

PROS Holdings, Inc.  
Form 10-K  
March 09, 2010

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**  
**Washington, D.C. 20549**  
**Form 10-K**

(MARK ONE)

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

**For the year ended December 31, 2009**

**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**

**PROS HOLDINGS, INC.**

*(Exact name of registrant as specified in its charter)*

**Delaware**

*(State or other jurisdiction of incorporation or  
organization)*

**76-0168604**

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

**3100 Main Street, Suite 900**

**Houston, Texas**

*(Address of principal executive offices)*

**77002**

*(Zip code)*

**Registrant's telephone number, including area code:**

**(713) 335-5151**

**Securities Registered Pursuant to Section 12(b) of the Act:**

**Title of Each Class**

**Name of Each Exchange on Which Registered**

Common Stock, par value \$0.001 per share

New York Stock Exchange

**Securities Registered Pursuant to Section 12(g) of the Act:**

**None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes ☐ No ☒

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act.

Yes ☐ No ☒

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements

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incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, 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. (Check one):

Large accelerated filer ☐ Accelerated filer ☐ Non-accelerated filer ☐ Smaller reporting company ☐  
(Do not check if a 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 ☐ No ☐

The aggregate market value of voting and non-voting common equity held by non-affiliates of the registrant was approximately \$155,214,758 as of June 30, 2009 based upon the closing sale price of the common stock on the New York Stock Exchange reported such date. Shares of common stock held by each officer and director and by each person who owns 5% or more of the outstanding Common Stock have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status was based on publicly filed documents and is not necessarily a conclusive determination for other purposes.

As of March 3, 2010, there were outstanding 25,886,928 shares of common stock, par value \$0.001, of the registrant.

**DOCUMENTS INCORPORATED BY REFERENCE:**

Portions of the registrant's Proxy Statement relating to its 2010 Annual Stockholders Meeting, to be filed subsequently are incorporated by reference into Part III.

**PROS Holdings, Inc.**  
**Annual Report on Form 10-K**  
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**SIGNIFICANT RELATIONSHIPS REFERENCED IN THIS ANNUAL REPORT**

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

**CAUTIONARY STATEMENT REGARDING FORWARD LOOKING STATEMENTS**

This Annual Report on Form 10-K contains certain statements that may be deemed to be forward-looking statements that anticipate results based on our estimates, assumptions and plans that are subject to uncertainty. These statements are made subject to the safe-harbor provisions of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. All statements in this report not dealing with historical results or current facts are forward-looking and are based on estimates, assumptions and projections. Statements which include the words believes, seeks, expects, may, should, intend, likely, targets, plans, anticipates, estimates, or the negative version of those words and similar statements of future forward-looking nature identify forward-looking statements.

Numerous important factors, risks and uncertainties affect our operating results, including, without limitation, those contained in this Report, and could cause our actual results to differ materially, from the results implied by these or any other forward-looking statements made by us or on our behalf. There can be no assurance that future results will meet expectations. You should pay particular attention to the important risk factors and cautionary statements described in the section of this Report entitled Risk Factors. You should also carefully review the cautionary statements described in the other documents we file from time to time with the Securities and Exchange Commission, or SEC, specifically all Quarterly Reports on Form 10-Q and Current Reports on Form 8-K. Information contained on our website is not part of this report.

**Part I**

**Item 1. *Business***  
**Overview**

We are a leading provider of pricing and margin optimization software, an emerging category of enterprise applications designed to allow companies to improve financial performance by implementing pricing excellence best practices through the use of our software products. We were founded in 1985 and initially focused our efforts on providing complex, science-based revenue management solutions to the global airline industry. In 1999, we began to consider ways to diversify our product offering to include a broader suite of pricing and margin optimization functionality. We expanded our focus beyond the airline industry to include other industries that we believed to have similar pricing challenges and a need for advanced pricing and margin optimization solutions. In July 2007, we completed our initial public offering, or IPO, of our common stock in which we sold and issued 5,118,750 shares of common stock and selling stockholders sold an additional 1,706,250 shares of common stock. In addition, in December 2007, we completed a follow on offering of 5,000,000 shares of our common stock in which we sold and issued 65,000 shares of common stock and selling stockholders sold an additional 4,935,000 shares of common stock.

By using our software products, our customers gain insight into their pricing strategies, identify detrimental pricing practices, scientifically segment their customers and markets to optimize their pricing decision-making and improve their business processes and financial performance. Our software products incorporate advanced pricing science, which includes operations research, forecasting and statistics. Our innovative science-based software products analyze, execute and optimize pricing strategies using data from traditional enterprise applications, often augmenting it with real-time and historical data. Our software also uses data elements that are determined using advanced pricing science and are stored in our database. Our high performance software architecture supports real-time high volume transaction processing and allows us to handle the processing and database requirements of the most sophisticated and largest customers, including customers with hundreds of simultaneous users and sub-second electronic transactions. We provide professional services to configure our software products to meet the specific pricing needs of each customer. Our Pricing Solution Suite product has a single code base and a single integrated database.

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Many of our customers process large volumes of individually priced business-to-consumer and business-to-business transactions every day. Our high-performance, real-time, dynamic pricing products differ from static retail pricing products by delivering the relevant pricing information at the time the price is quoted, the deal is negotiated and the sale transaction is made. Our software products are also used to provide optimized price lists and goal-driven price guidance. While companies in our target industries differ in the wide range of business-to-business and business-to-customer products and services that they provide, many are similar in their need to optimally and dynamically price each individual transaction. We have installed over 200 solutions for over 100 customers across a range of industries in more than 40 countries.

### **Industry background**

Pricing is an important component of an enterprise's business processes and financial performance. Companies in the manufacturing, distribution, services, hotel and cruise, and airline industries can face a variety of pricing problems such as unnecessary discounting and quoting prices below breakeven. We believe that improving pricing is one of the most strategic and powerful ways for companies to improve their business and financial performance.

A variety of trends are accelerating the need for better pricing. They include increasingly complex markets and business models as is evidenced through uncertain demand for products and services and volatile costs, greater sophistication of purchasers, proliferation of pricing entities and competitive alternatives, growing quantities of enterprise data and diminishing returns from traditional enterprise applications. One element contributing to pricing problems is the limited visibility into effective prices and margins at the time of quote. After accounting for discounts, promotions, rebates and allowances, a transaction's profitability is significantly impacted. In addition, a lack of uniform pricing and goals, an unscientific, ad-hoc approach to pricing and a lack of complete, relevant and timely data further add to the pricing problems that we believe most companies in our target industries face. We believe most companies in our target industries have yet to develop or systematically implement pricing technology solutions that can best meet business goals and generate optimal prices.

We believe the market for pricing and margin optimization software is a large and rapidly growing opportunity that spans most major industries. We are a leading provider of pricing and revenue optimization solutions and we implement and support our products on a global basis across multiple industries and in complex and changing information technology and business environments.

### **Our solution**

Our software solutions are not like enterprise resource planning, or ERP, supply chain management, or SCM, and customer relationship management, or CRM, which automate a paper-intensive process or a people-intensive process. The goal of a pricing and margin optimization software implementation for analytics, execution, or optimization is to improve pricing processes in an effort to achieve pricing excellence. Our software products currently operate in some of the largest, most complex and demanding information technology environments.

