SolarWinds, Inc.
Form 10-Q
May 01, 2013
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 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: 001-34358

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

Delaware (State or other jurisdiction of incorporation or organization)	73-1559348 (I.R.S. Employer Identification No.)

3711 S. MoPac Expressway
Building Two
Austin, Texas 78746
(512) 682.9300
(Address and telephone number of principal executive offices)

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. ý 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). ý Yes ¨ No

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

Large accelerated filer ý	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company ¨

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

On April 26, 2013, 75,196,872 shares of common stock, par value $0.001 per share, were outstanding.

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Safe Harbor Cautionary Statement

This quarterly report on Form 10-Q contains forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and the Private Securities Litigation Reform Act of 1995. Such statements may be signified by terms such as "anticipates," "believes," "continues," "estimates," "expects," "intend "targets," "may," "could," "should," "will," "would" or similar expressions and the negatives of those terms. In this report, forward-looking statements include statements regarding our financial projections, future financial performance and plans and objectives for future operations including, without limitation, the following:

- Our expectation to grow our business by focusing on initiatives such as acquisitions of products that will expand our network management and systems and application management offerings or potential acquisitions of products in new markets, increasing our presence in several key geographic markets including Asia-Pacific, Latin America, Europe, Middle East and Africa by expanding our product portfolio, websites and marketing material, which includes additional localization of our products, websites, and documentation, and establishing new relationships with distributors and resellers, expanding our web presence, brand awareness and improving our communication with prospects and our current customers domestically and internationally, and international expansion company-wide at lower cost locations to drive our competitive advantage;
- Our expectation to continue to generate solid growth while delivering strong operating income and increase our cash flows from operating activities with our disciplined approach to investing in our business combined with our large market opportunity;
- Our assumption that we will be able to deliver ongoing value to our customers and maintain a long-term financial relationship with the users of our IT management products;
- Our expectation that our revenue growth will be approximately 21-24% for the full year of 2013;
- Our expectation that core product transaction volume growth will be the primary driver of our new license growth;
- Our expectation that our Non-GAAP operating margin will be approximately 52-53% for the full year of 2013;
- Our belief that IT-related trends and the limitations of existing offerings present a significant market opportunity for our products;
- Our expectation that our revenue will continue to grow as we capitalize on IT-related trends and other market opportunities and target annual license revenue growth of 20% over the next three to five years;
- Our belief that there is a substantial opportunity for additional sales of our software in the Europe, Middle East and Africa, or EMEA, region, the Asian-Pacific region, and the Latin American region, and our intention to increase our sales, marketing and support operations in these regions;
- Our belief that although difficult economic conditions in certain geographic regions may adversely affect the sales of our products, such conditions also could offer us an opportunity to market and sell our products to mid-size businesses and enterprise customers at compelling prices compared to the prices of some competing products;
- Our expectation that the U.S. federal government will continue to be a significant market opportunity and our belief that the ease of deployment, power and scalability of our products gives us a competitive advantage to sell to various agencies and departments of the U.S. federal government;
- Our expectation that we will continue to experience inconsistency in the buying pattern of the U.S. federal government for larger transactions with our products;
- Our belief that many of our larger transactions with the U.S. federal government are dependent on specific projects that may not be continued at the same scale in the future due to budgetary cuts or other reasons, and the reduction or cancellation of specific projects such as these could result in our sales to the U.S. government growing less rapidly than expected or even decreasing;
- Our expectation that maintenance revenue will continue to increase in absolute dollars in future periods;
- Our expectation that our cost of revenue will increase in absolute dollars and fluctuate as a percentage of revenue as we acquire additional companies or technologies and as we increase our headcount to support new customers and product offerings;
- Our expectation that our operating expenses will continue to increase in absolute dollars as we make long-term investments in our business both domestically and internationally;
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Our expectation to continue to target our corporate margin structure as we acquire additional companies or technologies and integrate the businesses, although our operating expenses in future periods may increase in absolute dollars and fluctuate as a percentage of revenue as a result of such acquisitions;

