial Accounting Standards No. 5, "Accounting for Contingencies." As litigation and the resolution of regulatory matters are inherently unpredictable, the Company cannot predict with certainty the ultimate loss or range of loss related to matters where there is only a reasonable possibility that a loss may be incurred. The Company believes, based on current knowledge and after consultation with legal counsel, that the resolution of loss contingencies will not have a material adverse effect on the consolidated balance sheet, statement of earnings or statement of cash flows of the Company. However, the outcome of such matters could be material to the Company's operating results and cash flows for future or interim periods, depending, among other things, on the results of operations for these periods.

See Item 3. - Legal Proceedings for further discussion of legal and regulatory matters.

Liquidity and Capital Resources

The Companys assets fluctuate in the normal course of business, primarily due to the timing of certain transactions. The Company monitors and evaluates the composition and size of its balance sheet. A substantial portion of the Companys total assets consist of short-term receivables mainly resulting from margin loans to clients, along with highly liquid marketable securities. The principal sources for financing the Companys business are stockholders equity, cash generated from operations, short-term bank loans and securities-lending arrangements. The Company has no long-term debt. Average short-term bank loans of $2 million and $28 million and average securities-lending arrangements of $179 million and $144 million for the years ended February 28, 2007 and 2006, respectively, were primarily used to finance customer margin transactions.

The Trust Company has been authorized to begin accepting time and demand deposits by the OTS. The Trust Company plans to begin accepting demand deposits from the AGE Bank Deposit Program in mid-calendar 2007. For further discussion, see Asset Management and Service Fees. The Trust Company is required to maintain minimum capital amounts and ratios to be considered as well-capitalized under the OTS regulatory framework for prompt corrective action. These requirements are approximately 10 percent of deposits. The exact amount of additional capital to be required by the Trust Company is subject to uncertainty.

In November 2006, the Companys Board of Directors authorized the repurchase of 10,000,000 shares of the Companys outstanding stock during the period from January 1, 2007, through December 31, 2008. In November 2004, the Companys Board of Directors authorized the repurchase of up to 10,000,000 shares of the Companys outstanding stock during the period November 19, 2004, through December 31, 2006. There were 6,203,611 shares repurchased by the end of the expiration period for the November 19, 2004 authorization. In November 2002, the Companys Board of Directors authorized the repurchase of up to 10,000,000 shares of the Companys outstanding

common stock during the period of January 1, 2003, through December 31, 2004. The January 1, 2003 authorization was fulfilled in its entirety. The Company purchased 3,241,865 shares at an aggregate cost of $181 million in 2007, 3,204,769 shares at an aggregate cost of $142 million in 2006 and 7,026,392 shares at an aggregate cost of $250 million in 2005. At February 28, 2007, the Company had up to 9,419,832 shares available for repurchase under the January 2007 authorization.

In May 2005, the Companys Board of Directors authorized the repurchase of up to 5,000,000 shares of the Companys outstanding stock solely to effect employee stock transactions in the Companys Retirement and Profit Sharing Plan during the period May 24, 2005, through May 31, 2008. The Company purchased 332,437 shares at an aggregate cost of $19 million during the year ended February 28, 2007. The Company purchased 153,021 shares at an aggregate cost of $7 million during the year ended February 28, 2006. At February 28, 2007, the Company had up to 4,514,542 shares available for repurchase under this authorization.

In May 2005, the Companys Board of Directors authorized the sale of up to 5,000,000 shares of the Companys stock to the Companys Retirement and Profit Sharing Plan during the period May 24, 2005 through May 31, 2008. The Company sold 372,293 shares at aggregate proceeds of $18 million in 2007. The Company sold 153,727 shares at aggregate proceeds of $7 million during the year ended February 28, 2006. At February 28, 2007, the Company had 4,473,980 shares available to sell.

Tabular Disclosure of Contractual Obligations

The following table summarizes information about the Companys long-term contractual commitments and obligations as of February 28, 2007 (dollars in thousands):

Contractual Obligations	Total	2008	2009-2010	2011-2012	More than 5 years
Operating lease obligations	$ 470,600	$ 93,400	$ 156,000	$ 107,500	$ 113,700

Communications, technology, and other service commitments	216,300	103,100	77,800	32,300	3,100
	$ 686,900	$ 196,500	$ 233,800	$ 139,800	$ 116,800

The Company had unfunded commitments of $30 million to various private equity investments at February 28, 2007. These commitments are subject to calls by the partnerships, as funds are needed.

Management believes the Company has adequate sources of credit available, if needed, to finance customer-trading volumes, additional capital for the Trust Company, expansion of its branch system, stock repurchases, dividend payments and major capital expenditures. Currently the Company, with certain limitations, has access to $1.2 billion in uncommitted lines of credit as well as the ability to increase its securities lending activities.

Edwards is required by the SEC to maintain specified amounts of liquid net capital to meet its obligations to clients. At February 28, 2007, Edwards net capital of $785 million was $747 million in excess of the minimum requirement.

Critical Accounting Policies

The consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America. In preparing these consolidated financial statements, management makes use of certain estimates and assumptions. See Note 1 (Summary of Significant Accounting Policies) of the Notes to Consolidated Financial Statements. The Company believes that of its significant accounting policies, the following critical policies, estimates and assumptions may involve a higher degree of judgment and complexity and are the most susceptible to significant fluctuations in the near term.

Valuation of Investments

The fair value of investments, for which a quoted market or dealer price is not available, is based on managements estimate. Among the factors considered by management in determining the fair value of investments are cost, terms and liquidity of the investment, the sale price of recently issued securities, the financial condition and operating results of the issuer, earnings trends and consistency of operating cash flows, the long-term business potential of the issuer, the quoted market price of securities with similar quality and yields that are publicly traded,

information as to any transactions or offers with respect to the security, existence of merger proposals or tender offers affecting the securities, and other factors generally pertinent to the valuation of investments. The Company holds investments that may have quoted market prices but that are subject to restrictions (e.g., consent of the issuer or other investors to sell) that may limit our ability to realize the quoted market price. Accordingly, the Company estimates the fair value of these securities based on managements best estimates, which incorporates pricing models based on projected cash flows, earnings multiples, comparisons based on similar transactions and/or review of underlying financial conditions and other market factors.

Legal Reserves and Regulatory Matters

The Company is a defendant in a number of lawsuits, in some of which plaintiffs claim substantial amounts, relating primarily to its securities and commodities business. Management has determined that it is likely that ultimate resolution in favor of the plaintiffs will result in losses to the Company on certain of these claims and as a result, establishes accruals for potential litigation losses. The Company also is involved, from time to time, in investigations and proceedings by governmental and self-regulatory agencies, certain of which may result in adverse judgments, fines or penalties. Factors considered by management in estimating the Companys reserves for these matters are the loss and damages sought by the plaintiffs, the merits of the claims, the total cost of defending the litigation, the likelihood of a successful defense against the claims, and the potential for fines and penalties from regulatory agencies. The Company establishes reserves for potential losses to the extent that such matters are probable and can be estimated, in accordance with Statement of Financial Accounting Standards No.

5, Accounting for Contingencies. As litigation and the resolution of regulatory matters are inherently unpredictable, the Company cannot predict with certainty the ultimate loss or range of loss related to matters where there is only a reasonable possibility that a loss may be incurred. The Company believes, based on current knowledge and after consultation with legal counsel, that the resolution of loss contingencies will not have a material adverse effect on the consolidated balance sheet, statement of earnings or statement of cash flows of the Company. However, the outcome of such matters could be material to the Companys operating results and cash flows for future or interim periods, depending, among other things, on the results of operations for these periods.

See Item 3. - Legal Proceedings for further discussion of legal and regulatory matters.

Allowance for Doubtful Accounts From Customers

Receivables from customers consist primarily of floating rate loans collateralized by margin securities. Management estimates an allowance for doubtful accounts to reserve for potential losses from unsecured and partially secured customer accounts deemed uncollectible. The facts and circumstances surrounding each receivable and the number of shares, price and volatility of the underlying collateral are considered by management in determining the allowance. Management continually evaluates its receivables from customers for collectibility and possible write-off. The Company manages the credit risk associated with its receivables from customers through credit limits and continuous monitoring of collateral.

Income Taxes

The Company operates in multiple taxing jurisdictions, and as a result, accruals for tax contingencies require management to make estimates and judgments with respect to the ultimate tax liability in any given year. Actual results could vary from these estimates. In managements opinion, adequate provisions for income taxes have been made for all years.

Valuation of Stock Options

The Company uses SFAS No. 123R to account for awards of equity instruments to employees. SFAS No. 123R requires measurement of the cost of employee services received in exchange for an award based on the fair value of the award on the grant date. The fair value of the stock options is estimated using expected dividend yields of the Companys stock, the expected volatility of the stock, the expected length of time the options remain outstanding, and risk-free interest rates. Changes in one or more of these factors may significantly affect the estimated fair value of the stock options. Additionally, SFAS No. 123R requires the Company to estimate the number of instruments for which the required service is expected to be rendered. The Company estimates forfeitures using historical forfeiture rates for previous grants of equity instruments.

Recent Accounting Pronouncements

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Liabilities, including an amendment of FASB Statement No. 115 (SFAS No. 159). SFAS No. 159 permits entities to choose, at specified election dates, to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. Unrealized gains and losses shall be reported on items for which the fair value option has been elected in earnings at each subsequent reporting date. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. Early adoption is permitted as of the beginning of a fiscal year that begins on or before November 15, 2007, provided the entity also elects to apply the provisions of SFAS No. 157 Fair Value Measurements (SFAS No. 157). The Company is currently assessing the impact that SFAS No. 159 will have on the consolidated financial statements.

In September 2006, FASB issued SFAS No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans - an amendment of FASB Statements No. 87, 88, 106, and 132(R) (SFAS No. 158). SFAS No. 158 requires employers to recognize the overfunded or underfunded status of a defined benefit post-retirement plan as an asset or liability in its statement of financial position. Further, this statement requires employers to recognize changes in the funded status in the year in which the changes occur through comprehensive income. SFAS No. 158 is effective for fiscal years ending after December 15, 2006. The Companys adoption of SFAS No.

158 did not have a material impact on the consolidated financial statements.

In September 2006, the FASB issued SFAS No. 157 which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurement. This statement applies under other accounting pronouncements that require or permit fair value measurements and does not require any new fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007. The Company is currently assessing the impact that SFAS No. 157 will have on the consolidated financial statements.

In September 2006, the SEC issued Staff Accounting Bulletin No. 108, Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in the Current Year Financial Statements (SAB 108). SAB 108 addresses how the effects of prior year uncorrected misstatements should be considered when quantifying misstatements in current year financial statements. SAB 108 requires an entity to quantify misstatements using a balance sheet and income statement approach and to evaluate whether either approach results in quantifying an error that is material in light of relevant quantitative and qualitative factors. SAB No. 108 is effective for fiscal years ending after November 15, 2006. The Companys adoption of SAB No. 108 did not have a material impact on the consolidated financial statements.

In June 2006, FASB issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109 (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in a companys financial statements and prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company will adopt the provisions of FIN No. 48 beginning in the first quarter of 2008. The Company is currently evaluating the impact the adoption of FIN 48 may have on the consolidated financial statements.

In June 2005, the FASB issued SFAS No. 154, Accounting Changes and Error Corrections a replacement of APB Opinion No. 20 and FASB Statement No. 3, (SFAS No. 154). SFAS No. 154 changes the requirements for the accounting for and reporting of a change in accounting method. SFAS No. 154 is effective for accounting changes made in fiscal years beginning after December 15, 2005. The Company adopted SFAS No. 154 on March 1, 2006, and applied the pronouncement to its change in accounting method for stock awards granted to retirement-eligible employees.

Risk Management

General

Finding the proper balance of risk taking and risk mitigation, in a manner consistent with the Companys risk appetite, is critical to the success of the Companys financial stability and long-term profitability. The business activities of the Company expose it to a variety of risks, including operational, legal and regulatory, credit and market risk. Company management oversees the identification and assessment of the various risks and the development of appropriate risk mitigation activities, which primarily consist of internal controls, policies, and procedures. The execution of the risk mitigation activities is carried out at the business-unit level. The Company is in the early stages of developing an Enterprise Risk Management function to help coordinate and support firm-wide risk management efforts. Furthermore, the Internal Audit Department, reporting directly to the Audit Committee, provides independent assessments on the effectiveness of the risk management activities occurring throughout the Company. The following discussion highlights the principal risks faced by the Company and provides examples of how these risks are managed.

Operational Risk

Operational risk refers to the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events. This includes, but is not limited to, business interruptions, improper or unauthorized execution and processing of transactions, deficiencies in the Companys operating systems, and inadequacies or breaches in the Companys control processes. The Company is reliant on the ability of its

employees, its internal systems, and the systems of its third-party vendors to process a large number of transactions. In the event of a breakdown or improper operation of the Company's or third-party's systems or improper actions by employees, the Company could suffer financial loss, regulatory sanctions and damage to its reputation.

In order to mitigate and control operational risk, the Company has developed, and continues to enhance, specific internal controls, policies and procedures that are designed to identify and manage operational risk at appropriate levels throughout the organization. The purpose of these mechanisms is to provide reasonable assurance that the Company's business operations are functioning within the policies and limits established by management. Additionally, business continuity plans have been developed for critical processes and systems so that the Company can sufficiently recover its critical operations should a business interruption occur.

Legal and Regulatory Risk

Legal and regulatory risk includes the risk of non-compliance with applicable legal and regulatory requirements, the risk of adverse legal judgments against the Company, and the risk that a counterparty's performance obligations will be unenforceable. The Company is subject to extensive regulation in the different jurisdictions in which it conducts its business, and this regulatory scrutiny has been significantly increasing over the last several years. The Company has established and continues to enhance procedures based on legal and regulatory requirements that are reasonably designed to ensure compliance with all applicable statutory and regulatory requirements. In connection with its business, the Company has various procedures addressing significant topics such as regulatory capital requirements, sales and trading practices, new products, use and safekeeping of customer funds and securities, extension of credit, money laundering, privacy, and record keeping. The Company also has established procedures that are designed to ensure that senior management's policies relating to conduct, ethics and business practices are followed.

Credit Risk

Credit risk is the risk of loss resulting from a client or counterparty failing to satisfy its contractual obligations with the Company or from the value of collateral held by the Company to secure obligations proving to be insufficient. The Company is primarily exposed to credit risk in its role as a lender to its customers and as a trading counterparty to dealers and customers.

The primary source of the Company's credit exposure is through customer margin loans, which are collateralized in accordance with internal and regulatory guidelines and monitored on a daily basis. Additional collateral is requested from customers when necessary to maintain compliance with internal and regulatory guidelines. Large customer margin loans and those margin loans related to concentrated or restricted positions are

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evaluated by the Company's Credit Committee, which is comprised of senior members of management from across the Company. The collateral requirements are increased, if necessary, to ensure the risk remains at an acceptable level.

The Company is also exposed to credit risk by providing clearing services for securities transactions in its client accounts and by participating in the securities lending business. The Company has an obligation to settle transactions with clearing organizations and other financial institutions and is exposed to loss if a client or counterparty fails to meet its obligations to the Company. The Company also executes securities lending activity in order to obtain financing and securities to support its business activities and its customers' trading activities. In most cases, the customer or counterparty has provided financial instruments as collateral for these transactions. The collateral value is monitored and additional collateral is obtained when appropriate.

See Note 11 (Financial Instruments – Off-Balance Sheet Risk and Concentration of Credit Risk) of the Notes to Consolidated Financial Statements for additional information related to credit risk.

Market Risk

Market risk is the potential change in value of financial instruments resulting from fluctuations in interest rates and/or equity prices. The Company's primary exposure to market risk comes from maintaining an inventory of fixed-income and equity security positions to provide investment products for its clients. The Company purchases only inventory that it believes it can readily sell to its clients, thus reducing the Company's exposure to liquidity risk but not market fluctuations. The Company does not act as a dealer, trader or end-user of complex derivative products such as swaps, collars and caps. The Company may provide advice and guidance on complex derivative products to selected clients; however, this activity does not involve the Company acquiring a position or commitment in these products.

Interest Rate Risk. Interest rate risk refers to the risk of changes in the level or volatility of interest rates, in the speed of payments on mortgage-backed securities, in the shape of the yield curve and in credit spreads. The Company is exposed to this risk as a result of maintaining inventories of interest-rate-sensitive financial instruments. This is the Company's primary market risk.

The Company manages its interest rate risk through the establishment and monitoring of trading policies and securities inventory guidelines and through the implementation of control and review procedures. The Company also manages this risk using hedging practices that involve U.S. Treasury obligations. On a daily basis, management monitors trading results, current inventory levels, concentrated inventory positions, and aged inventory positions. Real-time inventory data allows for intraday inventory management, and there is daily communication between trading department management and senior management regarding the Company's inventory positions and risk profile.

The Company elects to use a sensitivity analysis approach to express the potential decrease in the fair value of the Company's debt inventory consisting of interest-rate-sensitive financial instruments. The Company calculated the potential loss in fair value of its debt inventory by calculating the change in the valuation of its fixed-income security inventories resulting from an increase of 10 percent or 50 basis points, whichever is greater, in the Treasury yield curve. Using this method, if such an increase occurred the Company calculated a potential loss in fair value of its debt inventory of $4 million at February 28, 2007, and 2006, respectively. The Company changed one assumption in its sensitivity analysis from the previous year. The Company no longer includes in its calculation those financial instruments with limited market risk exposure resulting from a short period of time until the interest rate resets. Including these financial instruments in the previous year's analysis, the resulting potential loss was calculated at $10 million at February 28, 2006.

