

PROS Holdings, Inc.  
Form 10-Q  
August 01, 2013  
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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington D.C. 20549

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FORM 10-Q

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

For the quarterly period ended June 30, 2013

OR

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

For the transition period from to .

Commission File Number: 001-33554

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PROS HOLDINGS, INC.

(Exact name of registrant as specified in its charter)

Delaware

76-0168604

(State or Other Jurisdiction of  
Incorporation or Organization)

(I.R.S. Employer  
Identification No.)

3100 Main Street, Suite 900 Houston TX  
(Address of Principal Executive Offices)

77002  
(Zip Code)

(713) 335-5151

(Registrant's telephone number, including area code)

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(Former Name, Former Address and Former Fiscal Year, if changed Since Last Report)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

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



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|                         |  |                           |                                     |
|-------------------------|--|---------------------------|-------------------------------------|
| Large Accelerated Filer |  | Accelerated Filer         | <input checked="" type="checkbox"/> |
| Non-Accelerated Filer   | <input type="checkbox"/> (do not check if a smaller reporting company) | Smaller Reporting Company | <input type="checkbox"/>            |

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

The number of shares outstanding of the Registrant's Common Stock, \$0.001 par value, was 28,072,266 as of July 30, 2013.

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Form 10-Q  
For the Quarterly Period Ended June 30, 2013

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CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Forward-looking statements relate to future events or our future financial performance. These forward-looking statements regarding future events and our future results are based on current expectations, estimates, forecasts and projections, and the beliefs and assumptions of our management including, without limitation, our expectations regarding the following: the sales of our software products and services; the impact of our revenue recognition policies; our belief that our current assets, including cash, cash equivalents, and expected cash flows from operating activities, will be sufficient to fund our operations; our anticipated additions to property, plant and equipment; our belief that our facilities are suitable and adequate to meet our current operating needs; and our belief that we do not have any material exposure to changes in the fair value of our investment portfolio as a result of changes in interest rates. Words such as “we expect,” “anticipate,” “target,” “project,” “believe,” “goals,” “estimate,” “potential,” “predict,” “may,” “might,” “could,” “intend,” and variations of these types of words similar expressions are intended to identify these forward-looking statements.

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## PART I. Financial Information

## ITEM 1. INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

## PROS Holdings, Inc.

## Condensed Consolidated Balance Sheets

(In thousands, except share amounts)

(Unaudited)

|  | June 30, 2013 | December 31, 2012 |
|--|---------------|-------------------|
| Assets:  |               |                   |
| Current assets:  |               |                   |
| Cash and cash equivalents  | \$88,227      | \$83,558          |
| Accounts and unbilled receivables, net of allowance of \$690 and \$760, respectively   | 37,553        | 38,801            |
| Prepaid and other current assets   | 6,041         | 5,067             |
| Total current assets   | 131,821       | 127,426           |
| Restricted cash  | 329           | 329               |
| Property and equipment, net  | 14,838        | 12,788            |
| Other long term assets, net  | 5,759         | 5,936             |
| Total assets   | \$152,747     | \$146,479         |
| Liabilities and Stockholders' Equity:  |               |                   |
| Current liabilities:   |               |                   |
| Accounts payable   | \$4,532       | \$3,775           |
| Accrued liabilities  | 4,129         | 3,258             |
| Accrued payroll and other employee benefits  | 4,828         | 7,669             |
| Deferred revenue   | 36,013        | 39,774            |
| Total current liabilities  | 49,502        | 54,476            |
| Long-term deferred revenue   | 3,149         | 2,007             |
| Other long-term liabilities  | 1,010         | 1,327             |
| Total liabilities  | 53,661        | 57,810            |
| Commitments and contingencies (Note 5)   |               |                   |
| Stockholders' equity:  |               |                   |
| Preferred stock, \$0.001 par value, 5,000,000 shares authorized none issued  | —             | —                 |
| Common stock, \$0.001 par value, 75,000,000 shares authorized; 32,486,851 and 31,966,432 shares issued, respectively; 28,069,266 and 27,548,847 shares outstanding, respectively | 32            | 32                |
| Additional paid-in capital   | 95,795        | 87,693            |
| Treasury stock, 4,417,585 common shares, at cost   | (13,938)      | (13,938)          |
| Retained earnings  | 17,197        | 14,882            |
| Total stockholders' equity   | 99,086        | 88,669            |
| Total liabilities and stockholders' equity   | \$152,747     | \$146,479         |

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

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PROS Holdings, Inc.

Condensed Consolidated Statements of Comprehensive Income

(In thousands, except share and per share data)

(Unaudited)

|  | For the Three Months Ended June 30, |            | For the Six Months Ended June 30, |            |
|--|-------------------------------------|------------|-----------------------------------|------------|
|  | 2013                                | 2012       | 2013                              | 2012       |
| Revenue:                                       |                                     |            |                                   |            |
| License and implementation                     | \$24,170                            | \$18,176   | \$46,762                          | \$35,972   |
| Maintenance and support                        | 11,357                              | 9,958      | 22,391                            | 19,183     |
| Total revenue                                  | 35,527                              | 28,134     | 69,153                            | 55,155     |
| Cost of revenue:                               |                                     |            |                                   |            |
| License and implementation                     | 8,808                               | 5,540      | 17,278                            | 11,543     |
| Maintenance and support                        | 1,978                               | 1,959      | 4,061                             | 3,895      |
| Total cost of revenue                          | 10,786                              | 7,499      | 21,339                            | 15,438     |
| Gross profit                                   | 24,741                              | 20,635     | 47,814                            | 39,717     |
| Operating expenses:                            |                                     |            |                                   |            |
| Selling, marketing, general and administrative | 15,935                              | 11,884     | 30,223                            | 22,140     |
| Research and development                       | 8,026                               | 6,772      | 16,121                            | 13,469     |
| Income from operations                         | 780                                 | 1,979      | 1,470                             | 4,108      |
| Other (expense) income, net                    | (129)                               | (129)      | (234)                             | (106)      |
| Income before income tax provision             | 651                                 | 1,850      | 1,236                             | 4,002      |
| Income tax provision (benefit)                 | 71                                  | 855        | (1,078)                           | 1,816      |
| Net income                                     | \$580                               | \$995      | \$2,314                           | \$2,186    |
| Net earnings per share:                        |                                     |            |                                   |            |
| Basic  | \$0.02                              | \$0.04     | \$0.08                            | \$0.08     |
| Diluted  | \$0.02                              | \$0.04     | \$0.08                            | \$0.08     |
| Weighted average number of shares:             |                                     |            |                                   |            |
| Basic  | 28,006,517                          | 27,375,429 | 27,881,957                        | 27,271,201 |
| Diluted  | 29,958,580                          | 28,337,143 | 29,710,202                        | 28,303,760 |
| Other comprehensive income, net of tax:        |                                     |            |                                   |            |
| Other comprehensive income                     | —                                   | —          | —                                 | —          |
| Comprehensive income                           | \$580                               | \$995      | \$2,314                           | \$2,186    |

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

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PROS Holdings, Inc.