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- Our intention to continue to grant equity awards to our current executives and employees and those who join us in the future through acquisitions or otherwise, which will result in additional stock-based compensation expense;
- Our expectation to continue to hire sales personnel in the United States and in our international sales offices at a rate consistent with our expected new license sales growth;
- Our expectation to continue to invest in our websites, online user community site and marketing programs to drive customer downloads and support our new product launches;
- Our expectation that we will continue to invest in our research and development activities by hiring engineers in our international locations, which will allow us to continue our research and development growth strategy internationally;
- Our expectation that we will incur higher administrative costs in future periods as our business continues to grow both organically and through acquisitions;
- Our expectation that our international income, as a percentage of total income, will increase and that such increase should result in a corresponding decline in our effective income tax rate;
- Our expectation that our international cash and cash equivalents will continue to increase as a percentage of our consolidated cash and cash equivalents;
- Our intention that the earnings generated by our international operations will be invested indefinitely in those operations and our expectation that we will not repatriate those earnings to our domestic operations;
- Our estimation that our capital expenditures for the remaining nine months of 2013 will be approximately $3.0 to $4.0 million, primarily including equipment, leasehold improvements, furniture and software related to the expected growth of our corporate headquarters in Austin, Texas, and our international research and development centers in the Czech Republic and India;
- Our belief that our existing cash and cash equivalents and our cash flows from operating activities will be sufficient to fund our operations and our capital expenditures for at least the next 12 months; and
- Our expectation to continue to pursue acquisitions that will enable us to enter new markets or new segments of our existing markets by bringing new product offerings to market more quickly than we can develop them.

Forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements to be materially and adversely different from any future results, performance or achievements expressed or implied by the forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those summarized under Risk Factors and Management’s Discussion and Analysis of Financial Condition and Results of Operations in our annual report on Form 10-K for the year ended December 31, 2012 and our quarterly reports on Forms 10-Q and other documents we file with the Securities and Exchange Commission ("SEC"). Given these risks and uncertainties, you should not place undue reliance on these forward-looking statements. Also, forward-looking statements represent our management’s beliefs and assumptions only as of the date of this quarterly report on Form 10-Q. Except as required by law, we assume no obligation to update these forward-looking statements publicly, or to update the reasons actual results could differ materially and adversely from those anticipated in these forward-looking statements, even if new information becomes available in the future.

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Item 1. Financial Statements
PART I: FINANCIAL INFORMATION
SolarWinds, Inc.
Condensed Consolidated Balance Sheets
(In thousands, except share and per share information)
(Unaudited)

	March 31, 2013	December 31, 2012
Assets		
Current assets:		
Cash and cash equivalents	$221,325	$179,702
Short-term investments	44,438	49,276
Accounts receivable, net of allowances of $308 and $271 as of March 31, 2013 and December 31, 2012, respectively	34,315	32,506
Income tax receivable	1,776	142
Deferred taxes	3,036	1,712
Prepaid and other current assets	2,723	3,322
Total current assets	307,613	266,660
Property and equipment, net	8,267	8,342
Long-term investments	8,232	12,823
Deferred taxes	1,207	338
Goodwill	157,882	158,601
Intangible assets and other, net	65,790	70,631
Total assets	$548,991	$517,395
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	$3,764	$4,050
Accrued liabilities	8,052	14,226
Accrued earnout	123	121
Income taxes payable	1,910	4,037
Current portion of deferred revenue	103,251	97,672
Total current liabilities	117,100	120,106
Long-term liabilities:		
Deferred revenue, net of current portion	6,028	5,084
Non-current deferred taxes	858	483
Other long-term liabilities	10,997	8,908
Total liabilities	134,983	134,581
Commitments and contingencies (Note 7)		
Stockholders' equity:		
Common stock, $0.001 par value: 123,000,000 shares authorized and 75,121,383 and 74,633,412 shares issued and outstanding as of March 31, 2013 and December 31, 2012, respectively	75	75
Additional paid-in capital	239,739	229,277
Accumulated other comprehensive loss	(3,412)	(1,145)
Accumulated earnings	177,606	154,607
Total stockholders' equity	414,008	382,814
Total liabilities and stockholders' equity	$548,991	$517,395