Equity Price Risk. Equity price risk refers to the risk of changes in the level or volatility of the price of equity securities. The Company is exposed to this risk as a result of its market making activities and other investment activities. The Company manages this risk by establishing guidelines for its equity inventories and managing position levels within those guidelines. At February 28, 2007, and 2006, the potential daily loss in the fair value of equity securities related to the Company's market-making activities was not material.

Included in Investments are $153 million in mutual funds that the Company uses to hedge its deferred compensation liability. The potential daily gain or loss in the fair value of these mutual funds is offset by a similar potential change in the value of the deferred compensation liability. Also included in Investments are $175 million in private equity investments that are subject to a high degree of volatility and valuation estimates, and may be susceptible to significant fluctuations particularly in the near term.

Forward-Looking Statements

The Management's Discussion and Analysis of Financial Condition and Results of Operations and other sections of this Form 10-K may contain forward-looking statements within the meaning of federal securities laws. Actual results are subject to risks and uncertainties, including both those specific to the Company and those to the industry, which could cause results to differ materially from those contemplated. The risks and uncertainties include, but are not limited to, general economic conditions, government monetary and fiscal policy, the actions of competitors, changes in and effects of marketing strategies, client interest in specific products and services, the completion of all contractual, technological, legal and other requirements for the introduction of new products or services, regulatory changes and actions, changes in legislation, risk management, the impact of the AGE Bank Deposit Program and the expansion of powers of the Trust Company, legal claims, potential changes in compensation for or charges to financial consultants, technology changes, price adjustments, compensation

changes, the impact of outsourcing agreements, the impact of SFAS No. 123R, including the timing of the recognition of expenses and the treatment of expenses for retirement-eligible employees, the impact and value of the Company's investments including NYSE Euronext, the ability to achieve and the potential impact of acquisitions by the Company, implementation and effects of expense-reduction strategies, and efforts to make more of non-compensation expenses variable in nature. Undue reliance should not be placed on the forward-looking statements, which speak only as of the date of this Form 10-K. The Company does not undertake any obligation to publicly update any forward-looking statements.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

The information required by this item is contained in Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations" under the caption "Risk Management – Market Risk" of this Form 10-K.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.

Supplemental Data

The quarterly financial data required by this item is included under Item 5 of Part II of this Form 10-K under the caption "Quarterly Information."

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of
A.G. Edwards, Inc.
St. Louis, Missouri

We have audited the accompanying consolidated balance sheets of A.G. Edwards, Inc. and subsidiaries (the "Company") as of February 28, 2007 and 2006, and the related consolidated statements of earnings, stockholders' equity, and cash flows for each of the three years in the period ended February 28, 2007. Our audits also included the financial statement schedule listed in the Index as Item 15. These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on the financial statements and financial statement schedule based on our audits.

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

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of A.G. Edwards, Inc. and subsidiaries as of February 28, 2007 and 2006, and the results of their operations and their cash flows for each of the three years in the period ended February 28, 2007, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

As discussed in Note 1 and Note 2 to the consolidated financial statements, in fiscal year 2006, the Company adopted Statement of Financial Accounting Standards No. 123 (revised 2004), "Share-Based Payment," and effective in fiscal year 2007, the Company changed its accounting policy for the recognition of equity awards granted to retirement-eligible employees, and retrospectively, adjusted the fiscal year 2006 financial statements for the change.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Company's internal control over financial reporting as of February 28,

2007, based on the criteria established in *Internal ControlIntegrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated April 27, 2007 expressed an unqualified opinion on managements assessment of the effectiveness of the Companys internal control over financial reporting and an unqualified opinion on the effectiveness of the Companys internal control over financial reporting.

/s/ Deloitte & Touche LLP

St. Louis, Missouri
April 27, 2007

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Financial Statements

A.G. Edwards, Inc.
Consolidated Balance Sheets

	February 28, 2007	February 28, 2006 (As Adjusted, See Note 2)
	(Dollars in thousands, except per share amounts)	
Assets		
Cash and cash equivalents	$ 299,758	$ 178,173
Cash and government securities deposited with clearing organizations or segregated under federal and other regulations	406,852	272,881
Securities purchased under agreements to resell	815,044	195,000
Securities borrowed	306,310	205,774
Receivables:		
Customers, less allowance for doubtful accounts of $2,700 and $2,600	1,710,857	2,084,278
Brokers and dealers	130,989	187,092
Clearing organizations	2,015	809
Fees, dividends and interest	160,375	118,465
Securities inventory, at fair value:		
State and municipal	352,269	284,539
Government and agencies	39,945	71,188
Corporate debt	55,194	35,638
Equities	7,634	22,788
Investments	406,021	367,822
Property and equipment, at cost, net of accumulated depreciation and amortization of $728,485 and $723,054	463,526	485,287
Deferred income taxes	106,947	107,114
Other assets	48,382	54,795
	$ 5,312,118	$ 4,671,643
Liabilities and Stockholders Equity		
Checks payable	$ 287,962	$ 313,448
Securities loaned	213,725	200,988
Payables:		
Customers	1,332,692	1,102,040
Brokers and dealers	96,150	118,403
Clearing organizations	67,134	37,561

Securities sold but not yet purchased, at fair value:		
State and municipal	3,324	5,055
Government and agencies	67,383	21,041
Corporate debt	8,523	18,174
Equities	492	1,372
Employee compensation and related taxes	577,918	495,828
Deferred compensation	238,256	228,548
Income taxes	72,991	22,453
Other liabilities	243,529	219,720
Total Liabilities	3,210,079	2,784,631
Stockholders Equity:		
Preferred stock, $25 par value:		
Authorized, 4,000,000 shares; none issued		
Common stock, $1 par value:		
Authorized, 550,000,000 shares; issued, 96,463,114 shares	96,463	96,463
Additional paid-in capital	301,514	293,362
Retained earnings	2,559,274	2,293,910
	2,957,251	2,683,735
Less: Treasury stock, at cost (21,146,664 and 20,872,779 shares)	855,212	796,723
Total Stockholders Equity	2,102,039	1,887,012
	$ 5,312,118	$ 4,671,643

See Notes to Consolidated Financial Statements.

A.G. Edwards, Inc.
Consolidated Statements of Earnings

Year Ended	February 28, 2007	February 28, 2006 (As Adjusted, See Note 2)	February 28, 2005
	(Dollars in thousands, except per share amounts)		
Revenues			
Asset management and service fees	$ 1,266,062	$ 1,062,872	$ 919,077
Commissions	1,031,957	1,017,716	1,034,166
Principal transactions	215,130	210,110	253,899
Investment banking	289,888	234,397	245,622
Interest	231,297	181,337	128,743
Other	91,743	44,334	30,288
Total Revenues	3,126,077	2,750,766	2,611,795
Interest expense	15,617	10,653	4,114
Net Revenues	3,110,460	2,740,113	2,607,681
Non-Interest Expenses			
Compensation and benefits	1,931,870	1,761,199	1,699,156
Communication and technology	257,838	236,379	241,830
Occupancy and equipment	150,464	144,114	151,426

Marketing and business development	76,950	71,635	65,682
Floor brokerage and clearance	19,101	21,073	21,341
Other	153,644	164,705	133,839
Total Non-Interest Expenses	2,589,867	2,399,105	2,313,274
Earnings Before Income Taxes	520,593	341,008	294,407
Income Taxes	189,240	117,684	107,933
Earnings before cumulative effect of accounting change	331,353	223,324	186,474
Cumulative effect of accounting change, net of $1,655 of income taxes		2,768	
Net Earnings	$ 331,353	$ 226,092	$ 186,474
Earnings per diluted share:			
Earnings before cumulative effect of accounting change	$ 4.34	$ 2.89	$ 2.37
Cumulative effect of accounting change, net of income taxes		0.04	
Earnings per diluted share	$ 4.34	$ 2.93	$ 2.37
Earnings per basic share:			
Earnings before cumulative effect of accounting change	$ 4.44	$ 2.91	$ 2.39
Cumulative effect of accounting change, net of income taxes		0.04	
Earnings per basic share	$ 4.44	$ 2.95	$ 2.39
Average common and common equivalent shares outstanding:			

	As of December 31, 2017	2016	2015	2014	2013
Cash, cash equivalents and marketable securities (1)	$ 2,415	$ 1,798	$ 1,915	$1,425	$1,723
Total assets (1)	$ 2,941	$ 2,335	$ 2,358	$1,901	$2,249
Deferred revenues	$ 999	$ 976	$ 961	$890	$856
Subordinated Convertible Debentures, including contingent interest derivative	$ 628	$ 630	$ 634	$621	$613
Long-term debt (1)	$ 1,783	$ 1,237	$ 1,235	$740	$739

(1) The increase in Long-term debt from 2016 to 2017 was due to the issuance of $550.0 million aggregate principal amount of 4.75% senior unsecured notes due 2027. The increase in Long-term debt from 2014 to 2015 was due to the issuance of $500.0 million aggregate principal amount of 5.25% senior unsecured notes due 2025. The proceeds from these senior notes issuances resulted in the increase in cash, cash equivalents and marketable securities as well as total assets in the same periods.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

FORWARD-LOOKING STATEMENTS

This Report on Form 10-K contains forward-looking statements within the meaning of Section 27A of the Securities Act and Section 21E of the Exchange Act. These forward-looking statements involve risks and uncertainties, including, among other things, statements regarding our anticipated costs and expenses and revenue mix. Forward-looking statements include, among others, those statements including the words "expects," "anticipates," "intends," "believes" and similar language. Our actual results may differ significantly from those projected in the forward-looking statements. Factors that might cause or contribute to such differences include, but are not limited to, those discussed in the section titled "Risk Factors" in Part I, Item 1A of this Form 10-K. You are cautioned not to place undue reliance on the forward-looking statements, which speak only as of the date of this Form 10-K. We undertake no obligation to publicly release any revisions to the forward-looking statements or reflect events or circumstances after the date of this document.

Overview

We are a global provider of domain name registry services and internet security, enabling internet navigation for many of the world's most recognized domain names and providing protection for websites and enterprises around the world. Our Registry Services ensure the security, stability and resiliency of key internet infrastructure and services, including the .com and .net domains, two of the internet's root servers, and the operation of the root zone maintainer function for the core of the internet's DNS. Our product suite also includes Security Services, consisting of DDoS Protection Services, and Managed DNS Services. Revenues from Security Services are not significant in relation to our consolidated revenues. On April 1, 2017, we completed the sale of our iDefense business.

As of December 31, 2017, we had approximately 146.4 million .com and .net registrations in the domain name base. The number of domain names registered is largely driven by continued growth in online advertising, e-commerce, and the number of internet users, which is partially driven by greater availability of internet access, as well as marketing activities carried out by us and third-party registrars. Growth in the number of domain name registrations under our management may be hindered by certain factors, including overall economic conditions, competition from ccTLDs, the introduction of new gTLDs, and ongoing changes in the internet practices and behaviors of consumers and businesses. Factors such as the evolving practices and preferences of internet users, and how they navigate the internet, as well as the motivation of domain name registrants and how they will manage their investment in domain names, can negatively impact our business and the demand for new domain name registrations and renewals.

2017 Business Highlights and Trends

- We recorded revenues of $1,165.1 million in 2017, which represents an increase of 2% compared to 2016.
- We recorded operating income of $707.7 million during 2017, which represents an increase of 3% as compared to 2016.
- We finished 2017 with 146.4 million .com and .net registrations in the domain name base, which represents a 3% increase from December 31, 2016.
- The final .com and .net renewal rate for the third quarter of 2017 was 74.4% compared with 73.0% for the same quarter in 2016. Renewal rates are not fully measurable until 45 days after the end of the quarter.
- We repurchased 6.3 million shares of our common stock for an aggregate cost of $592.7 million in 2017. As of December 31, 2017, there was $477.4 million remaining for future share repurchases under the share repurchase program.
- Through February 8, 2018, we repurchased an additional 0.6 million shares for $63.2 million under our share repurchase program. Effective February 8, 2018, our Board authorized the repurchase of approximately $585.8 million of our common stock, in addition to the $414.2 million of our common stock remaining available for repurchase under the previous share repurchase program, for a total repurchase authorization of up to $1.0 billion of our common stock.

- We generated cash flows from operating activities of $702.8 million in 2017, which represents an increase of 1% as compared to 2016.
- On April 1, 2017, we completed the sale of our iDefense business, which resulted in a pre-tax gain of approximately $10.4 million.

- On June 28, 2017, we entered into a renewal of the .net Registry Agreement with ICANN, pursuant to which we will remain the sole registry operator of the .net TLD through June 30, 2023.
- On July 5, 2017, we issued $550.0 million of 4.75% Senior Notes due July 15, 2027. The proceeds are being used for general corporate purposes, including, but not limited to, the repurchase of shares under our share repurchase program.
- We increased the annual fee for a .net domain name registration from $8.20 to $9.02, effective February 1, 2018.

Critical Accounting Policies and Significant Management Estimates

The discussion and analysis of our financial condition and results of operations are based upon our Consolidated Financial Statements, which have been prepared in accordance with U.S. generally accepted accounting principles. The preparation of these financial statements requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosures of contingent assets and liabilities. On an ongoing basis, management evaluates those estimates. Management bases its estimates on historical experience and on various assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily available from other sources. Actual results may differ from these estimates under different assumptions or conditions.

An accounting estimate is considered critical if the nature of the estimates or assumptions is material due to the levels of subjectivity and judgment involved, and the impact of changes in the estimates and assumptions would have a material effect on the consolidated financial statements. We believe the following critical accounting estimates and policies have the most significant impact on our consolidated financial statements:

Revenue recognition

We generate revenues by providing services over a period of time. Fees for these services are deferred and recognized as performance occurs. The majority of our revenue transactions contain standard business terms and conditions. However, at times, we enter into non-standard arrangements including multiple-element arrangements. As a result, we must evaluate (1) whether an arrangement exists; (2) how the arrangement consideration should be allocated among the deliverables; (3) when to recognize revenue on the deliverables; and (4) whether all elements of the arrangement have been delivered. Our revenue recognition policy also requires an assessment as to whether collection is reasonably assured, which requires us to evaluate the creditworthiness of our customers. As discussed in Note 1, “Description of Business and Summary of Significant Accounting Policies” of our Notes to Consolidated Financial Statements in Item 15 of this Form 10-K, the adoption of the new revenue guidance in Accounting Standards Codification 606 Revenue from Contracts with Customers, is not expected to have a material impact on our revenue recognition when it becomes effective in 2018.

Income taxes

Accounting for income taxes requires significant judgments in the development of estimates used in income tax calculations. Such judgments include, but are not limited to, the likelihood we would realize the benefits of carryforwards from net operating losses (“NOLs”), capital losses, domestic and/or foreign tax credits, the adequacy of valuation allowances, and the rates used to measure transactions with foreign subsidiaries. To the extent recovery of deferred tax assets is not likely, we record a valuation allowance to reduce our deferred tax assets to the amount that is more likely than not to be realized.

Our operations involve dealing with uncertainties and judgments in the application of complex tax regulations in multiple jurisdictions. The final taxes payable are dependent upon many factors, including negotiations with taxing authorities in various jurisdictions and resolution of disputes arising from U.S. federal, state, and international tax audits. We only recognize or continue to only recognize tax positions that are more likely than not to be sustained upon examination. We adjust these amounts in light of changing facts and circumstances; however, due to the complexity of some of these uncertainties, the ultimate resolution may result in a payment that is materially different from our current estimate of the tax liabilities.

Due to the enactment of the Tax Act, we no longer intend to indefinitely reinvest the earnings of our foreign subsidiaries. For further discussion of this change, see Note 10, “Income taxes” of our Notes to Consolidated Financial Statements in Item 15 of this Form 10-K.

Earnings per Share

We use the treasury stock method to calculate the impact of our Subordinated Convertible Debentures on diluted earnings per share. Under this method, only a positive conversion spread related to the Subordinated Convertible Debentures is included in the diluted earnings per share calculations. This is based on our intent and ability to settle the principal amount of the Subordinated Convertible Debentures in cash. A change in our intent and ability would require us to use the if-converted method, which could have a material impact on our diluted earnings per share.