Condensed Consolidated Statements of Cash Flows

(In thousands)

(Unaudited)

|   | For the Six Months Ended June 30, |           |
|---|-----------------------------------|-----------|
|   | 2013                              | 2012      |
| Operating activities:   |                                   |           |
| Net income  | \$2,314                           | \$2,186   |
| Adjustments to reconcile net income to net cash provided by operating activities: |                                   |           |
| Depreciation and amortization   | 1,999                             | 938       |
| Share-based compensation  | 7,559                             | 4,472     |
| Excess tax benefit on share-based compensation                                    | —                                 | (1,685)   |
| Tax (shortfall)/benefit from share-based compensation                             | (10)                              | ) 1,633   |
| Provision for doubtful accounts   | (70)                              | ) (257)   |
| Changes in operating assets and liabilities:                                      |                                   |           |
| Accounts and unbilled receivables   | 1,317                             | (2,407)   |
| Prepaid expenses and other assets   | (821)                             | ) 4,177   |
| Accounts payable  | 715                               | (2,465)   |
| Accrued liabilities   | 391                               | 630       |
| Accrued payroll and other employee benefits                                       | (2,841)                           | ) (1,115) |
| Deferred revenue  | (2,619)                           | ) 846     |
| Net cash provided by operating activities   | 7,934                             | 6,953     |
| Investing activities:   |                                   |           |
| Purchases of property and equipment   | (2,172)                           | ) (3,264) |
| Capitalized internal-use software development costs                               | (1,534)                           | ) (815)   |
| Net cash used in investing activities   | (3,706)                           | ) (4,079) |
| Financing activities:   |                                   |           |
| Exercise of stock options   | 2,771                             | 511       |
| Excess tax benefits on share-based compensation                                   | —                                 | 1,685     |
| Tax withholding related to net share settlement of restricted stock units         | (2,330)                           | ) (2,365) |
| Net cash provided by (used in) financing activities                               | 441                               | (169)     |
| Net increase in cash and cash equivalents   | 4,669                             | 2,705     |
| Cash and cash equivalents:  |                                   |           |
| Beginning of period   | 83,558                            | 68,457    |
| End of period   | \$88,227                          | \$71,162  |

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

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PROS Holdings, Inc.

Notes to Condensed Consolidated Financial Statements  
(Unaudited)

### 1. Organization and Nature of Operations

PROS Holdings, Inc., a Delaware corporation, through its operating subsidiaries (the “Company”), provides big data software applications designed to help companies outperform in their markets by using big data to sell more effectively. The Company applies data science to unlock buying patterns and preferences within transaction data to reveal which opportunities are most likely to close, which offers are most likely to sell and which prices are most likely to win. The Company offers big data software applications to analyze, execute, and optimize sales, pricing, quoting, rebates and revenue management. The Company also provides professional services to implement its software applications as well as business consulting. In addition, the Company provides product maintenance and support to its customers to receive unspecified upgrades, maintenance releases and bug fixes during the term of the support period on a when-and-if-available basis. The Company provides its big data software applications to enterprises across a range of industries, including manufacturing, distribution, services and travel.

### 2. Summary of Significant Accounting Policies

The accompanying unaudited condensed consolidated financial statements reflect the application of significant accounting policies as described below and elsewhere in these notes to the condensed consolidated financial statements.

#### Basis of presentation

The accompanying unaudited condensed consolidated financial statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) for interim financial reporting and applicable quarterly reporting regulations of the Securities and Exchange Commission (“SEC”). In management’s opinion, the accompanying interim unaudited condensed consolidated financial statements include all adjustments necessary for a fair statement of the financial position of the Company as of June 30, 2013, the results of operations for the three and six months ended June 30, 2013 and cash flows for the six months ended June 30, 2013.

During the second quarter of 2013, the Company recorded a \$0.1 million out-of-period tax benefit adjustment related to the first quarter of 2013 for non-deductible share-based compensation expense that is included in the Company's estimated annual tax rate. The error was not material to the first quarter of 2013 interim financial statements and the correction of the error is not material to the second quarter interim financial statements.

Certain information and disclosures normally included in the notes to the annual financial statements prepared in accordance with GAAP have been omitted from these interim unaudited condensed consolidated financial statements pursuant to the rules and regulations of the SEC. Accordingly, these unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements in the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2012 (“Annual Report”) filed with the SEC. The condensed consolidated balance sheet as of December 31, 2012 was derived from the Company’s audited consolidated financial statements, but does not include all disclosures required by GAAP.

#### Basis of consolidation

The unaudited condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All intercompany transactions and balances have been eliminated in consolidation.



Dollar amounts

The dollar amounts presented in the tabular data within these footnote disclosures are stated in thousands of dollars, except per unit amounts, or as noted within the context of each footnote disclosure.

Use of estimates

The Company's management prepares the unaudited condensed consolidated financial statements in accordance with GAAP. The Company makes estimates and assumptions in the preparation of its unaudited condensed consolidated financial statements, and its estimates and assumptions may affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the unaudited condensed consolidated financial statements, and the reported amounts of revenue and expenses during the reporting periods. Actual results could differ from those estimates. The complexity and judgment required in the Company's estimation process and issues related to the assumptions, risks and uncertainties inherent in the application of the percentage-of-completion method of accounting affect the amounts of revenue, expenses, unbilled receivables

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and deferred revenue. Estimates are also used for, but not limited to, receivables, allowance for doubtful accounts, useful lives of assets, depreciation, income taxes and deferred tax asset valuation, valuation of stock options, other current liabilities and accrued liabilities. Numerous internal and external factors can affect estimates. The critical accounting policies related to the estimates and judgments are discussed in the Company's Annual Report on Form 10-K for the year ended December 31, 2012 under management's discussion and analysis of financial condition and results of operations. There have been no significant changes to the Company's critical accounting policies as described in the Company's Annual Report.

### Revenue recognition

The Company derives its revenue from the licensing and implementation of software solutions and associated software maintenance and support. To a lesser extent, the Company's revenue includes nonsoftware related hosting services. The Company's arrangements with customers typically include: (a) license fees for the use of our solutions either in perpetuity or over a specified term, (b) professional services for configuration, implementation and training services and (c) maintenance and support related to technical support and software updates. If there is significant uncertainty about contract completion or collectability is not reasonably assured, revenue is deferred until the uncertainty is sufficiently resolved or collectability is reasonably assured. In addition, revenue is recognized when persuasive evidence of an arrangement exists and fees are fixed or determinable.

In determining whether professional services revenue should be accounted for separately from license revenue, the Company evaluates whether the professional services are considered essential to the functionality of the software using factors such as: the nature of its software products; whether they are ready for use by the customer upon receipt; the nature of professional services; the availability of services from other vendors; whether the timing of payments for license revenue is coincident with performance of services; and whether milestones or acceptance criteria exist that affect the realizability of the software license fee.

If the Company determines that professional services revenue should not be accounted for separately from license revenue,

the license revenue is recognized together with the professional services revenue using the percentage-of-completion method or completed contract method. The completed contract method is also used for contracts where there is a risk over final acceptance by the customer or for contracts that are short term in nature.

The percentage-of-completion computation is measured by the percentage of man-days incurred during the reporting period as compared to the estimated total man-days necessary for each contract for implementation of the software solutions. The Company measures performance under the percentage-of-completion method using total man-day method based on current estimates of man-days to complete the project. The Company believes that for each such project, man-days expended in proportion to total estimated man-days at completion represents the most reliable and meaningful measure for determining a project's progress toward completion. Under our fixed-fee arrangements, should a loss be anticipated on a contract, the full amount is recorded when the loss is determinable.

The Company also licenses software solutions under term license agreements that typically include maintenance during the license term. When maintenance is included for the entire term of the license, there is no renewal rate and the Company has not established vendor specific objective evidence ("VSOE") of fair value for the maintenance on term licenses. For term license agreements, revenue and the associated costs are deferred until the delivery of the solution and recognized ratably over the remaining license term.

For arrangements that include hosting services we allocate the arrangement consideration between the hosting service and other elements and recognize the hosting fee ratably beginning on the date the customer commences use of our services and continuing through the end of the customer term.