Our PROS Pricing Solution Suite is our set of integrated software products that enable enterprises in the manufacturing, distribution, services, hotel and cruise, and airline industries to apply pricing science to determine, analyze and execute optimal pricing strategies. Our software products support pricing decisions through the aggregation and analysis of extensive enterprise application data, transactional data and market information. Our software also uses data elements that are determined using advanced pricing science and are stored in our database. Our high performance software architecture supports real-time high volume transaction processing and allows us to handle the processing and database requirements of the most sophisticated and largest customers, including customers with hundreds of simultaneous users and sub-second electronic transactions. We provide professional services to configure our software products to meet the specific pricing needs of each customer. Our software products have a single code base and a single integrated database.

Our PROS Pricing Solution Suite provides science-based software solutions that address three areas necessary to implement and execute an effective pricing solution:

*Scientific analytics.* Our scientific analytics software product provides dynamic visibility into pricing data and performance across pricing the different segments of a business including markets, customers, products, distribution channels, divisions, etc. These analytics help companies understand the pocket margin and its components and locate detrimental pricing trends and underperforming segments of their businesses that

might otherwise be hard to identify.

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*Pricing execution.* Our pricing execution software products (deal optimizer and price optimizer) help companies set and implement pricing policies throughout an enterprise and improve execution through pricing decision and negotiation support. Our software products give our customers the ability to propagate pricing decisions to users or to another enterprise application, such as a CRM or ERP application. Our execution software products allow our customers to strategically manage a large number of prices, which helps to institutionalize pricing best practices and enforce compliance with pricing policies.

*Pricing optimization.* Our pricing optimization software products provide companies with pricing-related predictive analytics in the form of science-based price guidance in order to offer frontline sales representatives easy-to-use guidelines that help them in quoting a profitable price and to optimize their pricing decision-making. Using market and company data, our optimization software products enable our customers to forecast and determine an optimal price within a given set of objectives, such as maximizing market share, revenue or profit.

## **Products**

Our software products help our customers improve their business and financial performance through several key benefits, which include:

*Science-based approach to pricing.* Our software products enable our customers to apply advanced pricing science to identify and address their unique and complex pricing challenges. Our software products include a variety of advanced pricing analytics and forecasting and optimization engines that incorporate our pricing expertise and support real-time, high volume, individually priced transactions with accurate pricing information.

*Improved business insight.* Our software products enable our customers to gain insight into their business strategy, segment and product profitability and pricing challenges. As a result, our customers can identify and characterize the relative attractiveness of products, customers, geographies and even individual transactions based on sales volume and overall profitability.

*Enhanced planning and decision making.* Our software products enhance our customers' ability to process and implement pricing policies in a systematic manner. As a result, they are able to pursue more sophisticated and effective pricing strategies and make more informed pricing decisions. Additionally, our software products help companies implement best practices uniformly throughout an enterprise, from sales to marketing to finance.

Our PROS Pricing Solution Suite consists of our scientific pricing analytics, pricing execution and pricing optimization software products. The design of our PROS Pricing Solution Suite allows our customers to deploy all of the products at once or to implement our products incrementally. Our scientific analytics software product is the base product that is present in all implementations. Our pricing execution products, price optimizer and deal optimizer, extend the usability of the base analytics product and provide real-time transaction level optimized prices by customer and product. Our pricing optimization products help companies arrive at an optimal price by analyzing the relationships among demand, price and profit margin to provide pricing-related predictive analytics in the form of science-based price guidance in order to offer frontline sales representatives easy-to-use guidelines that help them in quoting a profitable price and to optimize their pricing decision-making. The scientifically determined price guidance can be integrated with existing sales force tools or delivered through the PROS software user interface. By deploying multiple products, our customers can analyze their pricing trends, execute consistent pricing policies, effectively negotiate prices and optimize their prices to support organizational goals.



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Our PROS Pricing Solution Suite uses our PROS database, which includes pricing data elements determined using advanced pricing science, including the pocket price, pocket margin, customer willingness-to-pay, customer cost-to-serve, win-loss ratios, market price, stretch price and other relevant information. Data sources also include our customers' enterprise applications and external market data sources. Our PROS database uses our internally developed data loaders to import data from these data sources for access by our PROS Pricing Solution Suite. The users of our PROS Pricing Solution Suite include executives, sales and marketing personnel, pricing managers and finance personnel. Significant value is realized by our customers early in the implementation cycle and the return on investment increases with time.

Hundreds of man-years of development and science effort are contained in one common set of code, which we believe allows us to configure our software products to meet each of our customers' unique requirements and enables us to effectively support a global customer base. The PROS configurator allows the PROS Pricing Solution Suite to be configured to meet the specific needs of each customer without writing any customer-specific code. The configuration capabilities include defining business rules, user workflows, executive dashboards, analytic views, approval processes, alerts and data, including hierarchical dimensions and measures.

***Scientific analytics***

Our scientific analytics software product helps companies gain insight into their pricing performance, allowing them to take action to correct poor performance and take advantage of time-sensitive opportunities. Our scientific analytics software product enables our customers to:

- determine pocket price and pocket margins by discrete metrics, such as by customer, product, channel, plant, sales territory and country;

- understand how various price and cost elements contribute to the pocket margin;

- identify and understand detrimental pricing trends;

- understand the components of margin variance, including price, cost, volume, product mix and exchange rate effects;

- understand differences in segment purchasing behavior;

- proactively monitor pricing performance and market conditions; and

- determine how individual customers contribute to overall revenue and profitability.

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### ***Pricing execution***

Our pricing execution software products consist of the price optimizer and deal optimizer products.

***Price Optimizer.*** Our price optimizer product allows companies to streamline pricing processes and institute control of pricing policies to support corporate business goals. It allows organizations to create multiple rules-based price lists and quickly modify prices or guidelines in response to changes in business conditions or strategy. Our price optimizer product enables our customers to:

- create and manage pricing policies and rules that are aligned with corporate strategies;

- automatically generate mass price updates when pricing inputs change, including costs, competitor prices, market indices, supply availability or demand metrics;

- set up and manage field pricing and discounting guidelines based on pricing policies and benchmarks; and

- manage pricing approval and exception thresholds and the pricing approval workflow to ensure consistency in the pricing process and maintain transaction histories.

***Deal Optimizer.*** Our deal optimizer product provides a sales force with the guidelines, additional context and information to negotiate better prices over the entire deal horizon. Specifically, the deal optimizer product enables our customers to:

- more accurately understand transaction economics including the impact of discounts, rebates, allowances, shipping terms, payment terms, replacement costs and other factors that can influence the profitability of a transaction;

- communicate price targets, price floors and profitability guidelines to appropriate decision-makers within an organization;

- consider important transaction context to aid in better price negotiations, including insight into customer price history and willingness-to-pay, current and planned inventory levels and recent trends in demand, supply, cost or competition; and

- evaluate transaction scenarios and allow comparisons to previous transactions and peer group benchmarks based on relevant metrics.

### ***Pricing optimization***

Our pricing optimization software products help companies arrive at an optimal price by analyzing the relationships among demand, price and profit margin taking into account operational and financial constraints. Our pricing optimization software products use advanced statistical techniques to determine optimal prices consistent with pricing strategies to provide pricing-related predictive analytics in the form of science-based price guidance. This guidance can be offered frontline sales representatives as easy-to-use guidelines that help them in quoting a profitable price and to optimize their pricing decision. These products utilize optimization and forecasting engines to solve many distinct pricing problems. Our pricing optimization software products enable our customers to:

- analyze and understand factors that influence demand in conjunction with price;

- understand customer or segment price elasticities and customer indifferences which supports the ability to cluster customers into segments based on purchasing behavior;

- construct and execute price testing to systematically manage and evaluate results of price changes;

- forecast demand and response to demand using a library of forecasting algorithms that support a vast number of business scenarios and that consider relevant variables; and

run optimization algorithms and apply appropriate methodology to recommend optimized prices or other business controls.