Results of Operations

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

	Year Ended December 31,		
	2017	2016	2015
Revenues	100.0 %	100.0 %	100.0 %
Costs and expenses:			
Cost of revenues	16.6	17.4	18.2
Sales and marketing	7.0	7.0	8.5
Research and development	4.5	5.2	6.0
General and administrative	11.2	10.3	10.1
Total costs and expenses	39.3	39.9	42.8
Operating income	60.7	60.1	57.2
Interest expense	(11.7)	(10.1)	(10.2)
Non-operating income (loss), net	2.4	0.9	(1.0)
Income before income taxes	51.4	50.9	46.0
Income tax expense	(12.2)	(12.3)	(10.6)
Net income	39.2 %	38.6 %	35.4 %

Revenues

Revenues related to our Registry Services are primarily derived from registrations for domain names in the .com and .net domain name registries. We also derive revenues from operating domain name registries for several other TLDs and from providing back-end registry services to a number of TLD registry operators, all of which are not significant in relation to our consolidated revenues. For domain names registered with the .com and .net registries we receive a fee from registrars per annual registration that is fixed pursuant to our agreements with ICANN. Individual customers, called registrants, contract directly with registrars or their resellers, and the registrars in turn register the domain names with Verisign. Changes in revenues are driven largely by changes in the number of new domain name registrations and the renewal rate for existing registrations as well as the impact of new and prior price increases, to the extent permitted by ICANN and the DOC. New registrations and the renewal rate for existing registrations are impacted by continued growth in online advertising, e-commerce, and the number of internet users, as well as marketing activities carried out by us and our registrar customers. We increased the annual fee for a .net domain name registration from $6.79 to $7.46 on February 1, 2016, from $7.46 to $8.20 on February 1, 2017, and from $8.20 to $9.02 on February 1, 2018. We have the contractual right to increase the fees for .net domain name registrations by up to 10% each year during the term of our agreement with ICANN, through June 30, 2023. The annual fee for a .com domain name registration is $7.85 for the duration of the current .com Registry Agreement through November 30, 2024, except that prices may be raised by up to 7% each year due to the imposition of any new Consensus Policy or documented extraordinary expense resulting from an attack or threat of attack on the Security and Stability (each as defined in the .com Registry Agreement) of the DNS, subject to approval of the DOC. We offer promotional marketing programs for our registrars based upon market conditions and the business environment in which the registrars operate. All fees paid to us for .com and .net registrations are in U.S. dollars. Revenues from Security Services are not significant in relation to our total consolidated revenues.

A comparison of revenues is presented below:

	Year Ended December 31,				
	2017	% Change	2016	% Change	2015
	(Dollars in thousands)				
Revenues	$1,165,095	2 %	$1,142,167	8 %	$1,059,366

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

	As of December 31,				
	2017	% Change	2016	% Change	2015
Domain name base for .com and .net	146.4 million	3 %	142.2 million	2 %	139.8 million

2017 compared to 2016: Revenues increased by $22.9 million, primarily due to a 4% increase in the domain name base for .com and increases in the .net domain name registration fees in February 2016 and 2017, partially offset by a 5% decline in the domain name base for .net. Additionally, 2016 revenue was elevated due to an increased volume of new domain name registrations primarily from our registrars in China during the second half of 2015 and the first quarter of 2016. The volume of these new registrations was inconsistent and episodic compared to prior periods, and by the end of the first quarter of 2016, reverted back to a more normalized registration pace. A significant portion of these registrations did not renew upon expiration.

2016 compared to 2015: Revenues increased by $82.8 million, primarily due to an increase in the average number of domain names ending in .com and .net and increases in the .net domain name registration fees in February 2015 and 2016. The increase in the average number of domain names ending in .com and .net was significantly impacted by the elevated volume of registrations from our registrars in China discussed above.

Growth in the domain name base has been primarily driven by continued internet growth and marketing activities carried out by us and our registrars. Competitive pressure from ccTLDs, the introduction of new gTLDs, ongoing changes in internet practices and behaviors of consumers and business, as well as the motivation of existing domain name registrants and how they will manage their investment in domain names, and historical global economic uncertainty, have limited the rate of growth of the domain name base in recent years and may continue to do so in 2018 and beyond. We expect revenues will continue to grow in 2018, as a result of the increased volume of domain registrations in 2017, continued growth in the domain name base in 2018, and increases in the .net domain name registration fees in February 2017 and 2018.

Geographic revenues

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

The following table presents a comparison of the Company's geographic revenues:

	Year Ended December 31,				
	2017	% Change	2016	% Change	2015
	(Dollars in thousands)				
U.S	$694,759	4 %	$667,301	4 %	$639,170
EMEA	211,349	2 %	207,474	7 %	193,623
China	106,526	(16)%	127,298	53 %	83,456
Other	152,461	9 %	140,094	(2)%	143,117
Total revenues	$1,165,095	2 %	$1,142,167	8 %	$1,059,366

Revenues for our Registry Services business are attributed to the country of domicile and the respective regions in which our registrars are located, however, this may differ from the regions where the registrars operate or where registrants are located. Revenue growth for each region may be impacted by registrars reincorporating, relocating, or from acquisitions or changes in affiliations of resellers. Revenue growth for each region may also be impacted by registrars domiciled in one region, registering domain names in another region. These factors impacted revenues in China and the Other region during 2017. Additionally, while revenues grew in the U.S., EMEA and Other regions during 2017, revenues from China decreased. Revenues from China in 2016 benefited from the increased volume of registrations in the second half of 2015 and the first quarter of 2016, as discussed earlier. However, a significant portion of those registrations did not renew, resulting in the decline in revenues from China in 2017.

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Cost of revenues

Cost of revenues consist primarily of salaries and employee benefits expenses for our personnel who manage the operational systems, depreciation expenses, operational costs associated with the delivery of our services, fees paid to ICANN, customer support and training, consulting and development services, costs of facilities and computer equipment used in these activities, telecommunications expense and allocations of indirect costs such as corporate overhead.
A comparison of cost of revenues is presented below:

	Year Ended December 31,				
	2017	% Change	2016	% Change	2015
	(Dollars in thousands)				
Cost of revenues	$193,326	(2)%	$198,242	3 %	$192,788

2017 compared to 2016: Cost of revenues decreased by $4.9 million, primarily due to decreases in depreciation expenses and salary and employee benefits expenses, partially offset by an increase in telecommunications expenses. Depreciation expenses decreased by $5.3 million as a result of lower average hardware purchases over the last several years. Salary and employee benefits expenses decreased by $3.1 million, primarily due to a reduction in average headcount related to the sale of the iDefense business in April 2017, partially offset by increases in salary and employee benefits expenses for the remaining employee base. Telecommunications expenses increased by $3.2 million as a result of an increase in network costs supporting our operations.

2016 compared to 2015: Cost of revenues increased by $5.5 million, primarily due to increases in salary and employee benefits expenses, and allocated overhead expenses, partially offset by a decrease in telecommunications expenses. Salary and employee benefits expenses increased by $6.0 million, primarily due to an increase in average headcount and an increase in bonus expenses. Allocated overhead expenses increased by $1.5 million as a result of an increase in average headcount compared to other cost types. Telecommunications expenses decreased by $1.9 million, primarily due to savings on renewals of colocation agreements.
We expect cost of revenues as a percentage of revenues to decrease slightly in 2018 as compared to 2017 as revenue is expected to grow faster than direct costs.
Sales and marketing

Sales and marketing expenses consist primarily of salaries, sales commissions, sales operations and other personnel-related expenses, travel and related expenses, trade shows, costs of lead generation, costs of computer and communications equipment and support services, facilities costs, consulting fees, costs of marketing programs, such as online, television, radio, print and direct mail advertising costs, and allocations of indirect costs such as corporate overhead.
A comparison of sales and marketing expenses is presented below:

	Year Ended December 31,				
	2017	% Change	2016	% Change	2015
	(Dollars in thousands)				
Sales and marketing	$81,951	2 %	$80,250	(11)%	$90,184

2017 compared to 2016: Sales and marketing expenses increased by $1.7 million, primarily due to an increase in advertising and marketing expenses, partially offset by a decrease in salary and employee benefits expenses. Advertising and marketing expenses increased by $7.0 million, primarily due to increases in costs related to certain marketing campaigns supporting our Registry Services business. Salary and employee benefits expenses decreased by $4.2 million due to a reduction in average headcount.

2016 compared to 2015: Sales and marketing expenses decreased by $9.9 million, primarily due to decreases in advertising and consulting expenses, salary and employee benefits expenses, stock-based compensation expenses, and allocated overhead expenses. Advertising and consulting expenses decreased by $3.7 million, primarily due to a decrease in marketing activities and advertising agency costs. Salary and employee benefits expenses, including stock-based compensation expenses, decreased by $2.9 million due to a reduction in average headcount. Allocated overhead expenses decreased by $1.4 million due to the decrease in average headcount relative to other cost types.

We expect sales and marketing expenses as a percentage of revenues to remain consistent in 2018 as compared to 2017.

Research and development

Research and development expenses consist primarily of costs related to research and development personnel, including salaries and other personnel-related expenses, consulting fees, facilities costs, computer and communications equipment, support services used in our service and technology development, and allocations of indirect costs such as corporate overhead.

A comparison of research and development expenses is presented below:

	Year Ended December 31,				
	2017	% Change	2016	% Change	2015
	(Dollars in thousands)				
Research and development	$52,342	(11)%	$59,100	(7)%	$63,718

2017 compared to 2016: Research and development expenses decreased by $6.8 million, primarily due to a decrease in salary and employee benefits expenses as a result of a reduction in average headcount.

2016 compared to 2015: Research and development expenses decreased by $4.6 million, primarily due to decreases in salary and employee benefits expenses, and allocated overhead costs, partially offset by a decrease in capitalized labor. Salary and employee benefits expenses, allocated overhead expenses, and capitalized labor decreased by $2.4 million, $1.7 million, and $1.5 million, respectively, due to a reduction in average headcount.

We expect research and development expenses as a percentage of revenues to remain consistent in 2018 as compared to 2017.

General and administrative

General and administrative expenses consist primarily of salaries and other personnel-related expenses for our executive, administrative, legal, finance, information technology and human resources personnel, costs of facilities, computer and communications equipment, management information systems, support services, professional services fees, certain tax and license fees, and bad debt expense, offset by allocations of indirect costs such as facilities and shared services expenses to other cost types.

A comparison of general and administrative expenses is presented below:

	Year Ended December 31,				
	2017	% Change	2016	% Change	2015
	(Dollars in thousands)				
General and administrative	$129,754	10 %	$118,003	11 %	$106,730

2017 compared to 2016: General and administrative expenses increased by $11.8 million, primarily due to increases in salary and employee benefits expenses, including stock-based compensation expenses, legal expenses, and a decrease in overhead expenses allocated to other cost types, partially offset by a decrease in depreciation expenses. Salary and employee benefits expenses, including stock-based compensation expenses, increased by $4.9 million due to an increase in average headcount and higher projected achievement levels on certain performance-based restricted stock units (“RSU”) grants. Legal expenses increased by $4.5 million primarily due to higher external legal fees. Overhead expenses allocated to other cost types decreased by $2.5 million due to an increase in the average headcount relative other cost types. Depreciation expenses decreased by $2.8 million as a result of a decrease in capital expenditures in recent years.

2016 compared to 2015: General and administrative expenses increased by $11.3 million, primarily due to increases in salary and employee benefits expenses, stock-based compensation expenses, legal expenses, and a decrease in overhead expenses allocated to other cost types, partially offset by a decrease in depreciation expenses and certain non-income related taxes. Salary and employee benefits expenses increased by $8.0 million due to increases in bonus expenses and average headcount. Stock based compensation expenses increased by $4.5 million due to increases in the total value of RSUs granted in 2015 and 2016 and higher projected achievement levels on certain performance-based RSU grants. Legal expenses increased by $2.6 million primarily due to an increase in services performed by external legal counsel. Overhead expenses allocated to other cost types decreased by $1.6 million due to lower average headcount for other cost types. Depreciation expenses decreased by $2.6 million as a result of a decrease in capital expenditures in recent years. We incurred $2.1 million of certain non-income taxes in 2015, which did not recur in 2016.

We expect general and administrative expenses as a percentage of revenues to remain consistent in 2018 as compared to 2017.

Interest expense

See Note 4, “Debt and interest expense” of our Notes to Consolidated Financial Statements in Item 15 of this Form 10-K. We expect interest expense to decrease in 2018 as compared to 2017 due to a decrease in interest expense related to the Subordinated Convertible Debentures as we notified holders that the Subordinated Convertible Debentures will be redeemed on May 1, 2018, partially offset by an increase related to the senior notes issued in July 2017.

Non-operating income (loss), net

See Note 9, “Non-operating income (loss), net” of our Notes to Consolidated Financial Statements in Item 15 of this Form 10-K.

Income tax expense

	Year Ended December 31,		
	2017	2016	2015
	(Dollars in thousands)		
Income tax expense	$141,764	$140,528	$112,414
Effective tax rate	24 %	24 %	23 %

Our effective tax rate for each year presented was lower than the statutory federal rate of 35% primarily due to benefits from foreign income taxed at lower rates, partially offset by state income taxes. Our effective tax rate for 2017 was also impacted by the changes arising out of the enactment of the Tax Act in December 2017.

Due to the change in tax law, we will owe U.S. federal taxes on our accumulated and future foreign earnings and as a result we no longer intend to indefinitely reinvest our foreign earnings. Our 2017 income tax expense includes a provisional $162.4 million of expense related to the U.S. tax on accumulated foreign earnings and a provisional $33.6 million deferred tax expense for foreign withholding tax on unremitted foreign earnings, both net of related, previously unrecognized foreign tax credits. These tax expenses are offset by a tax benefit of $186.8 million related to the remeasurement of our net deferred tax liabilities at the new U.S. federal corporate tax rate of 21% which became effective on January 1, 2018. We expect our effective tax rate to decrease slightly in 2018 as a result of the impact of the Tax Act. For further discussion of the Tax Act, see Note 10, “Income taxes” of our Notes to Consolidated Financial Statements in Item 15 of this Form 10-K.

As of December 31, 2017, we had deferred tax assets arising from deductible temporary differences, tax losses, and tax credits of $202.6 million, net of valuation allowances, but before the offset of certain deferred tax liabilities. With the exception of deferred tax assets related to capital loss and certain state NOL carryforwards, we believe it is more likely than not that the tax effects of the deferred tax liabilities, together with future taxable income, will be sufficient to fully recover the remaining deferred tax assets. Our deferred tax assets related to NOL carryforwards increased in 2017 due to the adoption of ASU No. 2016-09, Improvements to Employee Share-Based Payment Accounting, and the resulting recognition of $35.4 million of previously unrecognized excess tax benefits from stock-based compensation. Total deferred tax assets decreased in 2017 due to the usage of tax credit carryforwards to offset 2017 taxable income and the remeasurement of deferred tax assets due to the reduction in the U.S. corporate tax rate.

We qualify for a tax holiday in Switzerland which does not expire, unless the required non-Swiss income and expense thresholds are no longer met, or there is a law change which eliminates the holiday. The tax holiday provides reduced rates of taxation on certain types of income and also requires certain thresholds of foreign source income. The tax holiday increased the Company’s earnings per share by $0.10, $0.16, and $0.14 in 2017, 2016, and 2015, respectively.

Liquidity and Capital Resources

	As of December 31,	
	2017	2016
	(In thousands)	
Cash and cash equivalents	$465,851	$231,945
Marketable securities	1,948,900	1,565,962
Total	$2,414,751	$1,797,907

As of December 31, 2017, our principal source of liquidity was $465.9 million of cash and cash equivalents and $1.9 billion of marketable securities. The marketable securities consist primarily of debt securities issued by the U.S. Treasury meeting the criteria of our investment policy, which is focused on the preservation of our capital through investment in investment grade securities. The cash equivalents consist mainly of amounts invested in money market funds and U.S. Treasury bills purchased with original maturities of less than 90 days. As of December 31, 2017, all of our debt securities have contractual maturities of less than one year. Our cash and cash equivalents are readily accessible. For additional information on our investment portfolio, see Note 2, “Fair Value of Financial Instruments,” of our Notes to Consolidated Financial Statements in Item 15 of this Form 10-K.

As of December 31, 2017, the amount of cash and cash equivalents and marketable securities held by foreign subsidiaries was $1.7 billion. As a result of the recent changes in U.S. tax laws, we no longer intend to indefinitely reinvest these funds outside of the U.S. and accordingly, we recognized a provisional income tax expense of $162.4 million related to the U.S. tax on our accumulated foreign earnings and a provisional $33.6 million related to withholding taxes on unremitted foreign earnings. By early second quarter of 2018, we intend to repatriate approximately $1.1 billion of cash held by foreign subsidiaries, net of withholding taxes, based on current exchange rates.

In 2017, we repurchased 6.3 million shares of our common stock at an average stock price of $94.59 for an aggregate cost of $592.7 million under our share repurchase program. In 2016, we repurchased 7.8 million shares of our common stock at an average stock price of $81.73 for an aggregate cost of $636.5 million. In 2015, we repurchased 9.3 million shares of our common stock at an average stock price of $66.59 for an aggregate cost of $621.9 million. On February 8, 2018, our Board authorized the repurchase of approximately $585.8 million of our common stock, in addition to the $414.2 million of our common stock remaining available for repurchase under the previous share repurchase program, for a total repurchase authorization of up to $1.0 billion of our common stock.

On July 5, 2017, we issued $550.0 million of 4.75% senior unsecured notes due July 15, 2027. The proceeds are being used for general corporate purposes, including, but not limited to, the repurchase of shares under our share repurchase program. As of December 31, 2017, we also had $500.0 million principal amount outstanding of the 5.25% senior unsecured notes due 2025 and $750.0 million principal amount outstanding of the 4.625% senior unsecured notes due 2023.

As of December 31, 2017, we have a $200.0 million unsecured revolving credit facility with no borrowings outstanding. This facility will expire in 2020.