For multiple element arrangements that contain software and nonsoftware elements such as the Company's hosting service offerings, we allocate revenue between the software and software related elements as a group and any nonsoftware elements based on a relative fair value allocation. We determine fair value for each deliverable using the following hierarchy. We utilize VSOE of fair value if it exists, however in certain instances, the Company may not be able to establish VSOE for all deliverables in an arrangement with multiple elements. This may be due to infrequently selling each element separately, not pricing solutions or services within a narrow range, or only having a limited sales history. In addition, third party evidence ("TPE") may not be available. When the Company is unable to establish selling prices using VSOE or TPE, it uses best estimated selling price ("BESP") in the allocation of arrangement consideration. The objective of BESP is to determine the price at which the Company would transact a sale if the product or service were sold on a stand-alone basis. For transactions that only include software and software-related elements, the Company continues to account for such arrangements under the software revenue recognition standards which require it to establish VSOE of fair value to allocate arrangement consideration to multiple deliverables.

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Maintenance and support revenue includes post-implementation customer support and the right to unspecified software updates and enhancements on a when-and-if available basis. The Company generally invoices for maintenance and support services on a monthly, quarterly or on an annual basis through the maintenance and support period. The Company recognizes revenue from maintenance arrangements ratably over the period in which the services are provided.

Software license and implementation revenue that have been recognized, but for which the Company has not invoiced the customer, are recorded as unbilled receivables. Invoices that have been issued before software license, implementation and maintenance and support revenue has been recognized are recorded as deferred revenue in the accompanying unaudited condensed consolidated balance sheets.

Internal-use software

Costs incurred to develop internal-use software during the application development stage are capitalized, stated at cost, and depreciated using the straight-line method over the estimated useful lives of the assets. Application development stage costs generally include salaries and personnel costs and third party contractor expenses associated with internal-use software configuration, coding, installation and testing. Capitalized internal-use software development costs related to the Company's cloud-based offerings were \$0.8 million and \$0.5 million for the three months ended June 30, 2013 and 2012, respectively, and \$1.6 million and \$0.8 million for the six months ended June 30, 2013 and 2012, respectively. Capitalized internal-use software development costs related to our cloud-based offerings is amortized using the straight line method over the useful life of the asset. For the three and six months ended June 30, 2013, the Company amortized \$0.1 million and \$0.2 million, respectively, of capitalized internal-use software development costs related to its cloud-based offerings. Capitalized software for internal use is included in property and equipment, net in the unaudited condensed consolidated balance sheets. Amortization of capitalized internal-use software development costs related to the Company's cloud-based offerings is included in cost of license and implementation revenues in the accompanying unaudited condensed consolidated statements of comprehensive income.

Noncash share-based compensation

The Company measures all share-based payments to its employees based on the grant date fair value of the awards and recognizes expense in the Company's unaudited consolidated statement of comprehensive income on a straight-line basis over the period during which the recipient is required to perform service (generally over the vesting period of the awards). To date, the Company has granted Stock Options, Restricted Stock Units ("RSUs"), Stock Appreciation Rights ("SARs"), and Market Stock Units ("MSUs"). The MSUs are performance-based awards where the number of shares that vest are based upon the Company's relative shareholder return.

The following table presents the number of shares or units outstanding for each award type as of June 30, 2013 and December 31, 2012, respectively.

| Award type                | June 30, 2013 | December 31, 2012 |
|---------------------------|---------------|-------------------|
| Stock options             | 1,214,690     | 1,474,828         |
| Restricted stock units    | 1,596,935     | 1,182,726         |
| Stock appreciation rights | 736,717       | 789,637           |
| Market share units        | 469,000       | 205,000           |

Stock options, RSUs and SARs vest ratably between three and four years. The actual number of MSUs that will be eligible to vest is based on the total shareholder return of the Company relative to the total shareholder return of the

Russell 2000 Index (“Index”) over the Performance Period, as defined by each awards plan documents.

The fair value of the RSUs is based on the closing price of the Company’s stock on the date of grant.

The Company estimates the fair value of MSUs on the date of grant using a Monte Carlo simulation model. The determination of fair value of the MSUs is affected by the Company’s stock price and a number of assumptions including the expected volatilities of the Company’s stock and the Index, its risk-free interest rate and expected dividends. The Company’s expected volatility at the date of grant was based on the historical volatilities of the Company and the Index over the Performance Period.

The assumptions used to value the MSUs granted during the six months ended June 30, 2013 were as follows:

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|                               | For the Three Months<br>Ended June 30, 2013 |
|-------------------------------|---|
| Volatility                    | 57%   |
| Risk-free interest rate       | 0.35%                                       |
| Expected option life in years | 2.84  |
| Dividend yield                | —   |

### Earnings per share

The Company computes basic earnings per share by dividing net income by the weighted average number of common shares outstanding. Diluted earnings per share is computed by dividing net income by the weighted average number of common shares and dilutive potential common shares then outstanding. Potential common shares consist of shares issuable upon the exercise of stock options and SARs or the vesting of share-based awards. Diluted earnings per share reflect the assumed conversion of all dilutive share-based awards using the treasury stock method.

### Fair value measurement

The Company's financial assets that are measured at fair value on a recurring basis consisted of \$58.0 million invested in treasury money market funds at both June 30, 2013 and December 31, 2012, respectively. The fair value of these accounts is determined based on quoted market prices, which represents level 1 in the fair value hierarchy as defined by ASC 820, "Fair Value Measurement and Disclosure."

### Deferred revenue and unbilled receivables

Software license and implementation services that have been performed, but for which the Company has not invoiced the customer, are recorded as unbilled receivables, and invoices that have been issued before the software license and implementation services have been performed are recorded as deferred revenue in the accompanying unaudited condensed consolidated balance sheets. The Company generally invoices for maintenance and support services on a monthly, a quarterly or an annual basis through the maintenance and support period.

### Credit Facility

As of June 30, 2013, \$0.2 million of unamortized debt issuance costs related to the revolving credit facility ("Revolver") is included in other long term assets in the unaudited condensed consolidated balance sheets. For the three and six months ended June 30, 2013, \$13,000 and \$26,000, respectively, of debt issuance cost amortization is included in interest expense in the unaudited condensed consolidated statements of comprehensive income.

As of June 30, 2013, the Company had no outstanding borrowings under the Revolver.

### Income taxes

At the end of each interim reporting period, the Company estimates its annual effective tax rate to calculate its income tax provision. The estimated effective tax rate includes U.S. federal, state and foreign income taxes and is based on the application of an estimated annual income tax rate applied to the current quarter's year-to-date pre-tax income. This estimated effective tax rate is used in providing for income taxes on a year-to-date basis and may change in subsequent interim reporting periods.

In January 2013, Congress passed the American Taxpayer Relief Act of 2012 which included, among other legislation, the retroactive extension of the Research and Experimentations ("R&E") tax credit. The passage of this

legislation made the R&E tax credit retroactive to January 1, 2012 and extended the R&E tax credit until December 31, 2013.

The effective tax rate for the three months ended June 30, 2013 and 2012 was 11% and 46%, respectively. The effective tax rate (benefit) for the six months ended June 30, 2013 and 2012 was (87)% and 45%, respectively. The decrease in the effective tax rate in the three months ended June 30, 2013 compared to the three months ended June 30, 2012 is primarily due to the application of the 2013 R&E tax credit partially offset by a rate increase attributed to an increase in non-deductible share-based compensation expense. The difference between the effective tax rate for the six months ended June 30, 2013 compared to the six months ended June 30, 2012 is primarily due to the application of the 2013 R&E tax credit, a discrete benefit attributed to the

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2012 R&E tax credit recorded in the first quarter of 2013, partially offset by a rate increase attributed to an increase in non-deductible share-based compensation expense.