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### **Technology**

**Software architecture.** Our software architecture is based on open standards such as Java, XML and HTTP. We have created a component-based design in a service-oriented architecture to develop a flexible, layered framework. This framework supports evolution and innovation in technologies and product features.

**Optimization.** We have developed robust science-based forecasting and optimization engines, leveraging the deep expertise and research of our science and research group. These engines are industry-independent and are validated using our internally-developed verification and testing processes.

**Configuration vs. customization.** Rather than developing custom code for each customer, our PROS Pricing Solution Suite can be configured to meet each customer's business needs. The configuration capabilities include defining user workflows, executive dashboards, analytic views, approval processes, alerts and configuring data, including hierarchical dimensions and measures.

**Performance and scalability.** Our solutions operate in some of the largest and most demanding enterprise environments. The scalability of our technology has been tested at leading vendor benchmark performance centers, which validated the ability of our software products to scale to large data volumes and high request rates. For example, in one implementation of our real-time pricing execution product, our software products handled over 300 requests per second with 250 millisecond average response times. Another implementation of our pricing execution product handles 750 concurrent users. Also, an implementation of our pricing optimization product refreshes and maintains a data set with over one billion forecast entries and 150 million optimization results.

**Data integration.** The data needed to execute pricing and margin optimization functionality typically resides in a company's ERP, SCM and CRM systems, industry-specific transaction systems, office productivity tools such as spreadsheets and external market data sources. Rarely can the data needed to formulate and execute optimal pricing strategies be found in a single data source within a company. Our data integration capabilities utilize web services and file-based data interfacing to bring data from these disparate sources together into a single cohesive database to support our PROS Pricing Solution Suite. Our data integration capabilities allow us to quickly deploy our solutions to our customers.

**User interface.** Our technology provides a rich, browser-based interface that supports local and remote users. The user interface supports a wide variety of highly interactive charts and other data views and provides a comprehensive data security model based on user roles and scope of responsibility.

**Platform support.** Our software products run on most standard information technology platforms including Microsoft SQL Server and Oracle databases, 32-bit and 64-bit processors from HP, SUN, Intel, AMD and IBM, and the HP-UX, Solaris, Linux, Windows and AIX operating systems.

### **Science and research**

We believe that our long-term investment in pricing science differentiates us from our competitors. We are committed to developing high value science-based pricing and margin optimization software products as is evident by our continued investment in research and development. Research and development spending was 29% of total revenue for the year ended December 31, 2009.

We employ scientists, many of which are PhDs, and all of whom are engaged to the advancement of pricing and margin optimization technology and its implementation in our software products. These scientists have specialties including but not limited to operations research, management science, statistics, econometrics and computational methods. Our scientists regularly interact with our customers, and our product development, sales and marketing, and professional services staff, to keep our science efforts relevant to real-world demands.

### **Services**

#### ***Pricing and implementation professional services***

Our software product implementations are different from most IT projects. We have developed a standardized and tested implementation process and have experience implementing our software products in global enterprises across multiple industries. We have implemented over 200 solutions across a range of industries in more than 40 countries.

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Our pricing services personnel are responsible for planning the implementations of our software products and they accelerate time to value realization for our customers by starting with industry based pricing best practices already embedded in our products. Our pricing professional services include analyzing a customer's current pricing processes, identifying specific high-value pricing needs and relevant pricing data and initial configuration of our software products to meet the requirements of the customer's specific business. Our implementation services personnel are responsible for the configuration and the technical deployment of our software products. Our implementation professional services include implementing our software products to configuration specifications, assisting customers in loading and validating pricing data and supporting organizational activities to assist our customers' transition from awareness of their pricing challenges to adoption of pricing excellence best practices.

### ***Customer support***

After our software products are installed and training is complete, our customer support personnel provide ongoing support and maintenance of our software products. Our customer support personnel are responsible for providing product support for our customers through our SupportWeb Portal, a web-based interface for submitting and tracking issues, distributing software releases and bug fixes and hosting our knowledge base. In addition, our customer support personnel respond to customer issues promptly using an escalation process that prioritizes reported issues based on a defined set of severity levels and assist customers in deploying our standard releases for each software product by providing release web seminars and documentation.

### **Customers**

We provide our software products to customers in the manufacturing, distribution, services, hotel and cruise, and airline industries. Our customers are generally large global enterprises, although we have customers that are smaller in scope of operations. Approximately 59%, 54%, and 63% of our total revenue came from customers outside the United States for the years ended December 31, 2009, 2008 and 2007, respectively. Our business, financial condition and results of operations could be adversely impacted by currency fluctuations or regulatory, political, social and economic developments or instability in the foreign jurisdiction in which we operate. For additional geographic information with respect to our customers, see Note 11 of the Notes to the Consolidated Financial Statements. In 2009, 2008 and 2007, we had no single customer that accounted for 10% or more of revenue.

### **Backlog**

Our backlog is derived from agreements that we believe to be firm commitments to provide software products and related implementation and maintenance services in the future. Our backlog varies significantly period to period depending on a number of factors including the timing of our sales and the nature of the agreements we enter into with our customers. We do not recognize license and implementation revenue upon signing a new contract with a customer; and we do not seek to accelerate our sales processes around any reporting period.

Our backlog is also significantly based on estimates and judgments that we make regarding total contract values, requisite man-days to complete engagements and the value and number of man-days worked or expected to be worked in any particular period. For example, we could have agreements that include refund, delay or termination for convenience provisions, and we exercise judgment over the extent to which, if any, to include these agreements in our backlog. However, based on our history of successfully implementing our software products and we generally include the full estimated value of these agreements in backlog.

We make significant estimates and judgments regarding maintenance renewals and changes to existing maintenance agreements. Backlog includes committed maintenance amounts and amounts payable to us under maintenance agreements that we reasonably expect to renew. For example, we include annualized monthly maintenance revenue reduced by our historical average maintenance non-renewal rate in backlog.

We compute our backlog as of a specific date, and we update our backlog to reflect changes in our estimates and judgments or subsequent additions, delays, terminations or reductions in our agreements. We also have agreements denominated in foreign currencies, and variation in currency exchange rates can influence our calculation of backlog. We compute backlog using then-existing currency exchange rates and update backlog to reflect changes in these rates.

For these and other reasons, we do not believe that backlog is a meaningful indicator of future revenue to be recognized in any particular period, and there can be no assurance that our backlog at any point in time will translate

into revenue in any subsequent period.

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We had backlog of \$84.3 million as of December 31, 2009 as compared to backlog of \$83.6 million as of December 31, 2008. The portion of our backlog as of December 31, 2009 not reasonably expected to be recognized as revenue within the next twelve months is estimated to be \$33.0 million.

### **Sales and marketing**

We sell and market our software products primarily through our direct sales force from our headquarters in Houston, Texas. Our sales force is organized by our target markets of manufacturing, distribution, services, hotel and cruise, and airline and is responsible for the worldwide sale of our products to new customers. Our sales force works in concert with our pricing solutions personnel for selling and product demonstrations to new customers. Sales to our existing customers are generally the responsibility of our pricing professional services personnel.

Our marketing activities consist of a variety of programs designed to generate sales leads and build awareness of PROS and our pricing and margin optimization software products. We host conferences for pricing and margin optimization professionals, host informational web seminars and we participate in and sponsor other industry conferences and organizations.