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

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SolarWinds, Inc.
Condensed Consolidated Statements of Income
(In thousands, except per share information)
(Unaudited)

	Three months ended March 31,	
	2013	2012
Revenue:		
License	$30,725	$27,457
Maintenance and other	42,185	32,214
Total revenue	72,910	59,671
Cost of license revenue	2,761	1,880
Cost of maintenance and other revenue	2,870	2,393
Gross profit	67,279	55,398
Operating expenses:		
Sales and marketing	20,300	16,560
Research and development	7,846	6,671
General and administrative	9,821	8,449
Total operating expenses	37,967	31,680
Operating income	29,312	23,718
Other income (expense):		
Interest income	123	88
Other expense, net	(151)	(16)
Total other income (expense)	(28)	72
Income before income taxes	29,284	23,790
Income tax expense	6,285	6,659
Net income	$22,999	$17,131
Net income per share:		
Basic earnings per share	$0.31	$0.23
Diluted earnings per share	$0.30	$0.23
Weighted-average shares used to compute net income per share:		
Shares used in computation of basic earnings per share	74,987	73,743
Shares used in computation of diluted earnings per share	76,672	75,440

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

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SolarWinds, Inc.
Condensed Consolidated Statements of Comprehensive Income
(In thousands)
(Unaudited)

	Three months ended March 31,	
	2013	2012
Net income	$22,999	$17,131
Other comprehensive income (loss):		
Foreign currency translation adjustment	(2,312)	1,192
Unrealized gains on investments, net of income tax expense of $24 and $4 for the three months ended March 31, 2013 and 2012, respectively	45	7
Other comprehensive income (loss)	(2,267)	1,199
Comprehensive income	$20,732	$18,330

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

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SolarWinds, Inc.

Condensed Consolidated Statements of Cash Flows
(In thousands)
(Unaudited)

	Three months ended March 31,	
	2013	2012
Cash flows from operating activities		
Net income	$22,999	$17,131
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	5,322	4,296
Provision for doubtful accounts	73	40
Stock-based compensation expense	6,341	3,865
Deferred taxes	(1,879)	(495)
Excess tax benefit from stock-based compensation	(4,730)	(3,309)
Discount (premium) on investments	21	(168)
Other non-cash expenses (benefits)	(14)	382
Changes in operating assets and liabilities, net of assets acquired and liabilities assumed in business combinations:		
Accounts receivable	(1,995)	(814)
Income taxes receivable	15	50
Prepaid and other assets	570	73
Accounts payable	(278)	362
Accrued liabilities	(6,053)	(1,394)
Income taxes payable	3,074	3,216
Deferred revenue	7,421	4,936
Net cash provided by operating activities	30,887	28,171
Cash flows from investing activities		
Purchases of investments	—	(11,780)
Maturities of investments	9,279	9,540
Purchases of property and equipment	(782)	(771)
Purchases of intangible assets	(113)	(141)
Acquisition of businesses, net of cash acquired	—	(11,034)
Net cash provided by (used in) investing activities	8,384	(14,186)
Cash flows from financing activities		
Repurchase of common stock	(4,347)	(1,334)
Exercise of stock options	3,738	3,256
Excess tax benefit from stock-based compensation	4,730	3,309
Earnout payments for acquisitions	—	(3,203)
Net cash provided by financing activities	4,121	2,028
Effect of exchange rate changes on cash and cash equivalents	(1,769)	616
Net increase in cash and cash equivalents	41,623	16,629
Cash and cash equivalents		
Beginning of period	179,702	122,707
End of period	$221,325	$139,336
Supplemental disclosure of cash flow information		
Cash paid for income taxes	$5,009	$3,812
Non-cash financing transactions		