The difference between the effective tax rate and the federal statutory rate of 34% for the three months ended June 30, 2013 was due primarily to the 2013 R&E tax credit, partially offset by a rate increase attributable to nondeductible share-based compensation expense. The difference between the effective tax rate and the federal statutory rate of 34% for the six months ended June 30, 2013 was due primarily to rate decreases from the 2013 R&E tax credit and a discrete benefit attributed to the 2012 R&E tax credit, partially offset by a rate increase attributable to nondeductible share-based compensation expense.

### 3. Earnings per Share

The following table sets forth the computation of basic and diluted earnings per share for the three and six months ended June 30, 2013 and 2012:

|  | For the Three Months<br>Ended June 30, |            | For the Six Months Ended<br>June 30, |            |
|--|--|------------|--------------------------------------|------------|
|  | 2013                                   | 2012       | 2013                                 | 2012       |
| Numerator:                                 |  |            |                                      |            |
| Net income                                 | \$580                                  | \$995      | \$2,314                              | \$2,186    |
| Denominator:                               |  |            |                                      |            |
| Weighted average shares (basic)            | 28,006,517                             | 27,375,429 | 27,881,957                           | 27,271,201 |
| Dilutive effect of potential common shares | 1,952,063                              | 961,714    | 1,828,245                            | 1,032,559  |
| Weighted average shares (diluted)          | 29,958,580                             | 28,337,143 | 29,710,202                           | 28,303,760 |
| Basic earnings per share                   | \$0.02                                 | \$0.04     | \$0.08                               | \$0.08     |
| Diluted earnings per share                 | \$0.02                                 | \$0.04     | \$0.08                               | \$0.08     |

Dilutive potential common shares consist of shares issuable upon the exercise of stock options, settlement of SARs, vesting of RSUs and MSUs. Potential common shares determined to be antidilutive and excluded from diluted weighted average shares outstanding were approximately 3,400 and 722,200 for the three months ended June 30, 2013 and 2012, respectively, and approximately 2,300 and 528,400 for the six months ended June 30, 2013 and 2012, respectively.

### 4. Noncash Share-based Compensation

During the three months ended June 30, 2013, the Company granted 14,750 shares of RSUs with a weighted average grant-date fair value of \$28.87 per share. The Company did not grant stock options, SARs or MSUs during the three months ended June 30, 2013.

During the six months ended June 30, 2013, the Company granted 794,600 shares of RSUs with a weighted average grant-date fair value of \$19.77 per share. The Company granted 270,000 MSUs with a weighted average grant-date fair value of \$40.58 to certain executive officers and non-executive employees during the six months ended June 30, 2013. These MSU's vest on January 1, 2016 and the actual number of MSUs that will be eligible to vest is based on the total shareholder return of the Company relative to the total shareholder return of the Index over the Performance Period, as defined by each award's plan documents. The Company did not grant any stock options or SARs during the six months ended June 30, 2013.

Share-based compensation expense is allocated to expense categories on the unaudited condensed consolidated statements of comprehensive income. The following table summarizes share-based compensation expense included in



the Company's unaudited condensed consolidated statements of comprehensive income for the three and six months ended June 30, 2013 and 2012:

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|  | For the Three Months Ended |         | For the Six Months |         |
|--|----------------------------|---------|--------------------|---------|
|  | June 30,                   |         | Ended June 30,     |         |
|  | 2013                       | 2012    | 2013               | 2012    |
| Share-based compensation:                      |                            |         |                    |         |
| Cost of revenue:                               |                            |         |                    |         |
| License and implementation                     | \$534                      | \$301   | \$996              | \$630   |
| Total included in cost of revenue              | 534                        | 301     | 996                | 630     |
| Operating expenses:                            |                            |         |                    |         |
| Selling, marketing, general and administrative | 2,838                      | 1,636   | 5,059              | 2,904   |
| Research and development                       | 767                        | 503     | 1,504              | 938     |
| Total included in operating expenses           | 3,605                      | 2,139   | 6,563              | 3,842   |
| Total share-based compensation expense         | \$4,139                    | \$2,440 | \$7,559            | \$4,472 |

In February 2013, the number of shares available for issuance increased by 900,000 to 7,268,000 under an evergreen provision in our 2007 Equity Incentive Plan ("2007 Stock Plan"). As of June 30, 2013, 458,840 shares remained available for issuance under the 2007 Stock Plan. At June 30, 2013, there was an estimated \$36.6 million of total unrecognized compensation costs related to share-based compensation arrangements. These costs will be recognized over a weighted average period of 2.7 years.

## 5. Commitments and Contingencies

### Litigation:

In the ordinary course of the Company's business, the Company regularly becomes involved in contract and other negotiations and, in more limited circumstances, becomes involved in legal proceedings, claims and litigation. The outcomes of these matters are inherently unpredictable. The Company is not currently involved in any outstanding litigation that it believes, individually or in the aggregate, will have a material adverse effect on its business, financial condition, results of operations or cash flows.

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

The terms "we," "us," "PROS" and "our" refer to PROS Holdings, Inc. and all of its subsidiaries that are consolidated in conformity with accounting principles generally accepted in the United States of America.

This management's discussion and analysis of financial condition and results of operations should be read along with the unaudited condensed consolidated financial statements and unaudited notes to condensed consolidated financial statements included in Item 1 of this Quarterly Report on Form 10-Q, as well as the audited consolidated financial statements and notes to consolidated financial statements and management's discussion and analysis of financial condition and results of operations set forth in our Annual Report on Form 10-K for the year ended December 31, 2012.

### Overview

PROS provides big data software applications designed to help companies outperform in their markets by using big data to sell more effectively. We apply 27 years of data science experience to unlock buying patterns and preferences within transaction data to reveal which opportunities are most likely to close, which offers are most likely to sell and which prices are most likely to win. PROS offers big data software applications to analyze, execute and optimize

sales, pricing, quoting, rebates and revenue management. We also provide professional services to implement our software applications, as well as business consulting. Since inception, PROS has completed over 600 implementations of our solutions across more than 30 industries in more than 50 countries.

#### Opportunities, Trends and Uncertainties

We have noted opportunities, trends and uncertainties that we believe are particularly significant to understand our financial results and condition.

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Growth opportunities. We believe the market for our big data software applications is underpenetrated.

Market interest for our software has increased over the past several years, providing us with growth opportunities. We have and will continue to invest in our business to more effectively address these

- opportunities through significant investment in professional services, research and development, sales, marketing and back office. In addition to organic growth, we may acquire companies or technologies that can contribute to the strategic, operational and financial growth of our business. We expect to continue to explore both organic and other strategic growth opportunities.

Uncertain global economic conditions. Global economic conditions have been challenging in recent years, and continue to be somewhat uncertain. The uncertain economic conditions have had and may have a negative impact on the adoption of big data software and may increase the volatility in our business. Due to the uncertain economic conditions, we continue to experience long sales cycles, increased scrutiny on purchasing decisions and overall cautiousness taken by customers. In addition, certain foreign countries are still facing significant economic and political crises and it is possible that these crises could result in economic deterioration in the markets in which we operate. We believe our solutions provide value to our customers during periods of economic growth as well as in recessions, but the extent to which the current economic conditions will further affect our business is uncertain.