### **Competition**

The market for price and margin optimization solutions is competitive, fragmented and rapidly evolving. We believe the following factors are the principal basis of competition in the pricing and margin optimization software market:

- ability to offer integrated high-value solutions;
- pricing focus and domain expertise;
- organizational change management expertise;
- product architecture, functionality, performance, reliability and scalability;
- breadth and depth of product offerings;
- time to value for the customer;
- services organization and customer support;
- existing enterprise relationships;
- large and referenceable customer base;
- vendor viability; and
- price.

We compete with a number of larger and smaller companies and in the future we expect competition will increase as companies come into this market segment. We believe we are able to compete successfully with these vendors due to our long history of providing pricing and margin optimization software products, the scope of our offerings and the flexibility and scalability of our architecture.

There are also several large enterprise application providers, such as JDA Software, Oracle and SAP that have developed offerings that include pricing and margin optimization functionality. JDA Software and Oracle entered the market primarily through their acquisitions of Manugistics and Siebel Systems, respectively, and SAP resells Vendavo's products. We believe these vendors do not provide all of the pricing and margin optimization functionality needed to support a pricing excellence-focused organization. These vendors may seek to compete on price and by bundling their pricing and margin optimization applications with other enterprise applications. We distinguish ourselves from these vendors with the breadth and depth of the functionality of our products and providing high-value

pricing and margin optimization software to a global customer base in multiple industries.

In addition, there are a number of vendors that provide pricing and margin optimization software for specific industries. In the hotel industry, we compete with IDEaS and Easy RMS, and in the airline industry, we



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compete with Sabre Airline Solutions and Lufthansa Systems. One industry in which we do not compete is retail, where vendors include DemandTec, JDA Software, Oracle and SAP. Oracle and SAP entered this retail market through their acquisitions of ProfitLogic and Khimetrics, respectively.

Our products also compete with solutions developed internally by businesses. These businesses rely upon a combination of manual processes, external consultants, spreadsheets or internally developed software tools to conduct pricing activities.

### **Intellectual property**

Our success and ability to compete is dependent in part on our ability to develop and maintain the proprietary aspects of our technology and operate without infringing upon the proprietary rights of others. We rely primarily on a combination of patents, copyright, trade secret, confidentiality procedures, contractual provisions and other similar measures to protect our proprietary information. As of the date of this filing, we also have 3 issued U.S. patents and 6 pending U.S. patent applications. We have not pursued patent protection in any foreign countries. Due to the rapidly changing nature of applicable technologies, we believe that the improvement of existing products, reliance upon trade secrets and unpatented proprietary know-how and development of new products are generally more advantageous than patent and trademark protection.

### **Research and development**

Our research and development program involves enhancing existing products to add new functionality and creating new products to meet other market demands. Our research and development expenses include costs associated with our product management, product development and science and research groups. Our research and development expenses were \$20.1 million, \$20.3 million and \$16.8 million for the years ended December 31, 2009, 2008 and 2007, respectively.

### **Employees**

As of December 31, 2009, we had 400 full-time personnel which include 354 employees and 46 independent contractors. None of our employees are represented by a labor union or covered by a collective bargaining agreement. We have not experienced any work stoppages and consider our employee relations to be good. We expect that our continued success will depend in part on our ability to attract and retain highly skilled technical, sales, marketing and management personnel.

### **Where you can find additional information**

Our website address is [www.prospricing.com](http://www.prospricing.com). We make available free of charge through our website our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and all amendments to those reports as soon as reasonably practicable after such material is electronically filed with or furnished to the SEC. In addition, you may read and copy all or any portion of the registration statement or any reports, statements or other information in the files at the public reference room of the SEC located at 100 F Street, N.E., Washington, D.C. 20549. You can request copies of these documents upon payment of a duplicating fee by writing to the SEC. You may call the SEC at 1-800-SEC-0330 for further information on the operation of its public reference room. Our filings, including our registration statement, will also be available to you on the web site maintained by the SEC at <http://www.sec.gov>. No information on our website is incorporated by reference herein.

### **Annual CEO Certification**

Pursuant to Section 303A.12(a) of the New York Stock Exchange Listed Company Manual, we submitted to the New York Stock Exchange an annual certification signed by our Chief Executive Officer certifying that he was not aware of any violation by us of New York Stock Exchange corporate governance listing standards on June 5, 2009.

### **Item 1A. Risk factors**

We operate in a dynamic environment that involves numerous risks and uncertainties. The following section describes some of the risks that may adversely affect our business, financial condition or results of operations; these are not necessarily listed in terms of their importance or level of risk.

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**Risks relating to our business and industry:**

***The continued deterioration of general U. S. and global economic conditions could adversely affect our sales and operating results.***

We are a global company with customers around the world. As widely reported, global financial markets have experienced extreme disruption, including, among other things, extreme volatility in security prices, limited ability to raise capital in public and private financial markets, severely diminished liquidity, credit unavailability and company rating downgrades. These conditions have a negative impact on our prospects' and customers' ability to raise capital and operate their businesses.

The implementation of our software products, which is often accompanied by third party hardware purchases and other capital commitments, involves significant capital expenditure by our customers. Customers may reduce or defer their spending on technology. In addition, the weak and uncertain U.S. and global economic conditions could impair our customers' ability to pay for our products or services. Any of these factors could delay our revenue recognition or otherwise adversely impact our business, quarterly or annual operating results and financial condition.

Periodic fluctuations in the U.S. Dollar and other currencies, corporate profits, lower spending, the availability of credit, the impact of conflicts throughout the world, terrorist acts, natural disasters, volatile energy costs, the outbreak of diseases and other geopolitical factors have had, and may continue to have, a negative impact on the U.S. and global economies. Our customers and prospects may experience consolidation or bankruptcies in their industries which may result in project delays or cancellations. We are unable to predict the strength or duration of current market conditions or effects of consolidation. Uncertainties in anticipated spending levels or further consolidation may adversely affect our business, financial condition and results of operations.

***A significant or prolonged economic downturn in industries in which we focus, may result in our customers or prospects reducing or postponing spending on the products we offer.***

There are a number of factors, other than our performance, that could affect the size, frequency and renewal rates of our customer contracts. For instance, if economic conditions weaken in any industry in which we focus, our customers or prospects may reduce or postpone their spending significantly which may, in turn, lower the demand for our products and negatively affect our revenue and profitability. As a way of dealing with a challenging economic environment, customers may change their purchasing strategy, including increased negotiation of price or deciding to license one product rather than multiple products. Customers could also terminate or delay their implementations or maintenance contracts. The loss of, or any significant decline in business from, one or more of our customers likely would lead to a significant decline in our revenue and operating margins, particularly if we are unable to make corresponding reductions in our expenses in the event of any such loss or decline. Moreover, a significant change in the liquidity or financial position of any of these customers could have a material adverse effect on the collectability of our accounts receivable, liquidity, customers' ability to complete implementation and future operating results.

***A weakening economy and changing business conditions could result in substantial defaults or slowing of payments by our customers on our accounts receivable which could have a significant negative impact on our business, results of operations, financial condition or liquidity.***

A significant portion of our working capital consists of accounts receivable from customers. If customers responsible for a significant amount of accounts receivable were to become insolvent or otherwise unable to pay for products and services, or were to become unwilling or unable to make payments in a timely manner, our business, results of operations, financial condition or liquidity could be adversely affected.

***We focus exclusively on the pricing and revenue optimization software market, and if this market develops more slowly than we expect, our business will be harmed.***

We derive, and expect to continue to derive, all of our revenue from providing pricing and revenue optimization software products, implementation services and ongoing customer support. The pricing and revenue optimization software market is relatively new and still evolving, and it is uncertain whether this software will achieve and sustain high levels of demand and market acceptance. Our success will depend on the willingness of businesses in the manufacturing, distribution, services, hotel and cruise, and airline industries to implement pricing and revenue optimization software.