Accrued earnout (Note 3)	$—	$951

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

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SolarWinds, Inc.
Notes to Condensed Consolidated Financial Statements (Unaudited)
1. Summary of Significant Accounting Policies
Organization and Nature of Operations
SolarWinds, Inc., a Delaware corporation, and its subsidiaries ("we" or "us") design, develop, market, sell and support enterprise-class information technology, or IT, infrastructure management software to IT professionals in organizations of all sizes. Our product offerings range from individual software tools to more comprehensive software products that solve problems encountered every day by IT professionals. Our products are designed to help enable efficient and effective management of their networks, systems and application infrastructure.
Basis of Presentation
We prepared our interim condensed consolidated financial statements in conformity with United States of America generally accepted accounting principles, or GAAP, and the reporting regulations of the Securities and Exchange Commission, or the SEC. They do not include all of the information and footnotes required by GAAP for complete financial statements. The accompanying condensed consolidated financial statements include our accounts and the accounts of our wholly owned subsidiaries. We have eliminated all intercompany balances and transactions.
We have made estimates and judgments affecting the amounts reported in our condensed consolidated financial statements and the accompanying notes. The actual results that we experience may differ materially from our estimates. The accounting estimates that require our most significant, difficult and subjective judgments include:
- the valuation of goodwill, intangibles, long-lived assets and contingent consideration, including accrued earnouts;
- revenue recognition;
- stock-based compensation;
- income taxes; and
- loss contingencies.

The interim financial information is unaudited, but reflects all normal adjustments that are, in our opinion, necessary to provide a fair statement of results for the interim periods presented. This interim information should be read in conjunction with the audited consolidated financial statements in our Annual Report on Form 10-K for the year ended December 31, 2012.
Certain reclassifications have been made to prior periods' financial statements to conform to the current period presentation. These reclassifications did not result in any change in previously reported net income, total assets or shareholders' equity.
Recent Accounting Pronouncements
There have been no significant changes in recent accounting pronouncements that were disclosed in our Annual Report on Form 10-K for the fiscal year ended December 31, 2012 that have had a significant impact on our condensed consolidated financial statements or notes thereto.
Fair Value Measurements
We apply the authoritative guidance on fair value measurements for financial assets and liabilities that are measured at fair value on a recurring basis and non-financial assets and liabilities, such as goodwill, indefinite-lived intangible assets and property, plant and equipment that are measured at fair value on a non-recurring basis.
The guidance establishes a three-tiered fair value hierarchy that prioritizes inputs to valuation techniques used in fair value calculations. The three levels of inputs are defined as follows:
Level 1: Unadjusted quoted prices for identical assets or liabilities in active markets accessible by us.
Level 2: Inputs that are observable in the marketplace other than those inputs classified as Level 1.
Level 3: Inputs that are unobservable in the marketplace and significant to the valuation.
We determine the fair value of our available-for-sale securities based on inputs obtained from multiple pricing vendors, who may use quoted prices in active markets for identical assets (Level 1 inputs) or inputs other than quoted prices that are observable either directly or indirectly (Level 2 inputs) in determining fair value. However, we classify all of our available-for-sale securities as being valued using Level 2 inputs. The valuation techniques used to determine the fair value of our financial instruments having Level 2 inputs are derived from unadjusted, non-binding market consensus prices that are corroborated by

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observable market data, quoted market prices for similar instruments, or pricing models. Our procedures include controls to ensure that appropriate fair values are recorded by a review of the valuation methods and assumptions. See Note 3 for a summary of our financial instruments and acquisition related contingent considerations accounted for at fair value on a recurring basis. The carrying amounts reported in our condensed consolidated balance sheets for cash, accounts receivable, accounts payable and other accrued expenses approximate fair value due to relatively short periods to maturity.