As of December 31, 2017, we had $1.25 billion principal amount outstanding of our Subordinated Convertible Debentures. The price of our common stock exceeded the conversion price threshold trigger during the fourth quarter of 2017. Accordingly, the Subordinated Convertible Debentures are convertible at the option of each holder through March 31, 2018.

We have historically derived significant tax savings from the Subordinated Convertible Debentures as the interest deduction for tax purposes has exceeded the cash interest paid due to the structure of the debentures and the related tax laws. During 2017 and 2016, the interest deduction, for income tax purposes, related to our Subordinated Convertible Debentures, was $191.5 million and $183.7 million, respectively, compared to cash interest paid, including contingent interest, of $55.9 million and $54.0 million in 2017 and 2016, respectively. The size of the interest deduction for tax purposes resulted in a tax benefit that exceeded the cash interest paid for the debentures in each of these years. However, as a result of the enactment of the Tax Act, which includes limits on interest deductibility and a lower U.S. federal income tax rate, these tax savings are expected to diminish in the future. Due to the diminished tax savings and

several other factors, on February 15, 2018 we called for the redemption of all the outstanding Subordinated Convertible Debentures, with a redemption date of May 1, 2018. If holders elect to convert their debentures, we will settle the $1.25 billion principal amount in cash and settle the remaining value through the issuance of shares of Verisign's common stock. Based on the if-converted value of the Subordinated Convertible Debentures as of December 31, 2017, the conversion spread would have required us to issue up to 25.4 million shares of common stock.

We believe existing cash, cash equivalents and marketable securities, and funds generated from operations, together with our ability to arrange for additional financing should be sufficient to meet our working capital, capital expenditure requirements, and to service our debt for the next 12 months. We regularly assess our cash management approach and activities in view of our current and potential future needs.
In summary, our cash flows for 2017, 2016, and 2015 were as follows:

	Year Ended December 31,		
	2017	2016	2015
	(In thousands)		
Net cash provided by operating activities	$702,761	$693,007	$669,946
Net cash used in investing activities	(405,076)	(40,399)	(496,899)
Net cash used in financing activities	(65,073)	(648,821)	(136,242)
Effect of exchange rate changes on cash and cash equivalents	1,294	(501)	246
Net increase in cash and cash equivalents	$233,906	$3,286	$37,051

Net cash provided by operating activities

Our largest source of operating cash flows is cash collections from our customers. Our primary uses of cash from operating activities are for personnel related expenditures, and other general operating expenses, as well as payments related to taxes, interest and facilities.

2017 compared to 2016: Cash provided by operating activities increased primarily due to increases in cash received from customers and an increase in interest income, partially offset by increases in cash paid to suppliers and employees, cash paid for income taxes, and cash paid for interest on our debt obligations. Cash received from customers increased primarily due to higher .com domain name registrations and renewals and the increase in .net domain name registration fees in February 2017. Cash received from interest income increased due to increases in interest rates and our investments in debt securities. Cash paid to suppliers and employees increased primarily due to timing of certain vendor payments. Cash paid for income taxes increased due to higher non-U.S. income tax payments. Cash paid for interest increased due to higher contingent interest related to the Subordinated Convertible Debentures.

2016 compared to 2015: Cash provided by operating activities increased primarily due to an increase in cash received from customers and a decrease in cash paid for income taxes, partially offset by an increase in cash paid for interest. Cash received from customers increased primarily due to an increase in the number of domain name registration renewals and the increase in .net domain name registration fees in February 2016. Cash paid for income taxes decreased primarily due to income tax payments in 2015 related to the reorganization of certain international operations. Cash paid for interest increased due to the interest paid on the $500.0 million senior notes issued on March 2015, and higher contingent interest related to the Subordinated Convertible Debentures.

Net cash used in investing activities

The changes in cash flows from investing activities primarily relate to purchases, maturities and sales of marketable securities, and purchases of property and equipment and rights to intangible assets.

2017 compared to 2016: The increase in cash used in investing activities was primarily due to an increase in purchases of marketable securities, net of sales and maturities, and an increase in purchases of property and equipment, partially offset by the payments made in 2016 for the future assignment of the rights to the .web gTLD, and an increase in other investing activities including the proceeds received from the sale of our iDefense business.

2016 compared to 2015: The decrease in cash used in investing activities was primarily due to an increase in sales and maturities of marketable securities, net of purchases, and a decrease in purchases of property and equipment and other

investing activities, partially offset by the payments made for the future assignment of the rights to the .web gTLD.

Net cash used in financing activities

The changes in cash flows from financing activities primarily relate to share repurchases, proceeds from and repayment of borrowings, and our employee stock purchase plan (“ESPP”).

2017 compared to 2016: The decrease in net cash used in financing activities was primarily due to the proceeds received from the issuance of the 4.75% senior notes due 2027 in the third quarter of 2017, net of issuance costs, and a decrease in share repurchases.

2016 compared to 2015: The increase in net cash used in financing activities was primarily due to an increase in share repurchases, and proceeds from the issuance of senior notes in March 2015.

Impact of Inflation

We do not believe that inflation has had a significant impact on our operations in any of the periods presented.

Income taxes

As a result of the enactment of the Tax Act in December 2017, we will owe U.S. income tax on our foreign earnings and as a result, we no longer intend to indefinitely reinvest our foreign earnings. We expect the amount of cash paid for income taxes in 2018 to increase due to the foreign withholding taxes that will be paid related to funds repatriated to the U.S. and other impacts of the Tax Act.

Property and Equipment Expenditures

Our planned property and equipment expenditures for 2018 are anticipated to be between $45.0 million and $55.0 million and will primarily be focused on infrastructure upgrades and enhancements to our product portfolio.

Contractual Obligations

See Note 11, “Commitments and Contingencies,” Purchase Obligations and Contractual Agreements, of our Notes to Consolidated Financial Statements in Item 15 of this Form 10-K.

Off-Balance Sheet Arrangements

It is not our business practice to enter into off-balance sheet arrangements. As of December 31, 2017, we did not have any significant off-balance sheet arrangements. See Note 11, “Commitments and Contingencies,” Off-Balance Sheet Arrangements, of our Notes to Consolidated Financial Statements in Item 15 of this Form 10-K for further information regarding off-balance sheet arrangements.

Dilution from RSUs

Grants of stock-based awards are key components of the compensation packages we provide to attract and retain certain of our talented employees and align their interests with the interests of existing stockholders. We recognize that these stock-based awards dilute existing stockholders and have sought to control the number granted while providing competitive compensation packages. As of December 31, 2017, there are a total of 1.6 million unvested RSUs which represent potential dilution of 1.6%. This maximum potential dilution will only result if all outstanding RSUs vest and are settled. In recent years, our stock repurchase program has more than offset the dilutive effect of RSU grants to employees; however, we may reduce the level of our stock repurchases in the future as we may use our available cash for other purposes.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to financial market risks, including changes in interest rates, foreign exchange rates and market risks. We have not entered into any market risk sensitive instruments for trading purposes.

Interest rate sensitivity

The fixed income securities in our investment portfolio are subject to interest rate risk. As of December 31, 2017, we had $2.2 billion of fixed income securities, which consisted of U.S. Treasury bills with maturities of less than one year. A hypothetical change in interest rates by 100 basis points would not have a significant impact on the fair value of our investments.

Foreign exchange risk management

We conduct business in several countries and transact in multiple foreign currencies. The functional currency for all of our international subsidiaries is the U.S. Dollar. Our foreign currency risk management program is designed to mitigate foreign exchange risks associated with monetary assets and liabilities of our operations that are denominated in currencies other than the U.S. dollar. The primary objective of this program is to minimize the gains and losses to income resulting from fluctuations in exchange rates. We may choose not to hedge certain foreign exchange exposures due to immateriality, prohibitive economic cost of hedging particular exposures, and limited availability of appropriate hedging instruments. We do not enter into foreign currency transactions for trading or speculative purposes, nor do we hedge foreign currency exposures in a manner that entirely offsets the effects of changes in exchange rates. The program may entail the use of forward or option contracts, which are usually placed and adjusted monthly. These foreign currency forward contracts are derivatives and are recorded at fair market value. We attempt to limit our exposure to credit risk by executing foreign exchange contracts with financial institutions that have investment grade ratings.

As of December 31, 2017, we held foreign currency forward contracts in notional amounts totaling $29.7 million to mitigate the impact of exchange rate fluctuations associated with certain foreign currencies. Gains or losses on the foreign currency forward contracts would be largely offset by the remeasurement of our foreign currency denominated assets and liabilities, resulting in an insignificant net impact to income.

A hypothetical uniform 10% strengthening or weakening in the value of the U.S. dollar relative to the foreign currencies in which our revenues and expenses are denominated would not result in a significant impact to our financial statements.

Market risk management

The fair market values of our Subordinated Convertible Debentures and the senior notes are subject to interest rate risk. Generally, the fair market value of fixed interest rate debt will increase as interest rates fall and decrease as interest rates rise. The Subordinated Convertible Debentures are subject to market risk due to the convertible feature of the debentures. The fair market value will increase as the market price of our common stock increases, and decrease as the market price of our common stock falls. As of December 31, 2017, the fair value of the Subordinated Convertible Debentures was approximately $4.2 billion and the fair values of the senior notes issued in 2013, the senior notes issued in 2015, and the senior notes issued in 2017 were $772.9 million, $544.4 million, and $563.7 million, respectively, based on available market information from public data sources.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Financial Statements

Verisign's financial statements required by this Item are set forth as a separate section of this Form 10-K. See Item 15 for a listing of financial statements provided in the section titled "Financial Statements."

Supplementary Data (Unaudited)

The following tables set forth unaudited supplementary quarterly financial data for the two year period ended December 31, 2017. In management's opinion, the unaudited data has been prepared on the same basis as the audited information and includes all adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation of the data for the periods presented.

	2017				
	Quarter Ended				Year Ended
	March 31	June 30 (2)	September 30	December 31	December 31,
	(In thousands, except per share data)				
Revenues	$288,614	$288,552	$292,428	$295,501	$ 1,165,095
Gross Profit	$237,945	$240,908	$245,095	$247,821	$ 971,769
Operating Income	$175,271	$174,960	$181,059	$176,432	$ 707,722
Net income	$116,412	$123,100	$114,899	$102,837	$ 457,248
Earnings per share:					
Basic	$1.14	$1.22	$1.15	$1.05	$ 4.56
Diluted (1)	$0.94	$0.99	$0.93	$0.83	$ 3.68

(1) Earnings per share for the year is computed independently and may not equal the sum of the quarterly earnings per share.

(2) Results for the quarter ended June 30, 2017 include a $10.6 million pre-tax gain recognized on the sale of the iDefense business.

	2016				
	Quarter Ended				Year Ended
	March 31	June 30	September 30	December 31	December 31,
	(In thousands, except per share data)				
Revenues	$281,876	$286,466	$287,554	$286,271	$ 1,142,167
Gross Profit	$231,294	$237,713	$237,747	$237,171	$ 943,925
Operating Income	$166,767	$176,267	$174,776	$168,762	$ 686,572
Net income	$107,456	$113,210	$114,427	$105,552	$ 440,645
Earnings per share:					
Basic	$0.98	$1.05	$1.08	$1.01	$ 4.12
Diluted (1)	$0.82	$0.87	$0.90	$0.84	$ 3.42

(1) Earnings per share for the year is computed independently and may not equal the sum of the quarterly earnings per share.

Our quarterly revenues and operating results are difficult to forecast. Therefore, we believe that period-to-period comparisons of our operating results will not necessarily be meaningful, and should not be relied upon as an indication of future performance. Also, operating results may fall below our expectations and the expectations of securities analysts or investors in one or more future quarters. If this were to occur, the market price of our common stock would likely decline.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

Not applicable.

ITEM 9A. CONTROLS AND PROCEDURES

a. Evaluation of Disclosure Controls and Procedures

Based on our management's evaluation, with the participation of our Chief Executive Officer (our principal executive officer) and our Chief Financial Officer (our principal financial officer), as of December 31, 2017, our principal executive officer and principal financial officer have concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, (the "Exchange Act")) are effective to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms and is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

b. Management's Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act. Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting as of December 31, 2017 using the criteria established in Internal Control-Integrated Framework (2013 Framework) issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO").

Based on our evaluation under the COSO framework, management has concluded that our internal control over financial reporting is effective 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.

KPMG LLP, an independent registered public accounting firm, has issued a report concerning the effectiveness of our internal control over financial reporting as of December 31, 2017. See "Report of Independent Registered Public Accounting Firm" in Item 15 of this Form 10-K.

c. Changes in Internal Control over Financial Reporting

There was no change in our internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the three months ended December 31, 2017 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

d. Inherent Limitations of Disclosure Controls and Internal Control over Financial Reporting

Because of their inherent limitations, our disclosure controls and procedures and our internal control over financial reporting may not prevent material errors or fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. The effectiveness of our disclosure controls and procedures and our internal control over financial reporting is subject to risks, including that the controls may become inadequate because of changes in conditions or that the degree of compliance with our policies or procedures may deteriorate.

ITEM 9B. OTHER INFORMATION

On February 14, 2018, our Board of Directors amended our Bylaws to decrease the aggregate ownership percentage of stockholders needed to call a special meeting from 35% to 25% as described in Article I, Section 2 of the Bylaw. The amended Bylaws, which were effective upon approval by the Board of Directors, contain certain notice and other requirements relevant to the ability of stockholders to call a special meeting.
This description of the amendment to the Bylaws is qualified in its entirety by reference to the text of the Bylaws, filed as Exhibit 3.02 to this Form 10-K.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information required by this item relating to our directors and nominees, regarding compliance with Section 16(a) of the Exchange Act, and regarding our Audit Committee, Corporate Governance and Nominating Committee and Compensation Committee will be included under the captions “Proposal No. 1: Election of Directors,” “Security Ownership of Certain Beneficial Owners and Management-Section 16(a) Beneficial Ownership Reporting Compliance,” and “Corporate Governance” in our Proxy Statement related to the 2018 Annual Meeting of Stockholders and is incorporated herein by reference (“2018 Proxy Statement”).

Pursuant to General Instruction G(3) of Form 10-K, the information required by this item relating to our executive officers is included under the caption “Executive Officers of the Registrant” in Part I of this Annual Report on Form 10-K.

We have adopted a “Verisign Code of Conduct”, which is posted on our website under “Ethics and Business Conduct” at https://investor.verisign.com/corporate-governance.cfm. The code of conduct applies to all directors, officers and employees, including the principal executive officer, principal financial officer and other senior accounting officers. We have also adopted the “Corporate Governance Principles for the Board of Directors,” which provide guidance to our directors on corporate practices that serve the best interests of the Company and its shareholders.

We intend to satisfy any disclosure requirement under Item 5.05 of Form 8-K regarding an amendment to, or waiver from, a provision of the “Verisign Code of Conduct,” to the extent applicable to the principal executive officer, principal financial officer, or other senior accounting officers, by posting such information on our website, on the web page found by clicking through to “Ethics and Business Conduct” as specified above.

ITEM 11. EXECUTIVE COMPENSATION

Information required by this item is incorporated herein by reference to our 2018 Proxy Statement from the discussions under the captions “Compensation of Directors,” “Non-Employee Director Retainer Fees and Equity Compensation Information” and “Non-Employee Director Compensation Table for Fiscal 2017,” and “Executive Compensation.”

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

Information required by this item is incorporated herein by reference from the discussions under the captions “Security Ownership of Certain Beneficial Owners and Management” and “Equity Compensation Plan Information” in our 2018 Proxy Statement.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

Information required by this item is incorporated herein by reference to our 2018 Proxy Statement from the discussions under the captions “Policies and Procedures with Respect to Transactions with Related Persons,” “Certain Relationships and Related Transactions” and “Independence of Directors.”

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

Information required by this item is incorporated herein by reference to our 2018 Proxy Statement from the discussions under the captions “Principal Accountant Fees and Services” and “Policy on Audit Committee Pre-Approval

of Audit and Permissible Non-Audit Services of Independent Auditors."

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PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

(a) Documents filed as part of this report

1. Financial statements

- Reports of Independent Registered Public Accounting Firm
- Consolidated Balance Sheets as of December 31, 2017 and 2016
- Consolidated Statements of Comprehensive Income for the Years Ended December 31, 2017, 2016, and 2015
- Consolidated Statements of Stockholders' Deficit for the Years Ended December 31, 2017, 2016, and 2015
- Consolidated Statements of Cash Flows for the Years Ended December 31, 2017, 2016, and 2015
- Notes to Consolidated Financial Statements

2. Financial statement schedules

Financial statement schedules are omitted because the information called for is not material or is shown either in the consolidated financial statements or the notes thereto.

3. Exhibits

(a) Index to Exhibits

Pursuant to the rules and regulations of the Securities and Exchange Commission (the "SEC"), the Company has filed certain agreements as exhibits to this Form 10-K. These agreements may contain representations and warranties by the parties thereto. These representations and warranties have been made solely for the benefit of the other party or parties to such agreements and (1) may be intended not as statements of fact, but rather as a way of allocating the risk to one of the parties to such agreements if those statements prove to be inaccurate, (2) may have been qualified by disclosures that were made to such other party or parties and that either have been reflected in the Company's filings or are not required to be disclosed in those filings, (3) may apply materiality standards different from what may be viewed as material to investors and (4) were made only as of the date of such agreements or such other date(s) as may be specified in such agreements and are subject to more recent developments. Accordingly, these representations and warranties may not describe the Company's actual state of affairs at the date hereof or at any other time.