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Some businesses may be reluctant or unwilling to implement pricing and revenue optimization software for a number of reasons, including failure to understand the potential returns of improving their pricing processes and lack of knowledge about the potential benefits that such software may provide. Even if businesses recognize the need for improved pricing processes, they may not select our pricing and revenue optimization software products because they previously have made investments in internally developed pricing and revenue optimization solutions. Some businesses may elect to improve their pricing processes through solutions obtained from their existing enterprise software providers, whose solutions are designed principally to address one or more functional areas other than pricing. These enterprise solutions may appeal to customers that wish to limit the number of software vendors on which they rely and the number of different types of solutions used to run their businesses.

If businesses do not embrace the benefits of pricing and revenue optimization software, the pricing and revenue optimization software market may not continue to develop or may develop more slowly than we expect, either of which would significantly and adversely affect our revenue and operating results. Because the pricing and revenue optimization software market is developing and the manner of its development is difficult to predict, we may make errors in predicting and reacting to relevant business trends, which could harm our operating results.

***Any downturn in sales to our target markets of manufacturing, distribution, services, hotel and cruise, and airline would adversely affect our operating results.***

Our success is highly dependent upon our ability to sell our software products to customers in the manufacturing, distribution, services, hotel and cruise, and airline industries. If we are unable to market and sell our software products effectively to customers in these industries, we may not be able to grow our business. It is uncertain whether our software products will achieve and sustain the levels of demand and market acceptance that we anticipate. Such uncertainty is attributable to, among other factors, the following:

- the possibility that it may be more difficult than we currently anticipate to implement our software products in our target industries;

- the possibility that it may be more difficult than we currently anticipate to increase our customer base in our target industries;

- the possibility that it may take more time to train our personnel in the implementation of our software products in our target industries; and

- our limited experience implementing our software products in certain of our target industries.

Our revenue growth has been derived principally from customers in the manufacturing, distribution, services and hotel and cruise industries, where our products have recently begun to achieve market acceptance. Our revenue growth is highly dependent upon continued growth of market acceptance in all of these industries, and there is no assurance our products will achieve or sustain widespread acceptance among these potential customers. Failure to expand market acceptance of our products in the manufacturing, distribution, services and hotel and cruise industries or to maintain sales in the airline industry would adversely affect our operating results and financial condition.

***Our software products require implementation projects that are subject to significant risks and delays, the materialization of which could negatively impact the effectiveness of our solutions, resulting in harm to our reputation, business and financial performance.***

The implementation of our software products can involve complex, large-scale projects that require substantial support operations, significant resources and reliance on certain factors that may not be under our control. For example, the success of our implementation projects is heavily dependent upon the quality of data used by our software products, the commitment of customers' resources and personnel to the projects and the stability, functionality and scalability of the customer's information technology infrastructure. If weaknesses or problems in infrastructure or data or our customers' commitment and investment in personnel and resources exist, we may not be able to correct or compensate for such weaknesses. In addition, implementation of our software products can be highly complex and require substantial efforts and cooperation on the part of our customers and us. If we are unable to successfully manage the implementation of our software products such that those products do not meet customer

needs or expectations, we may become involved in disputes with our customers and our business, reputation and financial performance may be significantly harmed. We recognize our license and implementation revenues as implementation services are performed. Any delays in an implementation project or changes in the scope or timing of an implementation project would delay or alter the corresponding revenue recognition and could adversely affect our operating results. If an implementation project for a large customer or a number of customers is substantially delayed or cancelled, our ability to recognize the associated revenue and our operating results would be adversely affected.

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***Competition from vendors of pricing solutions and enterprise applications as well as from companies internally developing their own solutions could adversely affect our ability to sell our software products and could result in pressure to price our software products in a manner that reduces our margins and harms our operating results.***

The pricing and revenue optimization software market is competitive, fragmented and rapidly evolving. Our software products compete with solutions developed internally by businesses as well as solutions offered by competitors. Our principal competition consists of:

pricing and revenue optimization software vendors, including a number of vendors that provide pricing and revenue optimization software for specific industries; and

large enterprise application providers that have developed offerings that include pricing and revenue optimization functionality.

We expect additional competition from other established and emerging companies to the extent the pricing and revenue optimization software market continues to develop and expand. We also expect competition to increase as a result of the entrance of new competitors in the market and industry consolidation, including through a merger or partnership of two or more of our competitors or the acquisition of a competitor by a larger company. A number of our current and potential competitors have larger installed bases of users, longer operating histories and greater name recognition than we have. In addition, many of these companies have significantly greater financial, technical, marketing, service and other resources than we have. As a result, these companies may be able to respond more quickly to new or emerging technologies and changes in customer demands and to devote greater resources to the development, promotion and sale of their products than we can.

Competition could seriously impede our ability to sell additional software products and related services on terms favorable to us. We do not know how our competition will set prices for their products during a period of economic downturn. Businesses may continue to enhance their internally developed solutions, rather than investing in commercially-available solutions such as ours. Our current and potential competitors may develop and market new technologies that render our existing or future products obsolete, unmarketable or less competitive. In addition, if these competitors develop products with similar or superior functionality to our products, or if they offer products with similar functionality at a substantially lower price than our products, we may need to decrease the prices for our products in order to remain competitive. If we are unable to maintain our current product, services and maintenance pricing due to competitive pressures, our margins will be reduced and our operating results will be adversely affected. We cannot assure you that we will be able to compete successfully against current or future competitors or that competitive pressures will not materially and adversely affect our business, financial condition and operating results.

***We are subject to a lengthy sales cycle and delays or failures to complete sales may harm our business and cause our revenue and operating income to decline in the future.***

Our sales cycle may take several months to over a year. To sell our products successfully and obtain an executed contract, we generally have to educate our potential customers about the use and benefits of our products, which can require significant time, expense and capital without the ability to realize any revenue. During this sales cycle, we may expend substantial resources with no assurance that a sale will ultimately result. The length of a customer's sales cycle depends on a number of factors, many of which we may not be able to control. These factors include the customer's product and technical requirements and the level of competition we face for that customer's business. Any unexpected lengthening of the sales cycle would negatively affect the timing of our revenue, and hinder our revenue growth. Furthermore, a delay in our ability to obtain a signed agreement or other persuasive evidence of an arrangement or to complete certain contract requirements in a particular quarter could reduce our revenue in that quarter. Overall, any significant failure to generate revenue or delays in recognizing revenue after incurring costs related to our sales or services process could have a material adverse effect on our business, financial condition and results of operations.

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***Our revenue recognition is primarily based upon our ability to estimate the efforts required to complete our implementation projects, which may be difficult to estimate.***

We generally recognize revenue from our software licenses and implementation services over the period during which such services are performed using the percentage-of-completion method. The length of this period depends on the number of licensed software products and the scope and complexity of the customer's deployment requirements. Under the percentage-of-completion method, the revenue we recognize during a reporting period is based on the percentage of man-days incurred during the reporting period as compared to the estimated total man-days required to implement our software products. If we are unable to accurately estimate the overall total man-days required to implement our software products, such inaccuracies could have a material effect on the timing of our revenue. Any change in the timing of revenue recognition as a result of inaccurate estimates could adversely impact our quarterly or annual operating results.