2. Investments

Our cash and cash equivalents as of March 31, 2013 and December 31, 2012 consisted of demand deposit accounts and money market funds. The following table summarizes our cash and cash equivalents:

(in thousands)	March 31, 2013	December 31, 2012
Demand deposit accounts	$85,246	$82,195
Money market funds	136,079	97,507
Total cash and cash equivalents	$221,325	$179,702

Our short-term and long-term investments as of March 31, 2013 and December 31, 2012 consisted primarily of available-for-sale securities, such as corporate bonds, municipal bonds and commercial paper. The following table summarizes our short-term and long-term available-for-sale securities as of March 31, 2013 and December 31, 2012:

	March 31, 2013				December 31, 2012			
(in thousands)	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Short-term investments:								
Available-for-sale securities:								
Corporate bonds	$22,706	$60	$(1)	$22,765	$22,206	$16	$(14)	$22,208
Municipal bonds	10,185	4	—	10,189	11,604	—	(3)	11,601
Commercial paper	11,484	—	—	11,484	15,465	2	—	15,467
Total short-term investments	$44,375	$64	$(1)	$44,438	$49,275	$18	$(17)	$49,276
Long-term investments:								
Available-for-sale securities:								
Corporate bonds	$7,131	$30	$—	$7,161	$11,704	$35	$(10)	$11,729
Municipal bonds	1,070	1	—	1,071	1,095	—	(1)	1,094
Total long-term investments	$8,201	$31	$—	$8,232	$12,799	$35	$(11)	$12,823

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The following table summarizes the fair value of our available-for-sale securities with unrealized losses aggregated by type of investment instrument and length of time those securities have been in a continuous unrealized loss position:

	Less Than 12 Months		12 Months or Greater		Total	
(in thousands)	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
As of March 31, 2013						
Corporate bonds	$3,562	$(1)	$—	$—	$3,562	$(1)
	$3,562	$(1)	$—	$—	$3,562	$(1)

	Less Than 12 Months		12 Months or Greater		Total	
(in thousands)	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
As of December 31, 2012						
Corporate bonds	$20,167	$(24)	$—	$—	$20,167	$(24)
Municipal bonds	12,695	(4)	—	—	12,695	(4)
	$32,862	$(28)	$—	$—	$32,862	$(28)

The following table summarizes the contractual underlying maturities of our available-for-sale securities as of March 31, 2013:

(in thousands)	Cost	Fair Value
Due in one year or less	$44,375	$44,438
Due after one year through five years	8,201	8,232
	$52,576	$52,670

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3. Fair Value Measurements

The following table summarizes the fair value of our financial assets and liabilities that were measured on a recurring basis as of March 31, 2013 and December 31, 2012:

(in thousands)	Fair Value Measurements at March 31, 2013 Using				Fair Value Measurements at December 31, 2012 Using			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Assets:								
Cash equivalents:								
Money market funds	$136,079	$—	$—	$136,079	$97,507	$—	$—	$97,507
Total cash equivalents	136,079	—	—	136,079	97,507	—	—	97,507
Short-term investments:								
Corporate bonds	—	22,765	—	22,765	—	22,208	—	22,208
Municipal bonds	—	10,189	—	10,189	—	11,601	—	11,601
Commercial paper	—	11,484	—	11,484	—	15,467	—	15,467
Total short-term investments	—	44,438	—	44,438	—	49,276	—	49,276
Long-term investments:								
Corporate bonds	—	7,161	—	7,161	—	11,729	—	11,729
Municipal bonds	—	1,071	—	1,071	—	1,094	—	1,094
Total long-term investments	—	8,232	—	8,232	—	12,823	—	12,823
Total assets	$136,079	$52,670	$—	$188,749	$97,507	$62,099	$—	$159,606
Liabilities:								
Accrued earnout	$—	$—	$123	$123	$—	$—	$121	$121
Total liabilities	$—	$—	$123	$123	$—	$—	$121	$121

Contingent Consideration

A reconciliation of the beginning and ending balances of acquisition related accrued earnouts using significant unobservable inputs (Level 3) for the three months ended March 31, 2013 follows:

(in thousands)	
Accrued earnout liability as of December 31, 2012	$121
Acquisition date fair value of contingent consideration	—
Change in fair value of contingent consideration	2
Payment of contingent consideration	—
Accrued earnout liability as of March 31, 2013	$123

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The following table summarizes the quantitative information including the unobservable inputs related to our acquisition related accrued earnout as of March 31, 2013:

Quantitative Information about Level 3 Fair Value Measurements

(in thousands)	Fair Value at March 31, 2013	Valuation Technique	Unobservable Input	Range (Input Used)
Accrued earnout (1)	$123	Expected present value	Probability of achieving earnout objectives per the purchase agreement	0% - 100% (5%)
			Pre-tax cost of debt	4.8%

(1) Acquisition related contingent consideration of $2.5 million to be paid if new license sales during the one-year earnout measurement period equal or exceed the milestone specified in the purchase agreement.

At each reporting date, the contingent consideration liability is revalued to estimated fair value and changes in the estimates used to determine the probabilities could result in a change to the fair value measurement.

4. Derivative Instruments

As of March 31, 2013 and December 31, 2012, we did not have any forward contracts outstanding. The effect of derivative instruments not designated as hedging instruments in our condensed consolidated statements of income is summarized below:

(in thousands)	Gains (Losses) Recognized in Net Income on Derivatives		
	Location of Gain (Loss) Recognized in Net Income	Three months ended March 31,	
Derivatives not Designated as Hedging Instruments		2013	2012
Foreign exchange contracts	Other expense, net	$(140)	$103

5. Earnings Per Share

We computed basic earnings per share using the weighted-average number of our common shares outstanding during the reporting period. We adjusted diluted earnings per share for the after-tax impact of incremental shares that would be available for issuance upon the assumed exercise of stock options and vesting of restricted stock units using the treasury stock method.

A reconciliation of the number of shares in the calculation of basic and diluted earnings per share follows:

	Three months ended March 31,	
	2013	2012
(in thousands)		
Basic earnings per share		
Numerator:		
Net income	$22,999	$17,131
Denominator:		
Weighted-average common shares outstanding used in computing basic earnings per share	74,987	73,743
Diluted earnings per share		
Numerator:		
Net income	$22,999	$17,131
Denominator:		
Weighted-average shares used in computing basic earnings per share	74,987	73,743
Add options and restricted stock units to purchase common stock	1,685	1,697
Weighted-average shares used in computing diluted earnings per share	76,672	75,440

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Dilution from assumed exercises of stock options and vesting of restricted stock units is dependent upon several factors, including the market price of our common stock. The following stock-based incentive awards were outstanding but were not included in the computation of diluted earnings per share because the average market price of the underlying stock did not exceed the sum of the exercise price, unrecognized compensation expense and the excess tax benefit and thus the results would have been antidilutive:

	Three months ended March 31,	
(in thousands)	2013	2012
Antidilutive shares	536	739

The calculation of diluted earnings per share requires us to make certain assumptions related to the use of proceeds that would be received upon the assumed exercise of stock options and vesting of restricted stock units. These assumed proceeds include the excess tax benefit that we receive upon assumed exercises of stock options and vesting of restricted stock units.

6. Income Taxes

For the three months ended March 31, 2013 and 2012, we recorded income tax expense of $6.3 million and $6.7 million, respectively, resulting in an effective tax rate of 21.5% and 28.0%, respectively. The decrease in the effective tax rate from March 31, 2012 to March 31, 2013 was primarily attributable to the availability of the U.S. research and experimentation tax credit, or R&E tax credit, which resulted in the entire 2012 R&E tax credit of $1.3 million being recognized discretely this quarter, as well as an increase in international earnings, which are generally taxed at lower tax rates. On January 2, 2013, the American Taxpayer Relief Act of 2012 was enacted which retroactively reinstated and extended the Federal R&E tax credit from January 1, 2012 to December 31, 2013.

We recognize interest and penalties related to unrecognized tax benefits in the provision for income taxes. In the three months ended March 31, 2013 and 2012, interest and penalties recorded were not significant. As of