Exhibit Number	Exhibit Description	Incorporated by Reference			Filed Herewith
		Form	Date	Number	
2.01	Agreement and Plan of Merger dated as of March 6, 2000, by and among the Registrant, Nickel Acquisition Corporation and Network Solutions, Inc.	8-K	3/8/00	2.1	
3.01		10-K	2/17/17	3.01	

	Sixth Amended and Restated Certificate of Incorporation of the Registrant.				
3.02	Bylaws of VeriSign, Inc.				X
4.01	Indenture dated as of August 20, 2007 between the Registrant and U.S. Bank National Association.	8-K/A	9/6/07	4.1	
4.02	Indenture, dated as of April 16, 2013, between VeriSign, Inc., each of the subsidiary guarantors party thereto and U.S. Bank National Association, as trustee.	8-K	4/17/13	4.1	
4.03	Indenture dated as of March 27, 2015 between VeriSign, Inc. and U.S. Bank National Association, as trustee.	8-K	3/30/15	4.1	
4.04	Indenture, dated as of July 5, 2017, between VeriSign, Inc. and U.S. Bank National Association, as trustee.	8-K	7/5/17	4.1	
10.01	Amended and Restated 2007 Employee Stock Purchase Plan, as adopted August 30, 2007, and amended May 25, 2017. +	DEF 14A	4/12/17	Appendix A	

Exhibit Number	Exhibit Description	Incorporated by Reference			Filed Herewith
		Form	Date	Number	
10.02	Amendment No. Thirty (30) to Cooperative Agreement - Special Awards Conditions NCR-92-18742, between VeriSign and U.S. Department of Commerce managers.	10-K	7/12/07	10.27	
10.03	VeriSign, Inc. Annual Incentive Compensation Plan. +	DEF 14A	4/8/15	Appendix A	
10.04	Form of Amended and Restated Change-in-Control and Retention Agreement [CEO Form of Agreement]. +	10-Q	7/27/17	10.01	
10.05	Amended and Restated Change-in-Control and Retention Agreement. +	10-Q	7/27/17	10.02	
10.06	Purchase and Sale Agreement for 12061 Bluemont Way Reston, Virginia between 12061 Bluemont Owner, LLC, a Delaware limited liability company, as Seller and VeriSign, Inc., a Delaware corporation, as Purchaser Dated August 18, 2011.	8-K	9/7/11	10.01	
10.07	VeriSign, Inc. 2006 Equity Incentive Plan Form of Non-Employee Director Restricted Stock Unit Agreement. +	10-Q	7/27/12	10.03	
10.08	Registry Agreement between VeriSign, Inc. and the Internet Corporation for Assigned Names and Numbers, entered into on November 29, 2012.	8-K	11/30/12	10.1	
10.09	Amendment Number Thirty-Two (32) to the Cooperative Agreement between VeriSign, Inc. and Department of Commerce, entered into on November 29, 2012.	8-K	11/30/12	10.2	
10.10	VeriSign, Inc. 2006 Equity Incentive Plan Employee Restricted Stock Unit Agreement. +	10-Q	4/25/13	10.02	
10.11	VeriSign, Inc. 2006 Equity Incentive Plan Performance-Based Restricted Stock Unit Agreement +	10-Q	4/28/16	10.01	
10.12	Credit Agreement dated as of March 31, 2015 among VeriSign, Inc., the Lenders as defined therein, JPMorgan Chase Bank, N.A., as Administrative Agent, and J.P. Morgan Europe Limited, as London Agent.	8-K	4/1/15	99.1	
10.13	VeriSign, Inc. 2006 Equity Incentive Plan Form of Employee Restricted Stock Unit Agreement +	10-K	2/19/16	10.70	
10.14	Amendment to the .com Registry Agreement between VeriSign, Inc. and the Internet Corporation for Assigned Names and Numbers, entered into on October 20, 2016	8-K	10/20/16	10.1	

10.15	Amendment Number Thirty-Three (33) to the Cooperative Agreement between VeriSign, Inc. and Department of Commerce, entered into on October 20, 2016	8-K	10/20/16	10.2	
10.16	Amendment Number Thirty-Four (34) to the Cooperative Agreement between VeriSign, Inc. and Department of Commerce, entered into on October 20, 2016	8-K	10/20/16	10.3	
10.17	Amended and Restated VeriSign, Inc. 2006 Equity Incentive Plan, as amended and restated +	DEF 14A	4/29/16	Appendix A	
10.18	.Net Registry Agreement between VeriSign, Inc. and the Internet Corporation for Assigned Names and Numbers, entered into on June 28, 2017.	8-K	6/28/17	10.1	
21.01	Subsidiaries of the Registrant.				X
23.01	Consent of Independent Registered Public Accounting Firm.				X

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Exhibit Number	Exhibit Description	Incorporated by Reference Form	Date	Number	Filed Herewith
24.01	Powers of Attorney (Included as part of the signature pages hereto).				X
31.01	Certification of Principal Executive Officer pursuant to Exchange Act Rule 13a-14(a).				X
31.02	Certification of Principal Financial Officer pursuant to Exchange Act Rule 13a-14(a).				X
32.01	Certification of Principal Executive Officer pursuant to Exchange Act Rule 13a-14(b) and Section 1350 of Chapter 63 of Title 18 of the U.S. Code (18 U.S.C. 1350). *				X
32.02	Certification of Principal Financial Officer pursuant to Exchange Act Rule 13a-14(b) and Section 1350 of Chapter 63 of Title 18 of the U.S. Code (18 U.S.C. 1350). *				X
101.INS	XBRL Instance Document.				X
101.SCH	XBRL Taxonomy Extension Schema.				X
101.CAL	XBRL Taxonomy Extension Calculation Linkbase.				X
101.DEF	XBRL Taxonomy Extension Definition Linkbase.				X
101.LAB	XBRL Taxonomy Extension Label Linkbase.				X
101.PRE	XBRL Taxonomy Extension Presentation Linkbase.				X

* As contemplated by SEC Release No. 33-8212, these exhibits are furnished with this Annual Report on Form 10-K and are not deemed filed with the Securities and Exchange Commission and are not incorporated by reference in any filing of VeriSign, Inc. under the Securities Act of 1933 or the Securities Exchange Act of 1934, whether made before or after the date hereof and irrespective of any general incorporation language in such filings.

+ Indicates a management contract or compensatory plan or arrangement.

ITEM 16. 10-K SUMMARY

None.

FINANCIAL STATEMENTS

As required under Item 8—Financial Statements and Supplementary Data, the consolidated financial statements of Verisign, Inc. are provided in this separate section. The consolidated financial statements included in this section are as follows:

Financial Statement Description	Page
Reports of Independent Registered Public Accounting Firm	46
Consolidated Balance Sheets As of December 31, 2017 and December 31, 2016	48
Consolidated Statements of Comprehensive Income For the Years Ended December 31, 2017, 2016, and 2015	49
Consolidated Statements of Stockholders' Deficit For the Years Ended December 31, 2017, 2016, and 2015	50
Consolidated Statements of Cash Flows For the Years Ended December 31, 2017, 2016, and 2015	51
Notes to Consolidated Financial Statements	52

Report of Independent Registered Public Accounting Firm
To the stockholders and board of directors
VeriSign, Inc.:

Opinion on the Consolidated Financial Statements

We have audited the accompanying consolidated balance sheets of VeriSign, Inc. and subsidiaries (the “Company”) as of December 31, 2017 and 2016, the related consolidated statements of comprehensive income, stockholders’ deficit, and cash flows for each of the years in the three year period ended December 31, 2017, and the related notes (collectively, the “consolidated financial statements”). In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2017 and 2016, and the results of their operations and their cash flows for each of the years in the three year period ended December 31, 2017, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (“PCAOB”), the Company’s internal control over financial reporting as of December 31, 2017, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission, and our report dated February 16, 2018 expressed an unqualified opinion on the effectiveness of the Company’s internal control over financial reporting.

Basis for Opinion

These consolidated financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ KPMG LLP

We have served as the Company’s auditor since 1995.
McLean, Virginia
February 16, 2018

Report of Independent Registered Public Accounting Firm
To the stockholders and board of directors
VeriSign, Inc.:
Opinion on Internal Control Over Financial Reporting
We have audited VeriSign, Inc.'s and subsidiaries' (the "Company") internal control over financial reporting as of December 31, 2017, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission. In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2017, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission.
We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) ("PCAOB"), the consolidated balance sheets of the Company as of December 31, 2017 and 2016, the related consolidated statements of comprehensive income, stockholders' deficit, and cash flows for each of the years in the three-year period ended December 31, 2017, and the related notes (collectively, the consolidated financial statements), and our report dated February 16, 2018 expressed an unqualified opinion on those consolidated financial statements.
Basis for Opinion
The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.
We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.
Definition and Limitations of Internal Control Over Financial Reporting
A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.
Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ KPMG LLP
McLean, Virginia
February 16, 2018

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

	December 31, 2017	December 31, 2016
ASSETS		
Current assets:		
Cash and cash equivalents	$ 465,851	$ 231,945
Marketable securities	1,948,900	1,565,962
Other current assets	31,402	44,435
Total current assets	2,446,153	1,842,342
Property and equipment, net	263,513	266,125
Goodwill	52,527	52,527
Deferred tax assets	15,392	9,385
Deposits to acquire intangible assets	145,000	145,000
Other long-term assets	18,603	19,193
Total long-term assets	495,035	492,230
Total assets	$ 2,941,188	$ 2,334,572
LIABILITIES AND STOCKHOLDERS' DEFICIT		
Current liabilities:		
Accounts payable and accrued liabilities	$ 219,603	$ 203,920
Deferred revenues	713,309	688,265
Subordinated convertible debentures, including contingent interest derivative	627,616	629,764
Total current liabilities	1,560,528	1,521,949
Long-term deferred revenues	286,097	287,424
Senior notes	1,782,529	1,237,189
Deferred tax liabilities	444,108	371,433
Other long-term tax liabilities	128,197	117,172
Total long-term liabilities	2,640,931	2,013,218
Total liabilities	4,201,459	3,535,167
Commitments and contingencies		
Stockholders' deficit:		
Preferred stock—par value $.001 per share; Authorized shares: 5,000; Issued and outstanding shares: none	—	—
Common stock—par value $.001 per share; Authorized shares: 1,000,000; Issued shares: 325,218 at December 31, 2017 and 324,118 at December 31, 2016; Outstanding shares: 97,591 at December 31, 2017 and 103,091 at December 31, 2016	325	324
Additional paid-in capital	16,437,135	16,987,488
Accumulated deficit	(17,694,790)	(18,184,954)
Accumulated other comprehensive loss	(2,941)	(3,453)
Total stockholders' deficit	(1,260,271)	(1,200,595)
Total liabilities and stockholders' deficit	$ 2,941,188	$ 2,334,572

See accompanying Notes to Consolidated Financial Statements.

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

	Year Ended December 31,		
	2017	2016	2015
Revenues	$1,165,095	$1,142,167	$1,059,366
Costs and expenses:			
Cost of revenues	193,326	198,242	192,788
Sales and marketing	81,951	80,250	90,184
Research and development	52,342	59,100	63,718
General and administrative	129,754	118,003	106,730
Total costs and expenses	457,373	455,595	453,420
Operating income	707,722	686,572	605,946
Interest expense	(136,336)	(115,564)	(107,631)
Non-operating income (loss), net	27,626	10,165	(10,665)
Income before income taxes	599,012	581,173	487,650
Income tax expense	(141,764)	(140,528)	(112,414)
Net income	457,248	440,645	375,236
Realized foreign currency translation adjustments, included in net income	530	85	(291)
Unrealized gain (loss) on investments	385	533	(519)
Realized gain on investments, included in net income	(403)	(78)	(185)
Other comprehensive income (loss)	512	540	(995)
Comprehensive income	$457,760	$441,185	$374,241
Earnings per share:			
Basic	$4.56	$4.12	$3.29
Diluted	$3.68	$3.42	$2.82
Shares used to compute earnings per share			
Basic	100,325	107,001	114,155
Diluted	124,180	128,833	133,031

See accompanying Notes to Consolidated Financial Statements.

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VERISIGN, INC.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' DEFICIT
(In thousands)

	Common Stock		Additional Paid-In Capital	Accumulated Deficit	Accumulated Other Comprehensive Loss	Total Stockholders' Deficit
	Shares	Amount				
Balance at December 31, 2014	118,452	$ 322	$ 18,120,045	$ (19,000,835)	$ (2,998)	$ (883,466)
Net income	—	—	—	375,236	—	375,236
Other comprehensive loss	—	—	—	—	(995)	(995)
Issuance of common stock under stock plans	1,291	1	14,689	—	—	14,690
Stock-based compensation	—	—	48,793	—	—	48,793
Net excess income tax benefits associated with stock-based compensation	—	—	18,464	—	—	18,464
Repurchase of common stock	(9,671)	—	(643,169)	—	—	(643,169)
Balance at December 31, 2015	110,072	323	17,558,822	(18,625,599)	(3,993)	(1,070,447)
Net income	—	—	—	440,645	—	440,645
Other comprehensive income	—	—	—	—	540	540
Issuance of common stock under stock plans	1,128	1	13,669	—	—	13,670
Stock-based compensation	—	—	52,430	—	—	52,430
Net excess income tax benefits associated with stock-based compensation	—	—	25,058	—	—	25,058
Repurchase of common stock	(8,109)	—	(662,491)	—	—	(662,491)
Balance at December 31, 2016	103,091	324	16,987,488	(18,184,954)	(3,453)	(1,200,595)
Cumulative adjustment upon adoption of ASU 2016-09	—	—	2,544	32,916	—	35,460
Net income	—	—	—	457,248	—	457,248
Other comprehensive income	—	—	—	—	512	512
Issuance of common stock under stock plans	1,100	1	12,914	—	—	12,915
Stock-based compensation	—	—	55,362	—	—	55,362
Repurchase of common stock	(6,600)	—	(621,173)	—	—	(621,173)
Balance at December 31, 2017	97,591	$ 325	$ 16,437,135	$ (17,694,790)	$ (2,941)	$ (1,260,271)

See accompanying Notes to Consolidated Financial Statements

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

	Year Ended December 31,		
	2017	2016	2015
Cash flows from operating activities:			
Net income	$457,248	$440,645	$375,236
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation of property and equipment	49,878	58,167	61,491
Stock-based compensation	52,907	50,044	46,075
Gain on sale of business	(10,421)	—	—
Unrealized loss (gain) on contingent interest derivative on Subordinated Convertible Debentures	893	(2,402)	14,130
Payment of contingent interest	(15,232)	(13,385)	(10,759)
Amortization of debt discount and issuance costs	14,678	13,411	12,292
Amortization of discount on investments in debt securities	(14,860)	(5,527)	(1,843)
Other, net	(67)	1,740	62
Changes in operating assets and liabilities			
Prepaid expenses and other assets	13,775	8,109	(1,067)
Accounts payable and accrued liabilities	15,483	40,244	21,013
Deferred revenues	25,348	14,347	70,988
Net deferred income taxes and other long-term tax liabilities	113,131	87,614	82,328
Net cash provided by operating activities	702,761	693,007	669,946
Cash flows from investing activities:			
Proceeds from maturities and sales of marketable securities	4,562,161	3,817,899	2,767,027
Purchases of marketable securities	(4,929,834)	(3,691,057)	(3,219,329)
Purchases of property and equipment	(49,499)	(26,574)	(40,656)
Deposits to acquire intangible assets	—	(143,000)	—
Other investing activities	12,096	2,333	(3,941)
Net cash used in investing activities	(405,076)	(40,399)	(496,899)
Cash flows from financing activities:			
Proceeds from employee stock purchase plan	12,915	13,670	14,690
Repurchases of common stock	(621,173)	(662,491)	(643,169)
Proceeds from senior notes, net of issuance costs	543,185	—	492,237
Net cash used in financing activities	(65,073)	(648,821)	(136,242)
Effect of exchange rate changes on cash and cash equivalents	1,294	(501)	246
Net increase in cash and cash equivalents	233,906	3,286	37,051
Cash and cash equivalents at beginning of period	231,945	228,659	191,608
Cash and cash equivalents at end of period	$465,851	$231,945	$228,659
Supplemental cash flow disclosures:			
Cash paid for interest	$117,234	$115,544	$99,473
Cash paid for income taxes, net of refunds received	$28,294	$14,303	$39,723

See accompanying Notes to Consolidated Financial Statements.

VERISIGN, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2017, 2016 AND 2015
Note 1. Description of Business and Summary of Significant Accounting Policies

Description of Business

VeriSign, Inc. ("Verisign" or "the Company") was incorporated in Delaware on April 12, 1995. The Company has one reportable segment, which consists of Registry Services and Security Services. Registry Services ensure the security, stability and resiliency of key internet infrastructure and services, including the .com and .net domains, two of the Internet's root servers, and operation of the root-zone maintainer functions for the core of the internet's Domain Name System ("DNS"). Security Services provides infrastructure assurance services consisting of Distributed Denial of Services ("DDoS") Protection Services, and Managed DNS Services. On April 1, 2017, the Company completed the sale of its iDefense business.