Variability in revenue. Our revenue recognition policy provides visibility into a significant portion of our revenue in the near-term quarters, although the actual timing of revenue recognition varies based on the nature and requirements of our contracts. For the majority of our arrangements, we have not historically recognized license revenue upon customer contract signature and software delivery. We evaluate our contract terms and conditions as well as our implementation performance obligations in making our revenue recognition determination for each contract. Our contractual performance obligations in the future may differ from historical periods, impacting the timing of the recognition of revenue. For example, growth in our term license and SaaS service offerings may result in the deferral of revenue over the contractual term, whereas growth in perpetual license arrangements that meet the criteria for separation may result in the recognition of license revenue on delivery, provided revenue recognition criteria are met. Our revenue could also vary based on our customer mix and customer geographic location. We sell our software solutions to customers in the manufacturing, distribution, services and travel industries. From a geographical standpoint, approximately 52% and 61% of our consolidated revenues were derived from customers outside the United States for each of the three and six months ended June 30, 2013 and 2012, respectively. Our contracts with customers outside the United States are predominately denominated in U.S. dollars. The economic and political environments around the world could change our concentration of revenue within industries and across geographies.

Income taxes. For the three and six months ended June 30, 2013, our effective income tax rate provision was 11% and a tax benefit of 87% as compared to the federal rate of 34%. In January 2013, Congress passed the American Taxpayer Relief Act of 2012 which included, among other legislation, the retroactive extension of the Research and Experimentations ("R&E") tax credit. The passage of this legislation made the R&E tax credit retroactive to January 1, 2012 and extended the R&E tax credit until December 31, 2013. As a result of the retroactive reinstatement of the 2012 R&E tax credit in 2013, we recognized a discrete tax benefit of \$1.4 million in the first quarter of 2013.

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## Results of Operations

Comparison of three months ended June 30, 2013 with three months ended June 30, 2012

## Revenue:

| (Dollars in thousands)     | For the Three Months Ended June 30, 2013 |                                  | For the Three Months Ended June 30, 2012 |                                  |             |    |            |  |
|----------------------------|--|----------------------------------|--|----------------------------------|-------------|----|------------|--|
|                            | Amount                                   | As a Percentage of Total Revenue | Amount                                   | As a Percentage of Total Revenue | Variance \$ |    | Variance % |  |
| License and implementation | \$24,170                                 | 68                               | % \$18,176                               | 65                               | % \$5,994   | 33 | %          |  |
| Maintenance and support    | 11,357                                   | 32                               | % 9,958                                  | 35                               | % 1,399     | 14 | %          |  |
| Total                      | \$35,527                                 | 100                              | % \$28,134                               | 100                              | % \$7,393   | 26 | %          |  |

License and implementation. License and implementation revenue increased \$6.0 million to \$24.2 million for the three months ended June 30, 2013 from \$18.2 million for the three months ended June 30, 2012, representing a 33% increase. The increase in license and implementation revenue was principally the result of a 13% increase in the number of implementations from 85 to 96, which increased the number of man-days expended by 42%, partially offset by a 7% decrease in the average revenue recognized per man-day as compared to the corresponding period in 2012. The average revenue per man-day can vary from quarter to quarter based on the relative relationship between license and implementation revenue.

License and implementation revenue includes revenue from both term licenses and hosting services. Revenue from term licenses represented approximately 3% and 5% of total revenue for the three months ended June 30, 2013 and 2012, respectively. Revenue from hosting services represented approximately 2% and 3% of total revenue for the three months ended June 30, 2013 and 2012, respectively.

Maintenance and support. Maintenance and support revenue increased \$1.4 million to \$11.4 million for the three months ended June 30, 2013 from \$10.0 million for the three months ended June 30, 2012, representing a 14% increase. The increase in maintenance and support revenue is principally a result of an increase in the number of customers purchasing maintenance and support services.

## Cost of revenue and gross profit:

| (Dollars in thousands)             | For the Three Months Ended June 30, 2013 |                                    | For the Three Months Ended June 30, 2012 |                                    |             |    |            |  |
|------------------------------------|--|------------------------------------|--|------------------------------------|-------------|----|------------|--|
|                                    | Amount                                   | As a Percentage of Related Revenue | Amount                                   | As a Percentage of Related Revenue | Variance \$ |    | Variance % |  |
| Cost of license and implementation | \$8,808                                  | 36                                 | % \$5,540                                | 30                                 | % \$3,268   | 59 | %          |  |
| Cost of maintenance and support    | 1,978                                    | 17                                 | % 1,959                                  | 20                                 | % 19        | 1  | %          |  |
| Total cost of revenue              | \$10,786                                 | 30                                 | % \$7,499                                | 27                                 | % \$3,287   | 44 | %          |  |
| Gross profit                       | \$24,741                                 | 70                                 | % \$20,635                               | 73                                 | % \$4,106   | 20 | %          |  |

Cost of license and implementation. Cost of license and implementation increased \$3.3 million to \$8.8 million for the three months ended June 30, 2013 from \$5.5 million for the three months ended June 30, 2012, representing a 59%

increase. The increase in cost of license and implementation revenue was principally attributable to an increase of \$2.5 million of personnel costs. Personnel costs, which include our employees and third party contractors, increased primarily as a result of an increase in headcount needed to support the increased number of active and anticipated implementations. Included in the increase in personnel costs is an increase of \$0.2 million of noncash share-based compensation expense. In addition, there was an increase of \$0.3 million of travel expenses due to the increase in the number of implementations, an increase of \$0.2 million related to depreciation as a result of the renovation and the expansion of our corporate facility, an increase of \$0.2 million related to hosting and our cloud-based service offerings, and an increase of \$0.1 million related to third party deployment software costs.

License and implementation gross profit percentages were 64% for the three months ended June 30, 2013 as compared to 70% for the three months ended June 30, 2012. The decrease in the license and implementation gross profit percentage was

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principally the result of a 59% increase in license and implementation costs due primarily to an increase in headcount needed to support the increased number of active and anticipated implementations. License and implementation gross margins may vary from period to period depending on different factors, including the amount of implementation services required to deploy our solutions relative to the total contract price and additional headcount needed to support anticipated future implementations.

**Cost of maintenance and support.** Cost of maintenance and support was \$2.0 million for the three months ended June 30, 2013 and 2012. Maintenance and support gross profit percentages were 83% for the three months ended June 30, 2013 as compared to 80% for the three months ended June 30, 2012. The increase in maintenance and support gross profit percentages was principally the result of an increase of 14% in maintenance and support revenue and a 1% increase in cost of maintenance and support.

**Gross profit.** Gross profit increased \$4.1 million to \$24.7 million for the three months ended June 30, 2013 from \$20.6 million for the three months ended June 30, 2012, representing a 20% increase. The increase in overall gross profit was principally attributable to a 26% increase in total revenue.

## Operating expenses:

| (Dollars in thousands)                         | For the Three Months Ended June 30, |                                  |            |                                  |             |    |            |  |
|--|-------------------------------------|----------------------------------|------------|----------------------------------|-------------|----|------------|--|
|  | 2013                                |                                  | 2012       |                                  |             |    |            |  |
|  | Amount                              | As a Percentage of Total Revenue | Amount     | As a Percentage of Total Revenue | Variance \$ |    | Variance % |  |
| Selling, marketing, general and administrative | \$15,935                            | 45                               | % \$11,884 | 42                               | % \$4,051   | 34 | %          |  |
| Research and development                       | 8,026                               | 23                               | % 6,772    | 24                               | % 1,254     | 19 | %          |  |
| Total operating expenses                       | \$23,961                            | 67                               | % \$18,656 | 66                               | % \$5,305   | 28 | %          |  |

**Selling, marketing, general and administrative expenses.** Selling, marketing, general and administrative expenses increased \$4.1 million to \$15.9 million for the three months ended June 30, 2013 from \$11.9 million for the three months ended June 30, 2012, representing a 34% increase. The increase was principally attributable to an increase of \$3.1 million in sales, marketing, general and administrative personnel costs as a result of an increase in headcount to support our current and future growth objectives and higher commission expenses resulting from higher revenue levels. Included in the increase in personnel costs is an increase of \$1.2 million of noncash share-based compensation. In addition, there was an increase of \$0.4 million of marketing expenses resulting from increases in marketing initiatives, an increase of \$0.2 million in third party professional fees, an increase of \$0.2 million of depreciation as a result of the renovation and expansion of our corporate facility, and \$0.2 million of administrative costs.