***Failure to sustain our historical maintenance and support renewal rates and pricing would adversely affect our operating result.***

Maintenance and support agreements are typically for a term of one to two years. Historically, maintenance and support revenue has represented a significant portion of our total revenue, including approximately 36%, 29% and 30% of our total revenue for the years ended December 31, 2009, 2008 and 2007, respectively. If our customers choose not to renew their maintenance and support agreements with us on favorable terms or at all, our business, operating results and financial condition could be harmed.

***We might not generate increased business from our current customers, which could limit our revenue in the future.***

We sell our software products to both new customers and existing customers. Many of our existing customers initially purchase our software products for a specific business segment or a specific geographic location within their organization and later purchase additional software products for the same or other business segments and geographic locations within their organization. These customers might not choose to make additional purchases of our software products or to expand their existing software products to other business segments. In addition, as we deploy new applications and features for our software products or introduce new software products, our current customers could choose not to purchase these new offerings. If we fail to generate additional business from our existing customers, our revenue could grow at a slower rate or even decrease.

***If our cost estimates for fixed-fee arrangements do not accurately anticipate the cost and complexity of implementing our software products, our profitability could be reduced and we could experience losses on these arrangements.***

The majority of our license and implementation arrangements are priced on a fixed-fee basis. If we underestimate the amount of effort required to implement our software products, our profitability could be reduced. Moreover, if the actual costs of completing the implementation exceed the agreed upon fixed price, we would incur a loss on the arrangement.

***Our revenue recognition policy may cause any decreases in sales not to be reflected in our revenue immediately.***

The period over which we recognize license and implementation revenue for an implementation depends on the number of licensed software products and the scope and complexity of the customer's deployment requirements which may range from six months to several years. As a result, a significant majority of our revenue is recognized on arrangements that were executed in previous periods. Any shortfall in new sales of our software products may not be reflected in our revenue for several quarters, and as such the adverse impact on our business may not be readily apparent.

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***If we fail to develop or acquire new pricing and revenue optimization functionality to enhance our existing software products, we will not be able to grow our business and it could be harmed.***

The pricing and revenue optimization software market is characterized by:  
rapid technological developments;

newly emerging and changing customer requirements; and

frequent product introductions, updates and functional enhancements.

We must introduce new pricing and revenue optimization functionality that enhances our existing software products in order to meet our business plan, maintain or improve our competitive position, keep pace with technological developments, satisfy increasing customer requirements and increase awareness of pricing and revenue optimization software generally and of our software products in particular. Any new functionality we develop may not be introduced in a timely manner and may not achieve market acceptance sufficient to generate material revenue. Furthermore, we believe our competitors are heavily investing in research and development, and may develop and market new solutions that will compete with, and may reduce the demand for, our software products. We cannot assure you that we will be successful in developing or otherwise acquiring, marketing and licensing new functionality, or delivering updates and upgrades that meet changing industry standards and customer demands. In addition, we may experience difficulties that could delay or prevent the successful development, marketing and licensing of such functionality. If we are unable to develop or acquire new functionality, enhance our existing software products or adapt to changing industry requirements to meet market demand, we may not be able to grow our business and our revenue and operating results would be adversely affected.

In addition, because our software products are intended to operate on a variety of technology platforms, we must continue to modify and enhance our software products to keep pace with changes in these platforms. Any inability of our software products to operate effectively with existing or future platforms could reduce the demand for our software products, result in customer dissatisfaction and limit our revenue.

***Defects or errors in our software products could harm our reputation, impair our ability to sell our products and result in significant costs to us.***

Our pricing and revenue optimization software products are complex and may contain undetected defects or errors. Several of our products have recently been developed and may therefore be more likely to contain undetected defects or errors. In addition, we frequently develop enhancements to our software products that may contain defects. We have not suffered significant harm from any defects or errors to date, but we have found defects in our software products from time to time. We may discover additional defects in the future, and such defects could be material. We may not be able to detect and correct defects or errors before the final implementation of our software products. Consequently, we or our customers may discover defects or errors after our software products have been implemented. We have in the past issued, and may in the future need to issue, corrective releases of our products to correct defects or errors. The occurrence of any defects or errors could result in:

lost or delayed market acceptance and sales of our software products;

delays in payment to us by customers;

injury to our reputation;

diversion of our resources;

legal claims, including product liability claims, against us;

increased maintenance and support expenses; and

increased insurance costs.



Our license agreements with our customers typically contain provisions designed to limit our liability for defects and errors in our software products and damages relating to such defects and errors, but these provisions may not be enforced by a court or otherwise effectively protect us from legal claims. Our liability insurance may not be adequate to cover all of the costs resulting from these legal claims. Moreover, we cannot assure you that our current

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liability insurance coverage will continue to be available on acceptable terms. In addition, the insurer may deny coverage on any future claim. The successful assertion against us of one or more large claims that exceeds available insurance coverage, or the occurrence of changes in our insurance policies, including premium increases or the imposition of large deductible or co-insurance requirements, could have a material adverse effect on our business and operating results. Furthermore, even if we prevail in any litigation, we are likely to incur substantial costs and our management's attention will be diverted from our operations.

***If we fail to retain our key personnel or if we fail to attract additional qualified personnel, our operating results could be adversely affected.***

Our future success depends upon the continued service of our executive officers and other key sales, development, science and professional services staff. The loss of the services of our executive officers and other key personnel would harm our operations. In addition, our future success will depend in large part on our ability to attract and retain a sufficient number of highly qualified personnel, and there can be no assurance that we will be able to do so. In particular, given the highly sophisticated pricing science included in our products, the pool of scientists and software developers qualified to work on our products is limited. In addition, the implementation of our software products requires highly-qualified personnel, and hiring and retaining such personnel to support our growth may be challenging. Competition for such qualified personnel is intense, and we compete for these individuals with other companies that have greater financial, technical, marketing, service and other resources than we do. If we fail to retain our key personnel and attract new personnel, our operating results could be adversely affected.

***Intellectual property litigation and infringement claims may cause us to incur significant expense or prevent us from selling our software products.***

Our industry is characterized by the existence of a large number of patents, trademarks and copyrights, and by frequent litigation based on allegations of infringement or other violations of intellectual property rights. A third party may assert that our technology violates its intellectual property rights, or we may become the subject of a material intellectual property dispute. Pricing and revenue optimization solutions may become increasingly subject to infringement claims as the number of commercially available pricing and revenue optimization solutions increases and the functionality of these solutions overlaps. Future litigation may involve patent holding companies or other adverse patent owners who have no relevant product revenue and against whom our own potential patents may therefore provide little or no deterrence. Regardless of the merit of any particular claim that our technology violates the intellectual property rights of others, responding to such claims may require us to:

- incur substantial expenses and expend significant management efforts to defend such claims;

- pay damages, potentially including treble damages, if we are found to have willfully infringed such parties' patents or copyrights;

- cease making, licensing or using products that are alleged to incorporate the intellectual property of others;

- distract management and other key personnel from performing their duties for us;

- enter into potentially unfavorable royalty or license agreements in order to obtain the right to use necessary technologies; and

- expend additional development resources to redesign our products.

Any license required as a result of litigation under any patent may not be made available on commercially acceptable terms, if at all. In addition, some licenses may be nonexclusive, and therefore our competitors may have access to the same technology licensed to us. If we fail to obtain a required license or are unable to design around a patent, we may be unable to effectively develop or market our products, which could limit our ability to generate revenue or maintain profitability.

Contract terms generally obligate us to indemnify our customers for their use of the intellectual property associated with our current product suite or for other third-party products that are incorporated into our solutions and

that infringe the intellectual property rights of others. If we are unable to resolve our legal obligations by settling or paying an infringement claim or a related indemnification claim as described above, we may be required to compensate our customers under the contractual arrangement with the customers. Some of our intellectual property indemnification obligations are contractually capped at a very high amount or not capped at all.