Basis of Presentation

The accompanying consolidated financial statements of Verisign and its subsidiaries have been prepared in conformity with generally accepted accounting principles ("GAAP") in the United States ("U.S."). All significant intercompany accounts and transactions have been eliminated.

The preparation of these consolidated financial statements requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosures of contingent assets and liabilities. Actual results may differ from these estimates under different assumptions or conditions.

Reclassifications

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

Adoption of New Accounting Standards

Effective January 1, 2017, the Company adopted Accounting Standards Update ("ASU") No. 2016-09, Improvements to Employee Share-Based Payment Accounting, issued by the Financial Accounting Standards Board ("FASB"). The new guidance requires excess tax benefits and tax deficiencies to be recorded as a discrete adjustment to income tax expense when stock awards vest, rather than in additional paid-in capital when they reduce income taxes payable. The Company also made the accounting policy election, as allowed by the new guidance, to account for forfeitures of stock awards as they occur, rather than estimating forfeitures. These changes were required to be applied on a modified retrospective basis through a cumulative-effect adjustment to the opening balance of retained earnings. The cumulative effect of adopting ASU 2016-09 was an increase in Deferred tax assets of $11.0 million, a decrease in Deferred tax liabilities of $24.4 million, an increase in Additional paid-in capital of $2.5 million, and a decrease in Accumulated deficit of $32.9 million, as of January 1, 2017, as a result of recognizing $35.4 million of previously unrecognized excess tax benefits from stock-based compensation, and a $2.5 million adjustment related to the change in accounting policy for forfeitures. Additionally, the new guidance requires cash flows related to excess tax benefits from stock-based compensation to be recognized with other income tax cash flows in operating activities, rather than separately as a financing activity. The Company elected to apply this new cash flow presentation requirement retrospectively, which resulted in an increase to both net cash from operating activities and net cash used in financing activities of $25.1 million and $18.5 million for the years ended December 31, 2016 and 2015, respectively.

Effective January 1, 2017, the Company adopted ASU 2017-04, Simplifying the Test for Goodwill Impairment, which was issued by the FASB. The guidance in the ASU simplifies certain aspects of the goodwill impairment test, including the elimination of the requirement to perform a qualitative assessment of the likelihood of a goodwill impairment for reporting units with a negative carrying value. All of the Company's goodwill is included in the Registry Services reporting unit which has a negative carrying value. As a result, the Company will no longer be required to perform the qualitative assessment.

VERISIGN, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)
DECEMBER 31, 2017, 2016 AND 2015

Recent Accounting Pronouncements

On May 28, 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers, which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The ASU will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective. The new standard will be effective for the Company’s 2018 fiscal year. The FASB also issued several amendments to the standard, including clarification on accounting for licenses of intellectual property and identifying performance obligations. Upon adoption the Company will record an asset of $27.3 million related to fees paid to ICANN for registrations and renewals of domain names ending in .com. These costs have historically been recognized as expense in the period of the registration or renewal but the Company has determined that they represent costs incurred to obtain a contract under the new guidance and will be capitalized and amortized over the respective domain terms beginning in 2018. The standard will be adopted on a modified retrospective basis and recorded as a cumulative effect adjustment to Accumulated deficit on January 1, 2018. This adjustment will be reflected in the financial statements included in our Form 10-Q for the three months ended March 31, 2018. Apart from this adjustment and the inclusion of the additional required disclosures, the Company does not expect the adoption of the new revenue standard to impact its consolidated financial statements.
In February 2016, the FASB issued ASU No. 2016-02, Leases. The guidance introduces a lessee model that requires most leases to be reported on the balance sheet. This ASU will become effective for the Company on January 1, 2019 and requires the modified retrospective transition method. Based on its current portfolio of leases, the Company does not expect the adoption of this standard to have a material impact on its consolidated financial statements.

Significant Accounting Policies

Cash and Cash Equivalents

Verisign considers all highly-liquid investments purchased with original maturities of three months or less to be cash equivalents. Cash and cash equivalents include certain money market funds, debt securities and various deposit accounts. Verisign maintains its cash and cash equivalents with financial institutions that have investment grade ratings and, as part of its cash management process, performs periodic evaluations of the relative credit standing of these financial institutions.

Marketable Securities

Marketable securities primarily consist of debt securities issued by the U.S. Treasury. All marketable securities are classified as available-for-sale and are carried at fair value. Unrealized gains and losses, net of taxes, are reported as a component of Accumulated other comprehensive loss. The specific identification method is used to determine the cost basis of the marketable securities sold. The Company classifies its marketable securities as current based on their nature and availability for use in current operations.

Property and Equipment

Property and equipment are stated at cost less accumulated depreciation. Depreciation is calculated using the straight-line method over the estimated useful lives of the assets of 35 to 47 years for buildings, 10 years for building improvements and three to five years for computer equipment, software, office equipment, and furniture and fixtures. Leasehold improvements are amortized using the straight-line method over the lesser of the estimated useful lives of the assets or associated lease terms.

Capitalized Software

Software included in property and equipment includes amounts paid for purchased software and development costs for internally developed software. The Company capitalized $17.7 million and $18.0 million of costs related to internally developed software during 2017 and 2016, respectively.

Goodwill and Other Long-lived Assets

Goodwill represents the excess of purchase consideration over fair value of net assets of businesses acquired. Goodwill is not amortized, but instead tested for impairment. All of the Company's goodwill is included in the Registry Services reporting unit which has a negative carrying value. Upon adoption of ASU 2017-04, Simplifying the Test for Goodwill Impairment in 2017, the Company is no longer required to perform the qualitative assessment at the end of each reporting period to determine if any events have occurred or circumstances exist that would indicate that it is more likely than not that a goodwill impairment exists.

Long-lived assets, such as property, plant, and equipment are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset, or asset group, may not be recoverable. Such events or circumstances include, but are not limited to, a significant decrease in the fair value of the underlying business, a significant decrease in the benefits realized from an acquired business, difficulties or delays in integrating the business or a significant change in the operations of an acquired business. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset, or asset group, to estimated undiscounted future cash flows expected to be generated by the asset, or asset group. An impairment charge is recognized in the amount by which the carrying amount of the asset exceeds its fair value.
As of December 31, 2017, the Company's assets include a deposit related to the purchase of the contractual rights to the .web gTLD. The amount paid to date has been recorded as a deposit until such time that the contractual rights are transferred to the Company. This asset would be tested for recoverability if the Company were to determine that it is no longer probable that the rights will be transferred. At the time of the transfer of the contractual rights, the Company will record the amount as an indefinite-lived intangible asset subject to review for impairment on an annual basis or more frequently if events or changes in circumstances indicate that an impairment is more likely than not.

3.25% Junior Subordinated Convertible Debentures Due 2037 ("Subordinated Convertible Debentures")

Upon issuance of the Subordinated Convertible Debentures, Verisign separated the liability (debt) and equity (conversion option) components in a manner that reflected the borrowing rate for a similar non-convertible debt. The liability component was recognized based on the fair value of a similar instrument without a conversion feature at issuance. The excess of the principal amount of the Subordinated Convertible Debentures over the liability component at issuance is the equity component or debt discount. Such excess represents the estimated fair value of the conversion feature and is recorded as Additional paid-in capital. The debt discount is amortized using the Company's effective interest rate over the term of the Subordinated Convertible Debentures as a non-cash charge to interest expense.
The Subordinated Convertible Debentures also have a contingent interest payment provision that requires the Company to pay interest based on certain thresholds, and upon the occurrence of certain events, as outlined in the Indenture governing the Subordinated Convertible Debentures. The contingent interest payment provision was identified as an embedded derivative, and accounted for separately at fair value, with any gains and losses recorded in Non-operating income (loss), net. Contingent interest payments through August 15, 2017, reflected the settlement of the embedded derivative. Effective August 15, 2017, Verisign has the right to redeem the Subordinated Convertible Debentures under the terms of the indenture, Therefore, the fair value of the contingent interest embedded derivative for periods after August 15, 2017 is negligible and is no longer recognized separately. Expense for contingent interest payments after August 15, 2017 are included within Interest expense on the Consolidated Statements of Comprehensive Income.

Foreign Currency Remeasurement

Verisign conducts business in several different countries and transacts in multiple currencies. The functional currency for all of Verisign's international subsidiaries is the U.S. Dollar. The Company's subsidiaries' financial statements are remeasured into U.S. Dollars using a combination of current and historical exchange rates and any remeasurement gains and losses are included in Non-operating income (loss), net. Remeasurement gains and losses were not significant in each of the last three years.

Verisign maintains a foreign currency risk management program designed to mitigate foreign exchange risks associated with the monetary assets and liabilities that are denominated in currencies other than the U.S. dollar. The primary objective of this program is to minimize the gains and losses resulting from fluctuations in exchange rates.

The Company does not enter into foreign currency transactions for trading or speculative purposes, nor does it hedge foreign currency exposures in a manner that entirely offsets the effects of changes in exchange rates. The program may entail the use of forward or option contracts, which are usually placed and adjusted monthly. These foreign currency forward contracts are derivatives and are recorded at fair market value. The Company records gains and losses on foreign currency forward contracts in Non-operating income (loss), net. Gains and losses related to foreign currency forward contracts were not significant in each of the last three years.

As of December 31, 2017, Verisign held foreign currency forward contracts in notional amounts totaling $29.7 million to mitigate the impact of exchange rate fluctuations associated with certain assets and liabilities held in foreign currencies.

VERISIGN, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)
DECEMBER 31, 2017, 2016 AND 2015

Revenue Recognition

Verisign recognizes revenues when the following four criteria are met:

- Persuasive evidence of an arrangement exists: It is the Company's customary practice to have a written contract, signed by both the customer and Verisign or a service order form from those customers who have previously negotiated a standard master services agreement with Verisign.

- Delivery has occurred or services have been rendered: The Company's services are usually delivered continuously from service activation date through the term of the arrangement.

- The fee is fixed or determinable: Substantially all of the Company's revenue arrangements have fixed or determinable fees.

- Collectability is reasonably assured: Collectability is assessed on a customer-by-customer basis. Verisign typically sells to customers for whom there is a history of successful collection. The majority of customers either maintain a deposit with Verisign or provide an irrevocable letter of credit in excess of the amounts owed. New customers are subjected to a credit review process that evaluates the customer's financial condition and, ultimately, their ability to pay. If Verisign determines from the outset of an arrangement that collectability is not probable based upon its credit review process, revenues are recognized as cash is collected.

Registry Services

Registry Services revenues primarily arise from fixed fees charged to registrars for the initial registration or renewal of .com, .net, and other domain names. Revenues from the initial registration or renewal of domain names are deferred and recognized ratably over the registration term, generally one year and up to ten years. Fees for renewals and advance extensions to the existing term are deferred until the new incremental period commences. These fees are then recognized ratably over the renewal term.

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

Security Services

Following the revenue recognition criteria above, revenues from Security Services are usually deferred and recognized over the service term, generally one to two years.

Advertising Expenses

Advertising costs are expensed as incurred and are included in Sales and marketing expenses. Advertising expenses, including costs for advertising campaigns conducted jointly with our registrar customers were $27.4 million, $17.2 million, and $16.0 million in 2017, 2016, and 2015, respectively.

Income Taxes

Verisign uses the asset and liability method to account for income taxes. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and net operating loss carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The Tax Cuts and Jobs Act (“Tax Act”) was enacted on December 22, 2017, most provisions of which will take effect starting in 2018. The Tax Act makes substantial changes to U.S. taxation of corporations, including, lowering the U.S. federal corporate income tax rate from 35% to 21%, and instituting a territorial tax system, along with a one-time tax on accumulated foreign earnings. The effect on deferred tax assets and liabilities of a change in law or tax rates is recognized in income in the period that includes the enactment date. The Company records a valuation allowance to reduce deferred tax assets to an amount whose realization is more likely than not. For every tax-paying component and within each tax jurisdiction, all deferred tax liabilities and assets are offset and presented as a single net noncurrent asset or liability.

VERISIGN, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)
DECEMBER 31, 2017, 2016 AND 2015

The Company's income taxes payable is reduced by the tax benefits from restricted stock unit ("RSU") vestings equal to the fair market value of the stock at the vesting date. Subsequent to the adoption of ASU No. 2016-09, Improvements to Employee Share-Based Payment Accounting on January 1, 2017, if the income tax benefit at the exercise or vesting date differs from the income tax benefit recorded based on the grant date fair value of the RSUs, the excess or shortfall of the tax benefit is recognized within income tax expense.
Among other changes, the Tax Act includes a provision designed to currently tax global intangible low-taxed income ("GILTI"). The Company is evaluating available accounting policy alternatives to either record the U.S. income tax effect of future GILTI inclusions in the period in which they arise or establish deferred taxes with respect to the expected future tax liabilities associated with future GILTI inclusions, but has not yet made a policy election.
Verisign's global operations involve dealing with uncertainties and judgments in the application of complex tax regulations in multiple jurisdictions. The final taxes payable are dependent upon many factors, including negotiations with taxing authorities in various jurisdictions and resolution of disputes arising from U.S. federal, state, and international tax audits. The Company may only recognize or continue to recognize tax positions that are more likely than not to be sustained upon examination. The Company adjusts these liabilities for uncertain tax positions in light of changing facts and circumstances; however, due to the complexity of some of these uncertainties, the ultimate resolution may result in a payment that is materially different from its current estimate of the tax liabilities.

The Company's assumptions, judgments and estimates relative to the value of a deferred tax asset take into account predictions of the amount and character of future taxable income, such as income from operations or capital gains income. Actual operating results and the underlying amount and character of income in future years could render the Company's current assumptions, judgments and estimates of recoverable net deferred taxes inaccurate. Any of the assumptions, judgments and estimates mentioned above could cause the Company's actual income tax obligations to differ from its estimates, thus materially impacting its financial condition and results of operations.

Stock-based Compensation

The Company's stock-based compensation is primarily related to RSUs granted to employees and its employee stock purchase plan ("ESPP"). Stock-based compensation expense is typically recognized ratably over the requisite service period. Subsequent to the adoption of ASU No. 2016-09, Improvements to Employee Share-Based Payment Accounting on January 1, 2017, forfeitures of stock-based awards are no longer estimated at the time of grant but are recognized as they occur. The Company also grants RSUs which include performance conditions, and in some cases market conditions, to certain executives. The expense for these performance-based RSUs is recognized based on the probable outcome of the performance conditions. The expense recognized for awards with market conditions is based on the grant date fair value of the awards including the impact of the market conditions, using a Monte Carlo simulation model. The Company uses the Black-Scholes option pricing model to determine the fair value of its ESPP offerings. The determination of the fair value of stock-based payment awards using the Monte Carlo simulation model or the Black-Scholes option-pricing model is affected by the Company's stock price as well as assumptions regarding a number of complex and subjective variables.

Earnings per Share

The Company computes basic earnings per share by dividing net income by the weighted-average number of common shares outstanding during the period. Diluted earnings per share gives effect to dilutive potential common shares, including outstanding stock options, unvested RSUs, ESPP offerings and the conversion spread related to the Subordinated Convertible Debentures using the treasury stock method.

Fair Value of Financial Instruments

The Company applies the following fair value hierarchy, which prioritizes the inputs used to measure fair value into three levels and bases the categorization within the hierarchy upon the lowest level of input that is available and significant to the fair value measurement:

- Level 1: Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets.
- Level 2: Inputs reflect quoted prices for identical assets or liabilities in markets that are not active; quoted prices for similar assets or liabilities in active markets; inputs other than quoted prices that are observable for the assets or liabilities; or inputs that are derived principally from or corroborated by observable market data by correlation or other means.

VERISIGN, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)
DECEMBER 31, 2017, 2016 AND 2015

- Level 3: Unobservable inputs reflecting the Company's own assumptions incorporated in valuation techniques used to determine fair value. These assumptions are required to be consistent with market participant assumptions that are reasonably available.

The Company measures and reports certain financial assets and liabilities at fair value on a recurring basis, including its investments in money market funds classified as Cash and cash equivalents, marketable securities, and foreign currency forward contracts.

Legal Proceedings
Verisign is involved in various investigations, claims and lawsuits arising in the normal conduct of its business, none of which, in its opinion, will have a material adverse effect on its financial condition, results of operations, or cash flows. The Company cannot assure you that it will prevail in any litigation. Regardless of the outcome, any litigation may require the Company to incur significant litigation expense and may result in significant diversion of management attention.
While certain legal proceedings and related indemnification obligations to which the Company is a party specify the amounts claimed, such claims may not represent reasonably possible losses. Given the inherent uncertainties of the litigation, the ultimate outcome of these matters cannot be predicted at this time, nor can the amount of possible loss or range of loss, if any, be reasonably estimated, except in circumstances where an aggregate litigation accrual has been recorded for probable and reasonably estimable loss contingencies. A determination of the amount of accrual required, if any, for these contingencies is made after careful analysis of each matter. The required accrual may change in the future due to new developments in each matter or changes in approach such as a change in settlement strategy in dealing with these matters. The Company does not believe that any such matter currently being reviewed will have a material adverse effect on its financial condition, results of operations, or cash flows.