**Research and development expenses.** Research and development expenses increased \$1.3 million to \$8.0 million for the three months ended June 30, 2013 from \$6.8 million for the three months ended June 30, 2012, representing a 19% increase. The increase in research and development expenses was principally attributable to an increase of \$1.3 million in personnel costs as a result of increased headcount to support work on new projects and initiatives, offset by a \$0.4 million increase of capitalized personnel costs related to the development of our cloud-based service offerings. Included in the increase in personnel costs is an increase of \$0.3 million of noncash share-based compensation. In addition, there was an increase of \$0.3 million of overhead expenses, which includes facility, depreciation, software and hardware support, due to increased headcount.

## Other (expense) income, net:

| For the Three Months Ended June 30, |      |
|-------------------------------------|------|
| 2013                                | 2012 |

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| (Dollars in thousands)      | Amount | As a Percentage<br>of Total<br>Revenue | Amount    | As a Percentage<br>of Total<br>Revenue | Variance \$ | Variance % |
|-----------------------------|--------|--|-----------|--|-------------|------------|
| Other (expense) income, net | (129)  | ) —                                    | % \$(129) | ) —                                    | % \$—       | — %        |

Other (expense) income, net. Other (expense) income, net consists of interest income on our cash and cash equivalents, interest expense which includes debt issuance cost amortization on the revolving credit facility ("Revolver") and foreign currency exchange gains and losses on transactions denominated in currencies other than the functional currency. Other expense for the



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period remained unchanged and consisted of net decreases in foreign currency losses offset by an increase in interest expense from the Revolver.

## Income tax provision:

| (Dollars in thousands) | For the Three Months Ended<br>June 30, |       |             |            |     |    |
|------------------------|--|-------|-------------|------------|-----|----|
|                        | 2013                                   | 2012  | Variance \$ | Variance % |     |    |
| Effective tax rate     | 11                                     | % 46  | % n/a       | (35        | )   | %  |
| Income tax provision   | \$71                                   | \$855 | \$(784      | )          | (92 | )% |

Income tax provision. Our income tax provision decreased \$0.8 million to \$0.1 million for the three months ended June 30, 2013 from \$0.9 million for the three months ended June 30, 2012. The decrease in the income tax provision was principally attributable to a decrease of \$1.2 million in pre-tax income and a decrease in the effective tax rate. Our effective tax rate was 11% and 46% for the three months ended June 30, 2013 and 2012, respectively. The decrease in our effective tax rate was primarily due to the application of the 2013 R&E tax credit partially offset by a rate increase attributed to an increase in nondeductible share-based compensation expense

## Comparison of six months ended June 30, 2013 with six months ended June 30, 2012

## Revenue:

| (Dollars in thousands)     | For the Six Months Ended June 30, |                                  |   |          |                                  |   |             |            |
|----------------------------|-----------------------------------|----------------------------------|---|----------|----------------------------------|---|-------------|------------|
|                            | 2013                              | As a Percentage of Total Revenue |   | 2012     | As a Percentage of Total Revenue |   | Variance \$ | Variance % |
|                            | Amount                            |                                  |   | Amount   |                                  |   |             |            |
| License and implementation | \$46,762                          | 68                               | % | \$35,972 | 65                               | % | \$10,790    | 30 %       |
| Maintenance and support    | 22,391                            | 32                               | % | 19,183   | 35                               | % | 3,208       | 17 %       |
| Total                      | \$69,153                          | 100                              | % | \$55,155 | 100                              | % | \$13,998    | 25 %       |

License and implementation. License and implementation revenue increased \$10.8 million to \$46.8 million for the six months ended June 30, 2013 from \$36.0 million for the six months ended June 30, 2012, representing a 30% increase.

The increase in license and implementation revenue was principally the result of a 19% increase in the number of implementations from 94 to 112, which increased the number of man-days expended by 39%, partially offset by a 6% decrease in the average revenue recognized per man-day as compared to the corresponding period in 2012. The average revenue per man-day can vary from period to period based on the relative relationship between license and implementation revenue.

License and implementation revenue includes revenue from both term licenses and hosting services. Revenue from term licenses represented approximately 3% and 5% of total revenue for the six months ended June 30, 2013 and 2012, respectively. Revenue from hosting services represented approximately 2% and 3% of total revenue for the six months ended June 30, 2013 and 2012, respectively.

Maintenance and support. Maintenance and support revenue increased \$3.2 million to \$22.4 million for the six months ended June 30, 2013 from \$19.2 million for the six months ended June 30, 2012, representing a 17% increase. The increase in maintenance and support revenue is principally a result of an increase in the number of customers purchasing maintenance and support services.



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## Cost of revenue and gross profit:

| (Dollars in thousands)             | For the Six Months Ended June 30,<br>2013 |  | 2012     |  |             |            |   |  |
|------------------------------------|---|--|----------|--|-------------|------------|---|--|
|                                    | Amount                                    | As a percentage<br>of<br>related revenue | Amount   | As a percentage<br>of<br>related revenue | Variance \$ | Variance % |   |  |
| Cost of license and implementation | \$17,278                                  | 37 %                                     | \$11,543 | 32 %                                     | \$5,735     | 50         | % |  |
| Cost of maintenance and support    | 4,061                                     | 18 %                                     | 3,895    | 20 %                                     | 166         | 4          | % |  |
| Total cost of revenue              | \$21,339                                  | 31 %                                     | \$15,438 | 28 %                                     | \$5,901     | 38         | % |  |
| Gross profit                       | \$47,814                                  | 69 %                                     | \$39,717 | 72 %                                     | \$8,097     | 20         | % |  |

Cost of license and implementation. Cost of license and implementation increased \$5.7 million to \$17.3 million for the six months ended June 30, 2013 from \$11.5 million for the six months ended June 30, 2012, representing a 50% increase. The increase in cost of license and implementation is principally attributable to an increase of \$4.3 million of personnel costs. Personnel costs, which include our employees and third party contractors, increased primarily as a result of an increase in headcount needed to support the increased number of active and anticipated implementations. Included in the increase in personnel costs is an increase of \$0.3 million of noncash share-based compensation expense. In addition, there was an increase of \$0.7 million of travel expenses due to the increase in the number of implementations, an increase of \$0.4 million related to hosting and our cloud-based service offerings and an increase of \$0.3 million related to depreciation as a result of renovation and expansion of our corporate facility.

License and implementation gross profit percentages were 63% for the six months ended June 30, 2013 and 68% for the six months ended June 30, 2012. The decrease in the license and implementation gross profit percentage was principally the result of a 50% increase in license and implementation costs due primarily to an increase in headcount needed to support the increased number of active and anticipated implementations. License and implementation gross profit percentages may vary from period to period depending on different factors, including the amount of implementation services required to deploy our products relative to the total contract price.