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### ***If we fail to protect our proprietary rights and intellectual property adequately, our business and prospects may be harmed.***

Our success will depend in part on our ability to protect our proprietary methodologies and intellectual property. We rely upon a combination of trade secrets, confidentiality policies, nondisclosure and other contractual arrangements, and patent, copyright and trademark laws to protect our intellectual property rights. We cannot, however, be sure that steps we take to protect our proprietary rights will prevent misappropriation of our intellectual property, or the development and marketing of similar and competing products and services by third parties.

We rely, in some circumstances, on trade secrets to protect our technology. Trade secrets, however, are difficult to protect. In addition, our trade secrets may otherwise become known or be independently discovered by competitors, and in such cases, we could not assert such trade secret rights against such parties. We seek to protect our proprietary technology and processes, in part, by confidentiality agreements with our employees, consultants, customers, scientific advisors and other contractors. These agreements may be breached, and we may not have adequate remedies for any breach. To the extent that our employees, consultants or contractors use intellectual property owned by others in their work for us, disputes may arise as to the rights in related or resulting know-how and inventions.

As of the date of this filing, we have 3 issued U.S. patents and 6 pending U.S. patent applications. We have not pursued patent protection in any foreign countries. Our pending patent applications may not result in issued patents. The patent position of technology-oriented companies, including ours, is generally uncertain and involves complex legal and factual considerations. The standards that the United States Patent and Trademark Office use to grant patents are not always applied predictably or uniformly and can change. Accordingly, we do not know the degree of future protection for our proprietary rights or the breadth of claims allowed in any patents that may be issued to us or to others. If any of our patent applications issue, they may not contain claims sufficiently broad to protect us against third parties with similar technologies or products, or provide us with any competitive advantage. Moreover, once they have been issued, our patents and any patent for which we have licensed or may license rights may be challenged, narrowed, invalidated or circumvented. If our patents are invalidated or otherwise limited, other companies will be better able to develop products that compete with ours, which could adversely affect our competitive business position, business prospects and financial condition.

Patent applications in the U.S. are typically not published until, at least, 18 months after filing or in some cases not at all, and publications of discoveries in industry-related literature lag behind actual discoveries. We cannot be certain that we were the first to make the inventions claimed in our pending patent applications or that we were the first to file for patent protection. Additionally, the process of obtaining patent protection is expensive and time-consuming, and we may not be able to prosecute all necessary or desirable patent applications at a reasonable cost or in a timely manner. As a result, we may not be able to obtain adequate patent protection.

In addition, despite our efforts to protect our proprietary rights, unauthorized parties may be able to obtain and use information that we regard as proprietary. The issuance of a patent does not guarantee that it is valid or enforceable. As such, even if we obtain patents, they may not be valid or enforceable against third parties. In addition, the issuance of a patent does not guarantee that we have a right to practice the patented invention. Third parties may have blocking patents that could be used to prevent us from marketing or practicing our potentially patented products. As a result, we may be required to obtain licenses under these third-party patents. If licenses are not available to us on acceptable terms, or at all, we will not be able to make and sell our software products and competitors would be more easily able to compete with us.

### ***We use open source software in our products that may subject our software products to general release or require us to re-engineer our products, which may cause harm to our business.***

We use open source software in our products and may use more open source software in the future. From time to time, there have been claims challenging the ownership of open source software against companies that incorporate open source software into their products. As a result, we could be subject to suits by parties claiming ownership of what we believe to be open source software. Some open source licenses contain requirements that we make available source code for modifications or derivative works we create based upon the open source software and that we license such modifications or derivative works under the terms of a particular open source license or other license granting third parties certain rights of further use. If we combine our proprietary software products with open source software

in a certain manner, we could, under certain of the open source licenses, be required to release the source code of our proprietary software products. In addition to risks related to license requirements, usage of open source software can lead to greater risks than use of third party commercial software, as open source licensors generally do not provide warranties or controls on origin of the software. In addition, open source license

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terms may be ambiguous and many of the risks associated with usage of open source cannot be eliminated, and could, if not properly addressed, negatively affect our business. If we were found to have inappropriately used open source software, we may be required to re-engineer our products, to discontinue the sale of our products in the event re-engineering cannot be accomplished on a timely basis or take other remedial action that may divert resources away from our development efforts, any of which could adversely affect our business, operating results and financial condition.

***We utilize third-party software that we incorporate into our software products, and impaired relations with these third parties, defects in third-party software or a third party's inability or failure to enhance their software over time could adversely affect our operating performance and financial condition.***

We incorporate and include third-party software into our software products. If our relations with any of these third parties are impaired, or if we are unable to obtain or develop a replacement for the software, our business could be harmed. The operation of our products could be impaired if errors occur in the third-party software that we utilize. It may be more difficult for us to correct any defects in third-party software because the software is not within our control. Accordingly, our business could be adversely affected in the event of any errors in this software. There can be no assurance that these third parties will continue to invest the appropriate levels of resources in their products and services to maintain and enhance the capabilities of their software.

***New accounting standards or interpretations of existing accounting standards, including those related to revenue recognition, could adversely affect our operating results.***

GAAP in the United States are subject to interpretation by the Financial Accounting Standards Board, the American Institute of Certified Public Accountants, the SEC and various bodies formed to promulgate and interpret appropriate accounting principles. A change in principles or interpretations, in particular those related to revenue recognition, could have an adverse effect on our reported financial results.

***Our international sales subject us to risks that may adversely affect our operating results.***

Over the last several years, we derived a significant portion of our revenue from customers outside the United States. For the year ended December 31, 2009, 2008, and 2007, approximately 59%, 54% and 63% of our total revenue, respectively, was derived from outside the United States. We may not be able to maintain or increase international market demand for our products. Managing overseas growth could require significant resources and management attention and may subject us to new or larger levels of regulatory, economic, foreign currency exchange, tax and political risks. Among the risks we believe are most likely to affect us with respect to our international sales and operations are:

- economic conditions in various parts of the world;

- unexpected changes in regulatory requirements;

- less protection for intellectual property rights in some countries;

- new and different sources of competition;

- multiple, conflicting and changing tax laws and regulations that may affect both our international and domestic tax liabilities and result in increased complexity and costs;

- if we were to establish international offices, the difficulty of managing and staffing such international offices and the increased travel, infrastructure and legal compliance costs associated with multiple international locations;

- difficulties in enforcing contracts and collecting accounts receivable, especially in developing countries;

- if more contracts become denominated in local currency, fluctuations in exchange rates; and

tariffs and trade barriers, import/export controls and other regulatory or contractual limitations on our ability to sell or develop our products in certain foreign markets.

If we continue to expand our business globally, our success will depend, in large part, on our ability to anticipate and effectively manage these and other risks associated with our international operations. Our failure to manage any of these risks successfully could harm our international operations and reduce our international sales, adversely affecting our business, operating results and financial condition.

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***We may enter into acquisitions that may be difficult to integrate, fail to achieve our strategic objectives, disrupt our business, dilute stockholder value or divert management attention.***

We currently do not have any agreements with respect to any acquisitions, but in the future we may pursue acquisitions of businesses, technologies and products that we intend to complement our existing business, products and technologies. We cannot assure you that any acquisition we make in the future will provide us with the benefits we anticipated in entering into the transaction. Acquisitions are typically accompanied by a number of risks, including:

difficulties in integrating the operations and personnel of the acquired companies;

difficulties in maintaining acceptable standards, controls, procedures and policies;

potential disruption of ongoing business and distraction of management;

inability to maintain relationships with customers of the acquired business;

impairment of relationships with employees and customers as a result of any integration of new management and other personnel;

difficulties in incorporating acquired technology and rights into our products and services;

unexpected expenses resulting from the acquisition; and

potential unknown liabilities associated with acquired businesses.