Note 2. Financial Instruments
Cash, Cash Equivalents, and Marketable Securities
The following table summarizes the Company's cash, cash equivalents, and marketable securities and the fair value categorization of the financial instruments measured at fair value on a recurring basis:

	As of December 31,	
	2017	2016
	(In thousands)	
Cash	$135,092	$39,183
Time deposits	3,682	4,632
Money market funds (Level 1)	116,068	134,790
Debt securities issued by the U.S. Treasury and other U.S. government corporations and agencies (Level 1)	2,169,172	1,626,764
Equity securities of public companies (Level 1)	25	2,174
Total	$2,424,039	$1,807,543
Included in Cash and cash equivalents	$465,851	$231,945
Included in Marketable securities	1,948,900	1,565,962
Included in Other assets (Restricted cash)	9,288	9,636
Total	$2,424,039	$1,807,543

The fair value of the debt securities held as of December 31, 2017 was $2.2 billion, including less than $1.0 million of gross and net unrealized losses. All of the debt securities held as of December 31, 2017 have contractual maturities of less than one year.

VERISIGN, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)
DECEMBER 31, 2017, 2016 AND 2015

Fair Value Measurements

The fair value of the Company's investments in money market funds approximates their face value. Such instruments are classified as Level 1 and are included in Cash and cash equivalents.

The fair value of the debt securities consisting of U.S. Treasury bills is based on their quoted market prices and are classified as Level 1. Debt securities purchased with original maturities in excess of three months are included in Marketable securities. Debt securities purchased with original maturities less than three months are included in Cash and cash equivalents.
The fair value of the equity securities of public companies is based on quoted market prices and are classified as Level 1. Investments in equity securities of public companies are included in marketable securities.
As of December 31, 2017, the Company's other financial instruments include cash, accounts receivable, restricted cash, and accounts payable whose carrying values approximated their fair values. The fair value of the Company's Subordinated Convertible Debentures was $4.2 billion as of December 31, 2017. The fair values of the Company's senior notes due 2023 (the "2023 Senior Notes"), the senior notes due 2025 (the "2025 Senior Notes"), and the senior notes due 2027 (the "2027 Senior Notes") were $772.9 million, $544.4 million, and $563.7 million, respectively, as of December 31, 2017. The fair values of these debt instruments are based on available market information from public data sources and are classified as Level 2.

Note 3. Other Balance Sheet Items
Other Current Assets
Other current assets consist of the following:

	As of December 31,	
	2017	2016
	(In thousands)	
Prepaid expenses	$15,787	$14,385
Accounts receivable, net	5,111	13,051
Income taxes receivable	6,347	15,328
Other	4,157	1,671
Total other current assets	$31,402	$44,435

Property and Equipment, Net

The following table presents the detail of property and equipment, net:

	As of December 31,	
	2017	2016
	(In thousands)	
Land	$31,141	$31,141
Buildings and building improvements	246,654	246,237
Computer equipment and software	462,469	441,732
Capital work in progress	4,024	4,246
Office equipment and furniture	6,472	6,203
Leasehold improvements	1,403	1,350
Total cost	752,163	730,909
Less: accumulated depreciation	(488,650)	(464,784)
Total property and equipment, net	$263,513	$266,125

VERISIGN, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)
DECEMBER 31, 2017, 2016 AND 2015

Goodwill

The following table presents the detail of goodwill:

	As of December 31,	
	2017	2016
	(In thousands)	
Goodwill, gross	$1,537,843	$1,537,843
Accumulated goodwill impairment	(1,485,316)	(1,485,316)
Total goodwill	$52,527	$52,527

There was no impairment of goodwill or other long-lived assets recognized in any of the periods presented.

Deposits to Acquire Intangible Assets

As of December 31, 2017, the Company has recorded $145.0 million for the future assignment to the Company of contractual rights to the .web gTLD, pending resolution of objections by other applicants, regulatory review, and approval from ICANN. Upon assignment of the contractual rights, the Company will record the total investment as an indefinite-lived intangible asset.

Other Long-Term Assets
Other long-term assets consist of the following:

	As of December 31,	
	2017	2016
	(In thousands)	
Long-term restricted cash	9,288	9,636
Other taxes receivable	5,673	5,673
Long-term prepaid expenses and other assets	3,642	3,884
Total other long-term assets	$18,603	$19,193

Accounts Payable and Accrued Liabilities
Accounts payable and accrued liabilities consist of the following:

	As of December 31,	
	2017	2016
	(In thousands)	
Accounts payable	$20,923	$19,455
Accrued employee compensation	51,481	61,426
Customer deposits, net	63,617	52,173
Interest Payable	47,357	27,701
Taxes payable and other tax liabilities	13,477	23,144
Other accrued liabilities	22,748	20,021
Total accounts payable and accrued liabilities	$219,603	$203,920

VERISIGN, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)
DECEMBER 31, 2017, 2016 AND 2015

Note 4. Debt and Interest Expense
Senior Notes
As of December 31, 2017, the Company had senior notes outstanding of $1.8 billion, net of unamortized issuance costs. The balance of the senior notes includes the $550.0 million principal amount of 4.75% senior unsecured notes which were issued in July 2017. All of the outstanding senior notes were issued at par and are senior unsecured obligations of the Company. Interest is payable on each of the senior notes semi-annually. Each of the senior notes issuances is redeemable, in whole or in part, at the Company's option at times and redemption prices specified in the indentures.
The following table summarizes information related to our Senior notes (in thousands, except interest rates):

				As of December 31,	
				2017	2016
	Issuance Date	Maturity Date	Interest Rate	Principal	
Senior notes due 2023	April 16, 2013	May 1, 2023	4.625%	$750,000	$750,000
Senior notes due 2025	March 27, 2015	April 1, 2025	5.250%	500,000	500,000
Senior notes due 2027	July 5, 2017	July 15, 2027	4.750%	550,000	—
Unamortized issuance costs				(17,471)	(12,811)
Total senior notes				$1,782,529	$1,237,189

The indenture governing the 2023 Senior Notes contains covenants that limit the ability of the Company and/or its restricted subsidiaries, under certain circumstances, to, among other things: (i) pay dividends or make distributions on, or redeem or repurchase, its capital stock; (ii) make certain investments; (iii) create liens on assets; (iv) enter into sale/leaseback transactions and (v) merge or consolidate or sell all or substantially all of its assets. These covenants are subject to a number of important limitations and exceptions. The Indenture also provides for events of default, which, if any of them occurs, may permit or, in certain circumstances, require the principal, premium, if any, accrued and unpaid interest and any other monetary obligations on all the then outstanding Notes to be due and payable immediately. The Company has remained in compliance with these covenants and no events of default have occurred over the term of the Notes.

2015 Credit Facility

On March 31, 2015, the Company entered into a credit agreement for a $200.0 million committed senior unsecured revolving credit facility (the "2015 Credit Facility"). The 2015 Credit Facility includes financial covenants requiring that the Company's interest coverage ratio not be less than 3.0 to 1.0 for any period of four consecutive quarters and the Company's leverage ratio not exceed 2.5 to 1.0. As of December 31, 2017, there were no borrowings outstanding under the facility and the Company was in compliance with the financial covenants. The 2015 Credit Facility expires on April 1, 2020 at which time any outstanding borrowings are due. Verisign may from time to time request lenders to agree on a discretionary basis to increase the commitment amount by up to an aggregate of $150.0 million.

Subordinated Convertible Debentures

In August 2007, Verisign issued $1.25 billion principal amount of 3.25% subordinated convertible debentures due August 15, 2037, in a private offering. The Subordinated Convertible Debentures are initially convertible, subject to certain conditions, into shares of the Company's common stock at a conversion rate of 29.0968 shares of common stock per $1,000 principal amount of Subordinated Convertible Debentures, representing an initial effective conversion price of approximately $34.37 per share of common stock.

The Company's common stock price exceeded the current conversion price threshold trigger of $44.68 during the fourth quarter of 2017. Accordingly, the Subordinated Convertible Debentures were convertible at the option of each holder during the first quarter of 2018. Further, in the event of conversion, the Company intends, and has the ability, to settle the principal amount of the Subordinated Convertible Debentures in cash, and therefore, classified the debt component of the Subordinated Convertible Debentures, net of unamortized debt issuance costs as a current liability, as of December 31, 2017. As of December 31, 2017, the if-converted value of the Subordinated Convertible Debentures exceeded its principal amount. Based on the if-converted value of the Subordinated Convertible Debentures as of December 31, 2017, the conversion spread could have required the Company to issue up to an additional 25.4 million shares of common stock.

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At issuance, the Company calculated the carrying value of the liability component as the present value of its cash flows using a discount rate of 8.5% (borrowing rate for similar non-convertible debt with no contingent payment options), adjusted for the fair value of the contingent interest feature, yielding an effective interest rate of 8.39%. The excess of the principal amount of the debt over the carrying value of the liability component is also referred to as the “debt discount” or “equity component” of the Subordinated Convertible Debentures. The debt discount has been amortized using the Company’s effective interest rate of 8.39% over the 30 year term of the Subordinated Convertible Debentures as a non-cash charge included in Interest expense. Interest is paid semiannually in arrears on August 15 and February 15.

Proceeds upon issuance of the Subordinated Convertible Debentures were as follows (in thousands):

Principal value of Subordinated Convertible Debentures	$1,250,000
Less: Issuance costs	(25,777)
Net proceeds, Subordinated Convertible Debentures	$1,224,223
Amounts recognized at issuance:	
Subordinated Convertible Debentures, including contingent interest derivative (net of issuance costs of $11,328)	$546,915
Additional paid-in capital	418,996
Long-term deferred tax liabilities	267,225
Non-operating loss	(8,913)
Net proceeds, Subordinated Convertible Debentures	$1,224,223

The table below presents the carrying amounts of the liability and equity components:

	As of December 31,	
	2017	2016
	(In thousands)	
Debt discount upon issuance (net of issuance costs of $14,449)	$686,221	$686,221
Deferred taxes associated with the debt discount upon issuance	(267,225)	(267,225)
Carrying amount of equity component	$418,996	$418,996
Principal amount of Subordinated Convertible Debentures	$1,250,000	$1,250,000
Unamortized discount of liability component	(612,303)	(624,315)
Unamortized debt issuance costs associated with the liability component	(10,081)	(10,260)
Carrying amount of liability component	627,616	615,425
Contingent interest derivative	—	14,339
Subordinated Convertible Debentures, including contingent interest derivative	$627,616	$629,764

The Company evaluated its debt obligations, including the Subordinated Convertible Debentures subsequent to the enactment of the Tax Act which lowers the U.S. federal income tax rate and imposes a new limitation on interest deductibility for tax purposes. On February 15, 2018, the Company called for the redemption of all of the outstanding Subordinated Convertible Debentures. The debentures will be redeemed on May 1, 2018 at a redemption price equal to 100% of the principal, plus accrued but unpaid interest up to, but not including, the redemption date. The Subordinated Convertible Debentures called for redemption may be converted at any time before the close of business on Monday, April 30, 2018. If holders elect to convert their debentures, the Company intends to settle the $1.25 billion principal value in cash, and the excess value will be settled in shares of the Company’s stock.

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

	Year Ended December 31,		
	2017	2016	2015
	(In thousands)		
Contractual interest on Subordinated Convertible Debentures	$47,432	$40,625	$40,625
Contractual interest on Senior Notes	73,638	60,938	54,667
Amortization of debt discount on the Subordinated Convertible Debentures	12,012	11,094	10,218
Amortization of debt issuance costs and other interest expense	3,254	2,907	2,121
Total interest expense	$136,336	$115,564	$107,631

Note 5. Stockholders' Deficit

Treasury Stock

Treasury stock is accounted for under the cost method. Treasury stock includes shares repurchased under stock repurchase programs and shares withheld in lieu of minimum tax withholdings due upon vesting of RSUs.

On February 9, 2017, the Company's Board of Directors ("Board") authorized the repurchase of approximately $640.9 million of its common stock, in addition to the $359.1 million of its common stock remaining available for repurchase under the previous share repurchase program, for a total repurchase authorization of up to $1.0 billion of its common stock. The share repurchase program has no expiration date. Purchases made under the program could be effected through open market transactions, block purchases, accelerated share repurchase agreements or other negotiated transactions. As of December 31, 2017 there was approximately $477.4 million remaining available for repurchases under the share repurchase program.

Effective February 8, 2018, the Company's Board authorized the repurchase of approximately $585.8 million of its common stock, in addition to the $414.2 million of its common stock remaining available for repurchase under the previous share repurchase program, for a total repurchase authorization of up to $1.0 billion of its common stock.

The summary of the Company's common stock repurchases for 2017, 2016 and 2015 are as follows:

	2017		2016		2015	
	Shares	Average Price	Shares	Average Price	Shares	Average Price
	(In thousands, except average price amounts)					
Total repurchases under the repurchase plans	6,265	$ 94.59	7,789	$ 81.73	9,338	$ 66.59
Total repurchases for tax withholdings	335	$ 85.27	320	$ 80.74	333	$ 64.03
Total repurchases	6,600	$ 94.12	8,109	$ 81.70	9,671	$ 66.50
Total costs	$621,173		$662,491		$643,169	

Since inception, the Company has repurchased 227.6 million shares of its common stock for an aggregate cost of $8.8 billion, which is recorded as a reduction of Additional paid-in capital.

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Accumulated Other Comprehensive Loss

The following table summarizes the changes in the components of Accumulated other comprehensive loss for 2017 and 2016:

	Foreign Currency Translation Adjustments Loss	Unrealized (Loss) Gain On Investments	Total Accumulated Other Comprehensive Loss
	(In thousands)		
Balance, December 31, 2015	$(3,451)	$ (542)	$ (3,993)
Changes	85	455	540
Balance, December 31, 2016	(3,366)	(87)	(3,453)
Changes	530	(18)	512
Balance, December 31, 2017	$(2,836)	$ (105)	$ (2,941)

Note 6. Calculation of Earnings per Share
The following table presents the computation of weighted-average shares used in the calculation of basic and diluted earnings per share:

	Year Ended December 31,		
	2017	2016	2015
	(In thousands)		
Weighted-average shares of common stock outstanding	100,325	107,001	114,155
Weighted-average potential shares of common stock outstanding:			
Conversion spread related to Subordinated Convertible Debentures	23,247	21,074	18,047
Unvested RSUs, and ESPP	608	758	829
Shares used to compute diluted earnings per share	124,180	128,833	133,031

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

Note 7. Geographic and Customer Information

The Company generates revenue in the U.S.; Europe, the Middle East and Africa (“EMEA”); China; and certain other countries, including Canada, Australia and Japan.

The following table presents a comparison of the Company’s geographic revenues:

	Year Ended December 31,		
	2017	2016	2015
	(In thousands)		
U.S	$694,759	$667,301	$639,170
EMEA	211,349	207,474	193,623
China	106,526	127,298	83,456

Other	152,461	140,094	143,117
Total revenues	$1,165,095	$1,142,167	$1,059,366

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

The following table presents a comparison of property and equipment, net of accumulated depreciation, by geographic region:

	As of December 31,	
	2017	2016
	(In thousands)	
U.S.	$258,231	$261,837
Other	5,282	4,288
Total property and equipment, net	$263,513	$266,125

Major Customers

One customer accounted for approximately 31%, 30%, and 31% of revenues in 2017, 2016, and 2015, respectively. The Company does not believe that the loss of this customer would have a material adverse effect on the Company's business because, in that event, end-users of this customer would transfer to the Company's other existing customers.

Note 8. Employee Benefits and Stock-based Compensation

401(k) Plan

The Company maintains a defined contribution 401(k) plan (the "401(k) Plan") for substantially all of its U.S. employees. Under the 401(k) Plan, eligible employees may contribute up to 50% of their pre-tax salary, subject to the Internal Revenue Service ("IRS") annual contribution limits. The Company matches 50% of up to the first 6% of the employee's annual salary contributed to the plan. The Company contributed $4.0 million in 2017, $3.8 million in 2016, and $3.7 million in 2015 under the 401(k) Plan. The Company can terminate matching contributions at its discretion at any time.

Equity Incentive Plan

The majority of Verisign's stock-based compensation relates to RSUs. As of December 31, 2017, a total of 10.5 million shares of common stock were reserved for issuance upon the vesting of RSUs and for the future grant of equity awards.

On May 26, 2006, the stockholders of Verisign approved the 2006 Equity Incentive Plan, which was amended and restated on June 9, 2016 (the "2006 Plan"). The 2006 Plan authorizes the award of incentive stock options to employees and non-qualified stock options, restricted stock awards, RSUs, stock bonus awards, stock appreciation rights and performance shares to eligible employees, officers, directors, consultants, independent contractors and advisers. The 2006 Plan is administered by the Compensation Committee which may delegate to a committee of one or more members of the Board or Verisign's officers the ability to grant certain awards and take certain other actions with respect to participants who are not executive officers or non-employee directors. RSUs are awards covering a specified number of shares of Verisign common stock that may be settled by issuance of those shares (which may be restricted shares). RSUs generally vest over four years. Certain performance-based RSUs, granted to the Company's

executives, vest over either three or four year terms. Additionally, the Company has granted fully vested RSUs to members of its Board in each of the last three years. The Compensation Committee may authorize grants with a different vesting schedule in the future. A total of 27.0 million common shares were authorized and reserved for issuance under the 2006 Plan.