Cost of maintenance and support. Cost of maintenance and support increased \$0.2 million to \$4.1 million for the six months ended June 30, 2013 from \$3.9 million for the six months ended June 30, 2012, representing a 4% increase. The increase in cost of maintenance in the first six months of 2013 when compared to the corresponding period in 2012 is attributable to an increase of \$0.2 million of personnel costs associated with the continued growth in our customer maintenance and support function commensurate with maintenance and support revenue growth.

Maintenance and support gross profit percentages were 82% for the six months ended June 30, 2013 and 80% for the six months ended June 30, 2012. The increase in maintenance and support gross profit percentages was principally the result of an increase of 17% in maintenance and support revenue.

Gross profit. Gross profit increased \$8.1 million to \$47.8 million for the six months ended June 30, 2013 from \$39.7 million for the six months ended June 30, 2012, representing a 20% increase. The increase in overall gross profit was attributable to a 25% increase in total revenue.

## Operating expenses:

| (Dollars in thousands) | For the Six Months Ended June 30,<br>2013 |                                     | 2012   |                 |             |            |  |  |
|------------------------|---|-------------------------------------|--------|-----------------|-------------|------------|--|--|
|                        | Amount                                    | As a Percentage<br>of Total Revenue | Amount | As a Percentage | Variance \$ | Variance % |  |  |

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|   |          |    |   |          | of Total<br>Revenue |   |          |    |   |
|---|----------|----|---|----------|---------------------|---|----------|----|---|
| Selling, marketing, general<br>and administrative | \$30,223 | 44 | % | \$22,140 | 40                  | % | \$8,083  | 37 | % |
| Research and development                          | 16,121   | 23 | % | 13,469   | 24                  | % | 2,652    | 20 | % |
| Total operating expenses                          | \$46,344 | 67 | % | \$35,609 | 65                  | % | \$10,735 | 30 | % |

Selling, marketing, general and administrative expenses. Selling, marketing, general and administrative expenses increased \$8.1 million to \$30.2 million for the six months ended June 30, 2013 from \$22.1 million for the six months ended

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June 30, 2012, representing a 37% increase. The increase was principally due to an increase of \$6.8 million in sales, marketing, general and administrative personnel costs as a result of an increase in headcount to support our current and future growth objectives and higher commission expenses resulting from higher revenue levels. Included in the increase in personnel costs is an increase of \$2.2 million of noncash share-based compensation. In addition, there was a \$0.6 million increase of overhead and other expenses, which consists of facility and depreciation, an increase of \$0.3 million of professional fees, an increase of \$0.2 million of software and hardware support, an increase of \$0.1 million of marketing initiatives and \$0.1 million of travel expense primarily as a result of increase in sales activity. These increases were offset by a decrease of \$0.1 million of consultants fees related to the implementation of an enterprise resource planning system in 2012.

Research and development expenses. Research and development expenses increased \$2.7 million to \$16.1 million for the six months ended June 30, 2013 from \$13.5 million for the six months ended June 30, 2012, representing a 20% increase. The increase was principally attributed to an increase of \$3.3 million in personnel costs as a result of increased headcount to support work on new projects and initiatives, offset by \$1.0 million of capitalized personnel costs related to the development of our cloud-based service offerings. Included in the increase in personnel costs is an increase of \$0.6 million of noncash share-based compensation. In addition, there was an increase of \$0.3 million of overhead expenses which was primarily due to increased depreciation expense related to the renovation and expansion of our corporate facility.

## Other income (expense), net:

| (Dollars in thousands)      | For the Six Months Ended June 30, |                                  | 2012   |                                  | As a Percentage of Total Revenue | Variance \$ | Variance % |
|-----------------------------|-----------------------------------|----------------------------------|--------|----------------------------------|----------------------------------|-------------|------------|
|                             | Amount                            | As a Percentage of Total Revenue | Amount | As a Percentage of Total Revenue |                                  |             |            |
| Other income (expense), net | (234 )                            | —                                | (106 ) | —                                |                                  | (128 )      | nm         |

Other income (expense), net. Other (expense) income, net consists of interest income on our cash and cash equivalents, interest expense which includes debt issuance cost amortization on the Revolver and foreign currency exchange gains and losses on transactions denominated in currencies other than the functional currency. Other income (expense), net increased by \$0.1 million during the six months ended June 30, 2013 primarily due to interest expense related to the Revolver.

## Income tax (benefit) provision:

| (Dollars in thousands)         | For the Six Months Ended June 30, |  | 2012    |  | Variance \$ | Variance % |
|--------------------------------|-----------------------------------|--|---------|--|-------------|------------|
|                                | 2013                              |  | 2012    |  |             |            |
| Effective tax rate             | (87 )%                            |  | 45 %    |  | n/a         | (132 )%    |
| Income tax (benefit) provision | \$(1,078 )                        |  | \$1,816 |  | \$(2,894 )  | (159 )%    |

Income tax (benefit) provision. Our income tax provision decreased \$2.9 million to a tax benefit of \$1.1 million for the six months ended June 30, 2013 from a tax provision of \$1.8 million for the six months ended June 30, 2012. The decrease in the income tax provision was principally attributable to a decrease of \$2.8 million of pretax income and a decrease in the effective tax rate. Our effective tax rate was a tax benefit of 87% and a tax provision of 45% for the six months ended June 30, 2013 and 2012, respectively. The decrease in our effective tax rate was primarily due to the effect of the application of the 2013 R&E tax credit, and a discrete benefit attributed to the 2012 R&E tax credit recorded in the first quarter of 2013, partially offset by a rate increase attributed to an increase in nondeductible share-based compensation expense.

## Liquidity and Capital Resources

### Liquidity

At June 30, 2013, we had \$88.2 million of cash and cash equivalents and \$82.3 million of working capital as compared to \$83.6 million of cash and cash equivalents and \$73.0 million of working capital at December 31, 2012. The majority of our cash and cash equivalents are denominated in the U.S. dollar and are held in financial institutions located in the U.S. Our principal sources of liquidity are our cash and cash equivalents, cash flows generated from operations and potential borrowings under our Revolver. Our material drivers or variants of operating cash flow are net income, noncash expenses (principally share-based compensation) and the timing of periodic billings and collections related to the sale of our software and related services. The primary source of operating cash flows is the collection of accounts receivable from our customers. Our operating cash flows are also impacted by the timing of payments to our vendors for accounts payable and other liabilities. We generally pay our vendors and service providers in accordance with the invoice terms and conditions.

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Based on existing cash and cash equivalent balances, availability under our Revolver and our current estimates of revenues and expenses, we believe that we will have adequate liquidity and capital resources to meet our operational requirements and anticipated capital expenditures for the next twelve months. Our future working capital requirements will depend on many factors, including the operations of our existing business, our potential strategic expansion, future acquisitions we might undertake, and the expansion into complementary businesses. If such need arises, we may raise additional funds through equity or debt financings. At June 30, 2013, we had restricted cash of \$0.3 million related to letters of credit.