2007 Employee Stock Purchase Plan

On August 30, 2007, the Company's stockholders approved the 2007 Employee Stock Purchase Plan, and in 2017 approved an amendment to increase the shares reserved for issuance by 2.5 million to a total of 8.5 million common shares authorized and reserved for issuance under the ESPP. Eligible employees may purchase common stock through payroll deductions by electing to have between 2% and 25% of their compensation withheld to cover the purchase price. Each

participant is granted an option to purchase common stock on the first day of each 24-month offering period and this option is automatically exercised on the last day of each six-month purchase period during the offering period. The purchase price for the common stock under the ESPP is 85% of the lesser of the fair market value of the common stock on the first day of the applicable offering period or the last day of the applicable purchase period. Offering periods begin on the first business day of February and August of each year. As of December 31, 2017, 3.5 million shares of the Company's common stock remain reserved for future issuance under this plan.

Stock-based Compensation

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

	Year Ended December 31,		
	2017	2016	2015
	(In thousands)		
Cost of revenues	$7,030	$7,253	$7,009
Sales and marketing	5,688	5,738	6,763
Research and development	6,113	6,739	6,488
General and administrative	34,076	30,314	25,815
Total stock-based compensation	$52,907	$50,044	$46,075

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

	Year Ended December 31,		
	2017	2016	2015
	(In thousands)		
RSUs	$38,087	$37,325	$36,664
Performance-based RSUs	13,270	11,512	8,078
ESPP	4,005	3,593	4,051
Capitalization (Included in Property and equipment, net)	(2,455)	(2,386)	(2,718)
Total stock-based compensation expenses	$52,907	$50,044	$46,075

The income tax benefit that was included within Income tax expense related to these stock-based compensation expenses for 2017, 2016, and 2015 was $12.5 million, $17.7 million, and $16.0 million, respectively. In 2017, the tax benefit reflects the reduction in the U.S. statutory corporate tax rate from 35% to 21%.

RSUs Information

The following table summarizes unvested RSUs activity:

	Year Ended December 31,					
	2017		2016		2015	
	Shares	Weighted-Average Grant-Date Fair Value	Shares	Weighted-Average Grant-Date Fair Value	Shares	Weighted-Average Grant-Date Fair Value
	(Shares in thousands)					
Unvested at beginning of period	1,846	$ 66.30	2,110	$ 54.77	2,179	$ 46.36
Granted	732	79.94	760	78.58	1,075	61.74
Vested and settled	(885)	61.75	(873)	49.95	(932)	43.92
Forfeited	(105)	72.90	(151)	61.57	(212)	51.47
	1,588	$ 74.69	1,846	$ 66.30	2,110	$ 54.77

The RSUs in the table above include certain RSUs granted to the Company's executives that are subject to performance conditions, and in some cases, market conditions. The unvested RSUs as of December 31, 2017 include approximately 0.4 million RSUs subject to performance and/or market conditions. The number of RSUs, subject to these performance and market conditions, that ultimately vest may range from zero to a maximum of 0.8 million RSUs depending on the level of performance achieved and whether any market conditions are satisfied.

The closing price of Verisign's stock was $114.44 on December 31, 2017. As of December 31, 2017, the aggregate market value of unvested RSUs was $181.7 million. The fair values of RSUs that vested during 2017, 2016, and 2015 were $75.9 million, $70.5 million, and $59.8 million, respectively. As of December 31, 2017, total unrecognized compensation cost related to unvested RSUs was $77.5 million which is expected to be recognized over a weighted-average period of 2.5 years.

Note 9. Non-operating Income (Loss), Net

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

	Year Ended December 31,		
	2017	2016	2015
	(In thousands)		
Interest income	$17,944	$6,191	$2,128
Gain on sale of business	10,421	—	—
Unrealized (loss) gain on contingent interest derivative on Subordinated Convertible Debentures	(893)	2,402	(14,130)
Other, net	154	1,572	1,337
Total non-operating income (loss), net	$27,626	$10,165	$(10,665)

Interest income is earned principally from the Company's surplus cash balances and marketable securities. On April 1, 2017, the Company completed the sale of its iDefense business, which resulted in a gain of approximately $10.4 million in 2017. The unrealized gains and losses on the contingent interest derivative on the Subordinated Convertible Debentures reflects the change in value of the derivative that results primarily from the changes in the Company's stock price. The fair value of the contingent interest derivative for periods after August 15, 2017 is negligible due to the Company's right to redeem the debentures. Contingent interest after August 15, 2017 was included in Interest expense.

Note 10. Income Taxes

Income before income taxes is categorized geographically as follows:

	Year Ended December 31,		
	2017	2016	2015
	(In thousands)		
United States	$313,351	$299,304	$248,932
Foreign	285,661	281,869	238,718
Total income before income taxes	$599,012	$581,173	$487,650

The provision for income taxes consisted of the following:

	Year Ended December 31,		
	2017	2016	2015
	(In thousands)		
Current expense:			
Federal	$16,870	$34,842	$13,601
State	294	240	156
Foreign, including withholding tax	15,539	19,268	17,241
	32,703	54,350	30,998
Deferred expense (benefit):			
Federal	90,113	64,301	65,168
State	19,654	21,492	15,767
Foreign	(706)	385	481
	109,061	86,178	81,416
Total income tax expense	$141,764	$140,528	$112,414

The difference between income tax expense and the amount resulting from applying the federal statutory rate of 35% to Income before income taxes is attributable to the following:

	Year Ended December 31,		
	2017	2016	2015
	(In thousands)		
Income tax expense at federal statutory rate	$209,654	$203,410	$170,677
State taxes, net of federal benefit	13,029	14,517	9,616
Differences between statutory rate and foreign effective tax rate	(83,808)	(79,087)	(66,238)
U.S. federal tax rate change	(186,800)	—	—
U.S. tax on accumulated foreign earnings, net of foreign tax credits	162,353	—	—
Foreign withholding tax on unremitted foreign earnings, net of foreign tax credits	33,619	—	—
Other	(6,283)	1,688	(1,641)
Total income tax expense	$141,764	$140,528	$112,414

The Tax Act was enacted on December 22, 2017, most provisions of which will take effect starting in 2018. The Tax Act makes substantial changes to U.S. taxation of corporations, including, lowering the U.S. federal corporate income tax rate from 35% to 21%, and instituting a territorial tax system, along with a one-time tax on accumulated foreign earnings. Upon enactment, the Company remeasured its deferred tax balances to reflect the new 21% U.S. federal tax rate, which resulted in a tax benefit of $186.8 million in 2017. The Company also recorded a provisional deferred tax liability for the one-time U.S. tax of $162.4 million, triggered by the Tax Act, on accumulated foreign earnings, net of $38.3 million of resulting previously unrecognized foreign tax credits. As a result of the Tax Act, the Company no longer intends to indefinitely reinvest the earnings of its foreign subsidiaries offshore, and therefore, recognized a provisional deferred tax liability of $33.6 million for foreign withholding tax on its unremitted foreign earnings, net of $26.3 million of resulting foreign tax credits.

The Company has not completed its accounting for the tax effects of the enactment of the Tax Act. Specifically, the amounts recorded for the U.S. tax on accumulated foreign earnings, net of foreign tax credits and the foreign withholding tax on unremitted foreign earnings, net of foreign tax credits, and the state income tax effects of these two items are provisional amounts based on the Company’s estimates. The Company expects to complete the accounting for these impacts of the Tax Act in the fourth quarter of 2018 as it finalizes its cumulative earnings and profits of its foreign subsidiaries and receives additional guidance from the IRS pertaining to the Tax Act. The impacts of additional guidance and changes in estimates related to the effects of the Tax Act, if any, will be recorded in the period the additional guidance or information is available.

The Company qualifies for a tax holiday in Switzerland which does not expire, unless the required non-Swiss income and expense thresholds are no longer met, or there is a law change which eliminates the holiday. The tax holiday provides reduced rates of taxation on certain types of income and also require certain thresholds of foreign source income. The tax holiday increased the Company's earnings per share by $0.10, $0.16, and $0.14 in 2017, 2016, and 2015, respectively.

The tax effects of temporary differences that give rise to significant portions of the Company's deferred tax assets and liabilities are as follows:

	As of December 31,	
	2017	2016
	(In thousands)	
Deferred tax assets:		
Net operating loss carryforwards	$70,587	$46,879
Deductible goodwill and intangible assets	1,192	10,473
Tax credit carryforwards	52,659	59,337
Deferred revenue, accruals and reserves	77,869	114,548
Capital loss carryforwards	778,430	1,161,772
Other	5,584	4,791
Total deferred tax assets	986,321	1,397,800
Valuation allowance	(783,725)	(1,162,101)
Net deferred tax assets	202,596	235,699
Deferred tax liabilities:		
Property and equipment	(1,577)	(4,212)
U.S. tax on accumulated foreign earnings	(162,912)	—
Foreign withholding tax on unremitted earnings	(33,619)	—
Subordinated Convertible debentures	(430,088)	(590,921)
Other	(3,116)	(2,614)
Total deferred tax liabilities	(631,312)	(597,747)
Total net deferred tax liabilities	$(428,716)	$(362,048)

With the exception of deferred tax assets related to capital loss and certain state net operating loss carryforwards, management believes it is more likely than not that the tax effects of the deferred tax liabilities together with future taxable income, will be sufficient to fully recover the remaining deferred tax assets.

As of December 31, 2017, the Company had federal, state and foreign net operating loss carryforwards of approximately $5.5 million, $1.3 billion and $18.9 million, respectively, before applying tax rates for the respective jurisdictions. As of December 31, 2017, the Company had federal and state research tax credits of $4.2 million and $2.3 million, respectively, and alternative minimum tax credits of $17.0 million available for future years. Certain net operating loss carryforwards and credits are subject to an annual limitation under Internal Revenue Code Section 382, but are expected to be fully realized. The federal and state net operating loss and federal tax credit carryforwards expire in various years from 2018 through 2034. The foreign net operating loss can be carried forward indefinitely. As of December 31, 2017, the Company had federal and state capital loss carryforwards of $2.9 billion and $3.1 billion, respectively, before applying tax rates for the respective jurisdictions. The capital loss carryforwards expire in 2018 and are also subject to annual limitations under Internal Revenue Code Section 382. The Company does not expect to realize any tax benefits from the capital loss carryforwards and accordingly has reserved the entire amount through valuation allowance and accrual for uncertain tax positions. As of December 31, 2017, the Company has foreign tax credit carryforwards of $121.5 million. The majority of these foreign tax credits will expire in 2024.

The deferred tax liability related to the Subordinated Convertible Debentures is driven by the excess of the tax deduction taken for interest expense over the amount of interest expense recognized in the consolidated financial

statements. The interest expense deducted for tax purposes is based on the adjusted issue price of the Subordinated Convertible Debentures, while the interest expense recognized in accordance with GAAP is based only on the liability portion of the Subordinated Convertible

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Debentures. The adjusted issue price of the Subordinated Convertible Debentures grows over the term due to the difference between the interest deduction taken for income tax, using a comparable yield of 8.5%, and the coupon rate of 3.25%, compounded annually, adjusted for actual versus projected contingent interest payments

The Company maintains liabilities for uncertain tax positions. These liabilities involve considerable judgment and estimation and are continuously monitored by management based on the best information available including changes in tax regulations and other information. A reconciliation of the beginning and ending balances of the total amounts of gross unrecognized tax benefits is as follows:

	As of December 31,	
	2017	2016
	(In thousands)	
Beginning balance	$220,682	$220,280
Increases in tax positions for prior years	3,699	119
Decreases in tax positions for prior years	(144)	(71)
Increases in tax positions for current year	395	354
Decreases in tax positions due to settlement with taxing authorities	(1,416)	—
Ending balance	$223,216	$220,682

As of December 31, 2017, approximately $217.0 million of unrecognized tax benefits, including penalties and interest, could affect the Company's tax provision and effective tax rate. It is reasonably possible that during the next twelve months, the Company's unrecognized tax benefits may change by a significant amount as a result of IRS audits. However the timing of completion and ultimate outcome of the audits remains uncertain. Therefore, the Company cannot currently estimate the impact on the balance of unrecognized tax benefits.
In accordance with its accounting policy, the Company recognizes accrued interest and penalties related to unrecognized tax benefits as a component of tax expense. These accruals were not material in any period presented.

The Company's major taxing jurisdictions are the U.S., the state of Virginia, and Switzerland. The Company's U.S. federal income tax returns are currently under examination by the IRS for 2010 through 2014. The Company's other tax returns are not currently under examination by their respective taxing jurisdictions. Because the Company has used net operating loss carryforwards and other tax attributes to offset its taxable income in current and future years' income tax returns for the U.S. and Virginia, such attributes can be adjusted by these taxing authorities until the statute closes on the year in which such attributes were utilized. The open years in Switzerland are the 2012 tax year and forward.

Note 11. Commitments and Contingencies

Purchase Obligations and Contractual Agreements

The following table represents the minimum payments required by Verisign under certain purchase obligations, leases, the .tv Agreement with the Government of Tuvalu, and the interest payments and principal on the Subordinated Convertible Debentures and the Senior Notes:

	Purchase Obligations	.tv Agreement	Senior Notes	Subordinated Convertible Debentures	Total
	(In thousands)				
2018	$33,175	$ 5,000	$87,063	$ 1,279,388	$1,404,626
2019	4,893	5,000	87,063	—	96,956
2020	806	5,000	87,063	—	92,869
2021	612	5,000	87,063	—	92,675
2022	301	—	87,063	—	87,364
Thereafter	—	—	2,030,938	—	2,030,938

Total	$39,787	$ 20,000	$2,466,253	$1,279,388	$3,805,428

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The amounts included in the table above related to the Subordinated Convertible Debentures include the February 2018 coupon and contingent interest payments in addition to the repayment of the full principal amount as a result of the redemption of the debentures as discussed in Note 4, "Debt and Interest Expense."
The amounts in the table above exclude $217.0 million of income tax related uncertain tax positions, as the Company is unable to reasonably estimate the ultimate amount or time of settlement of those liabilities.

Verisign enters into certain purchase obligations with various vendors. The Company's significant purchase obligations include firm commitments with telecommunication carriers and other service providers. The Company does not have any significant purchase obligations beyond 2022.
The Company has an agreement with Internet Corporation for Assigned Names and Numbers ("ICANN") to be the sole registry operator for domain names in the .com registry through November 30, 2024. Under this agreement, the Company pays ICANN on a quarterly basis, $0.25 for each annual increment of a domain name registered or renewed during such quarter. As of December 31, 2017, there were 131.9 million domain names in the .com registry. However, the number of domain names registered and renewed each quarter may vary significantly. The Company incurred registry fees for the .com registry of $32.3 million in 2017, $31.5 million in 2016, and $30.9 million in 2015. Registry fees for other top-level domains that we operate have been excluded from the table above because the amounts are variable or passed through to registrars.
The Company has an agreement with the Government of Tuvalu to be the sole registry operator for .tv domain names through December 31, 2021. Registry fees were $5.0 million in each of the last three years.
Verisign leases a small portion of its facilities under operating leases that extend into 2020. Rental expenses under operating leases were not material in any period presented. Future rental expenses under existing operating leases are not material.

Off-Balance Sheet Arrangements

As of December 31, 2017 and 2016, the Company did not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. As such, the Company is not exposed to any financing, liquidity, market or credit risk that could arise if the Company had engaged in such relationships.

It is not the Company's business practice to enter into off-balance sheet arrangements. However, in the normal course of business, the Company does enter into contracts in which it makes representations and warranties that guarantee the performance of the Company's products and services. Historically, there have been no significant losses related to such guarantees.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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, in the City of Reston, Commonwealth of Virginia, on the 16th day of February 2018.

VERISIGN, INC.

By: /S/ D. JAMES BIDZOS
D. James Bidzos
President and Chief Executive Officer
(Principal Executive Officer)

KNOW ALL PERSONS BY THESE PRESENTS that each individual whose signature appears below constitutes and appoints D. James Bidzos, George E. Kilguss, III, and Thomas C. Indelicarto, and each of them, his or her true lawful attorneys-in-fact and agents, with full power of substitution, for him or her and in his or her name, place and stead, in any and all capacities, to sign any and all amendments to this Annual Report on Form 10-K and to file the same, with all exhibits thereto and all documents in connection therewith, with the Securities and Exchange Commission, granted unto said attorneys-in-fact and agents, and each of them, full power and authority to do and perform each and every act and thing requisite and necessary to be done in and about the premises, as fully to all intents and purposes as he or she might or could do in person, hereby ratifying and confirming all that said attorneys-in-fact and agents or any of them, or his, her or their substitute or substitutes, may lawfully do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed by the following persons on behalf of the registrant and in the capacities indicated on the 16th day of February 2018.

Signature	Title
/S/ D. JAMES BIDZOS D. JAMES BIDZOS	President, Chief Executive Officer, Executive Chairman and Director (Principal Executive Officer)
/S/ GEORGE E. KILGUSS, III GEORGE E. KILGUSS, III	Chief Financial Officer (Principal Financial and Accounting Officer)
/S/ KATHLEEN A. COTE KATHLEEN A. COTE	Director
/S/ THOMAS F. FRIST III THOMAS F. FRIST III	Director
/S/ JAMIE S. GORELICK JAMIE S. GORELICK	Director
/S/ ROGER H. MOORE ROGER H. MOORE	Director
/S/ LOUIS A. SIMPSON LOUIS A. SIMPSON	Director
/S/ TIMOTHY TOMLINSON TIMOTHY TOMLINSON	Director

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