The following table presents key components of our unaudited condensed consolidated statements of cash flows for the six months ended June 30, 2013 and 2012.

| (Dollars in thousands)                              | For the Six Months<br>Ended June 30, |          |
|---|--------------------------------------|----------|
|   | 2013                                 | 2012     |
| Net cash provided by operating activities           | \$7,934                              | \$6,953  |
| Net cash used in investing activities               | (3,706)                              | (4,079)  |
| Net cash provided by (used in) financing activities | 441                                  | (169)    |
| Cash and cash equivalents (beginning of period)     | 83,558                               | 68,457   |
| Cash and cash equivalents (end of period)           | \$88,227                             | \$71,162 |

Net cash provided by operating activities. Net cash provided by operating activities for the six months ended June 30, 2013 was \$7.9 million, which represents an increase of \$1.0 million when compared to the corresponding period in 2012. For the six months ended June 30, 2013, our cash flows from operations were derived principally from our earnings from on-going operations prior to noncash expenses such as depreciation and amortization, share-based compensation and related tax benefits, provision for doubtful accounts and changes in our working capital. The \$1.0 million increase was due to an increase of \$4.4 million of noncash expenses principally as the result of the increase in share-based compensation and an increase of \$0.1 million in net income, partially offset by a decrease of \$3.5 million attributed to changes in operating assets and liabilities, which are comprised of accounts receivable, unbilled receivables, prepaid and other assets, accounts payable, accrued liabilities, accrued payroll and other employee benefits and deferred revenue. Included in our changes in operating assets and liabilities in 2013 and 2012 was \$5.7 million and \$2.8 million of incentive payments paid to our employees that were earned in 2012 and 2011, respectively. Also included in our changes in operating assets and liabilities in 2012 was \$5.1 million of cash provided from a tax refund received in the second quarter.

Net cash used in investing activities. Net cash used in investing activities was \$3.7 million for the six months ended June 30, 2013 compared to \$4.1 million for the six months ended June 30, 2012. The decrease in net cash used in investing activities for the six months ended June 30, 2013 as compared to the corresponding period in 2012 is primarily the result of a \$1.1 million decrease in purchases of property and equipment, partially offset by a \$0.7 million increase in capitalized internal-use software development costs related to our cloud-based service offerings.

Net cash provided by (used in) financing activities. Net cash provided by financing activities was \$0.4 million for the six months ended June 30, 2013 compared to net cash used in financing activities of \$0.2 million for the six months ended June 30, 2012. The increase for the six months ended June 30, 2013 as compared to the corresponding period in 2012 is primarily the result of an increase in net cash provided by the exercise of stock options and stock appreciation rights of \$2.3 million, offset by a \$1.7 million decrease in excess tax benefits as a result of the vesting of restricted stock units.

## Off-Balance Sheet Arrangements

We do not have any relationships with unconsolidated entities or financial partnerships, such as variable interest entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes.

#### Contractual Obligations and Commitments

There have been no material changes to our contractual obligations and commitments as disclosed in our Annual Report on SEC Form 10-K for the year ended December 31, 2012.

#### Credit facility



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As of June 30, 2013, there were \$0.2 million of unamortized debt issuance costs related to the Revolver included in other long-term assets in the unaudited condensed consolidated balance sheets. For the three and six months ended June 30, 2013, \$13,000 and \$26,000, respectively, of debt issue cost amortization is included in other income (expense), net in the unaudited condensed consolidated statements of comprehensive income.

There were no outstanding borrowings under the Revolver as of June 30, 2013.

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

#### Foreign Currency Exchange Risk

Our contracts are predominately denominated in U.S. dollars; however, we have contracts denominated in foreign currencies and therefore a portion of our revenue is subject to foreign currency exchange risk. The primary market risk we face is from foreign currency exchange rate fluctuations on our financial results. The effect of an immediate 10% adverse change in exchange rates on our foreign denominated receivables as of June 30, 2013 would result in a loss of approximately \$30,000. In addition, the Company has operating subsidiaries in the United Kingdom, Canada and Germany. However, due to the relatively low volume of payments made by the Company through these foreign subsidiaries, the Company does not believe that it has significant exposure to foreign currency exchange risks. Fluctuations in foreign currency exchange rates could harm our financial results in the future.

We currently do not use derivative financial instruments to mitigate foreign currency exchange risks. We continue to review this issue and may consider hedging certain foreign exchange risks through the use of currency futures or options in future years.

#### Exposure to Interest Rates

The Company is exposed to market risk for changes in interest rates related to the variable interest rate on borrowings under the Company's Revolver. As of June 30, 2013, the Company had no borrowings under the Revolver.

### ITEM 4. CONTROLS AND PROCEDURES

#### Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our chief executive officer and chief financial officer, evaluated the effectiveness of our disclosure controls and procedures as defined in Rules 13a-15(e) or 15d-15(e) under the Exchange Act of 1934, as amended (the "Exchange Act") as of June 30, 2013. Based on our evaluation of our disclosure controls and procedures as of June 30, 2013, our chief executive officer and chief financial officer concluded that our disclosure controls and procedures were effective to ensure that information we are required to disclose in reports that we file or submit under the Exchange Act (i) is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms, and (ii) is accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate to allow timely decisions regarding required disclosure.

#### Changes in Internal Control over Financial Reporting

There have been no changes in our internal control over financial reporting during the three months ended June 30, 2013 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

### PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

From time to time, we are a party to legal proceedings and claims arising in the ordinary course of business. We are not currently aware of any such proceedings or claims that we believe will have, individually or in the aggregate, a material adverse effect on our business, financial condition, results of operations or cash flows.

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ITEM 1A. RISK FACTORS

There have been no material changes from the risk factors previously described under Item 1A of each of our Annual Report on Form 10-K for the year ended December 31, 2012.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS.

We have an ongoing authorization from our Board of Directors to repurchase up to \$15.0 million in shares of our common stock in the open market or through privately negotiated transactions. As of June 30, 2013, \$10.0 million remained available for repurchase under the existing repurchase authorization.

We did not make any purchases of our common stock under this program for the three months ended June 30, 2013.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

None.

ITEM 4. MINE SAFETY DISCLOSURE

None.

ITEM 5. OTHER INFORMATION.

None.

ITEM 6. EXHIBITS.

| Number   | Description  |
|----------|--|
| 10.18(1) | Amended and Restated Employment Agreement by and between PROS, Inc., PROS Holdings, Inc., and Ronald F. Woestemeyer, dated as of May 13, 2013. |
| 10.19(2) | PROS 2013 Employee Stock Purchase Plan.  |
| 31.1     | Certification of Chief Executive Officer Pursuant to Exchange Act Rule 13a-14(a)/15d-14(a).  |
| 31.2     | Certification of Chief Financial Officer Pursuant to Exchange Act Rule 13a-14(a)/ 15d-14(a).   |
| 32.1*    | Certifications of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350.                                      |
| 101.INS  | XBRL Instance Document.  |
| 101.SCH  | XBRL Taxonomy Extension Schema Document.   |
| 101.CAL  | XBRL Taxonomy Extension Calculation Linkbase Document.   |
| 101.DEF  | XBRL Taxonomy Extension Definition Linkbase Document.  |
| 101.LAB  | XBRL Taxonomy Extension Label Linkbase Document.   |

101.PRE XBRL Taxonomy Extension Presentation Linkbase Document.

\* This certification shall not be deemed “filed” for purposes of Section 18 of the Securities Act of 1934, or otherwise subject to the liability of that Section, nor shall it be deemed to be incorporated by reference into any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934

(1) Incorporated by reference to our Current Report on Form 8-K dated May 15, 2013. Constitutes management contracts or compensatory arrangements.

(2) Incorporated by reference to our Current Report on Form 8-K dated June 7, 2013.

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SIGNATURES

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

PROS HOLDINGS, INC.

August 1, 2013

By:

/s/ Andres Reiner  
Andres Reiner  
President and Chief Executive Officer  
(Principal Executive Officer)

August 1, 2013

By:

/s/ Charles H. Murphy  
Charles H. Murphy  
Executive Vice President and Chief Financial Officer  
(Principal Financial and Accounting Officer)