In addition, acquisitions may result in the incurrence of debt, restructuring charges and write-offs. Acquisitions may also result in goodwill and other intangible assets that are subject to impairment tests, which could result in future impairment charges. Furthermore, if we finance acquisitions by issuing convertible debt or equity securities, our existing stockholders may be diluted and earnings per share may decrease. To the extent we finance future acquisitions with debt; such debt could include financial or operational covenants that restrict our business operations.

We may enter into negotiations for acquisitions that are not ultimately consummated. Those negotiations could result in diversion of management time and significant out-of-pocket costs. If we fail to evaluate and execute acquisitions successfully, we may not be able to achieve our anticipated level of growth and our business and operating results could be adversely affected.

***Our operations might be affected by the occurrence of a natural disaster or other catastrophic event in Houston, Texas.***

Our headquarters are located in Houston, Texas, from which we base our operations. Although we have contingency plans in effect for natural disasters or other catastrophic events, these events, including terrorist attacks and natural disasters such as hurricanes, could disrupt our operations. Even though we carry business interruption insurance and typically have provisions in our contracts that protect us in certain events, we might suffer losses as a result of business interruptions that exceed the coverage available under our insurance policies or for which we do not have coverage. For example, even a temporary disruption to our business operations may create a negative perception in the marketplace. Any natural disaster or catastrophic event affecting us could have a significant negative impact on our operations.

***Our ability to raise capital in the future may be limited, and our failure to raise capital when needed could prevent us from executing our strategy.***

We believe that our existing cash and cash equivalents and our cash flow from future operating activities will be sufficient to meet our anticipated cash needs for the foreseeable future. The timing and amount of our working capital and capital expenditure requirements may vary significantly depending on numerous factors, including the other risk factors described in this Annual Report on Form 10-K. In addition, we may require additional financing to fund the purchase price of future acquisitions. Additional financing may not be available on terms favorable to us, or at all.



Any additional capital raised through the sale of equity or convertible debt securities may dilute your percentage ownership of our common stock. Furthermore, any new debt or equity securities we

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issue could have rights, preferences and privileges superior to our common stock. Capital raised through debt financings could require us to make periodic interest payments and could impose potentially restrictive covenants on the conduct of our business.

***We incur significant increased costs as a result of operating as a public company, and our management will be required to devote substantial time to new compliance initiatives.***

As a public company, we incur significant legal, accounting and other expenses that we did not incur as a private company. SEC and New York Stock Exchange ( NYSE ) rules and regulations impose heightened requirements on public companies, including requiring changes in corporate governance practices. Our management and other personnel devote a substantial amount of time to these compliance initiatives. We may also need to hire additional finance and administrative personnel to support our compliance requirements. Moreover, these rules and regulations increase our legal and financial costs and make some activities more time-consuming.

In addition, we are required to maintain effective internal controls for financial reporting and disclosure controls and procedures. In particular, we are required to perform system and process evaluation and testing of our internal controls over financial reporting to allow management to report on, and our independent registered public accounting firm to report on, the effectiveness of our internal controls over financial reporting, as required by Section 404 of the Sarbanes-Oxley Act. Our testing, or the subsequent testing by our independent registered public accounting firm, may reveal deficiencies or material weaknesses in our internal controls over financial reporting. Our compliance with Section 404 will require that we incur substantial accounting expense and expend significant management efforts. We may need to hire additional accounting and financial staff or a third party firm with appropriate public company experience and technical accounting knowledge. If we or our independent registered public accounting firm identifies deficiencies or material weaknesses in our internal controls over financial reporting, the market price of our stock could decline and we could be subject to sanctions or investigations by the NYSE, SEC or other regulatory authorities, which would require additional financial and management resources.

### **Risks relating to ownership of our common stock:**

#### ***Market volatility may affect our stock price and the value of your investment.***

The market price for our common stock has been and is likely to continue to be volatile, in part because our shares have been traded publicly since June 2007. Volatility could make it difficult to trade shares of our common stock at predictable prices or times.

Many factors could cause the market price of our common stock to be volatile, including the following:

variations in our quarterly or annual operating results;

decreases in market valuations of comparable companies;

fluctuations in stock market prices and volumes;

decreases in financial estimates by equity research analysts;

announcements by our competitors of significant contracts, new products or product enhancements, acquisitions, distribution partnerships, joint ventures or capital commitments;

departure of key personnel;

changes in governmental regulations and standards affecting the software industry and our products;

sales of common stock or other securities by us in the future;

damages, settlements, legal fees and other costs related to litigation, claims and other contingencies;

deterioration of the general U. S. and global economic condition; and

other risks described elsewhere in this section.

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In the past, securities class action litigation often has been initiated against a company following a period of volatility in the market price of the company's securities. If class action litigation is initiated against us, we will incur substantial costs and our management's attention will be diverted from our operations. All of these factors could cause the market price of our stock to decline, and you may lose some or all of your investment.

### ***Shares of our common stock are relatively illiquid***

Our common stock is thinly traded and we have a relatively small public float. Our common stock may be less liquid than the stock of companies with a broader public ownership. In addition, trading of a large volume of our common stock may also have a significant impact on its trading price.

***If equity research analysts cease to publish research or reports about us or if they issue unfavorable commentary or downgrade our common stock, the price of our common stock could decline.***

The trading market for our common stock relies in part on the research and reports that equity research analysts publish about us and our business. The price of our stock could decline if one or more equity research analysts downgrade our stock or if those analysts issue other unfavorable commentary or cease publishing reports about our business.

***Anti-takeover provisions in our Certificate of Incorporation and Bylaws and under Delaware law could make an acquisition of us, which may be beneficial to our stockholders, more difficult and may prevent attempts by our stockholders to replace or remove our current management.***

Our Certificate of Incorporation and by-laws and Section 203 of the Delaware General Corporation Law contain provisions that might enable our management to resist a takeover of our company. These provisions include the following:

- the division of our board of directors into three classes to be elected on a staggered basis, one class each year;

- a prohibition on actions by written consent of our stockholders;

- the elimination of the right of stockholders to call a special meeting of stockholders;

- a requirement that stockholders provide advance notice of any stockholder nominations of directors or any proposal of new business to be considered at any meeting of stockholders;

- a requirement that a supermajority vote be obtained to amend or repeal certain provisions of our certificate of incorporation; and

- the ability of our board of directors to issue preferred stock without stockholder approval.

In addition, because we are incorporated in Delaware, we are governed by the provisions of Section 203 of the Delaware General Corporation Law, which limits the ability of stockholders owning in excess of 15% of our outstanding voting stock to merge or combine with us. Although we believe these provisions collectively provide for an opportunity to obtain higher bids by requiring potential acquirors to negotiate with our board of directors, they would apply even if an offer were considered beneficial by some stockholders. In addition, these provisions may frustrate or prevent any attempts by our stockholders to replace or remove our current management by making it more difficult for stockholders to replace members of our board of directors, which is responsible for appointing the members of our management.

### ***We do not intend to pay dividends on our common stock in the foreseeable future.***

We do not currently anticipate paying any cash dividends on our common stock in the foreseeable future. We currently anticipate that we will retain all of our available cash, if any, for use as working capital and for other general corporate purposes. Any payment of future dividends will be at the discretion of our board of directors and will depend upon, among other things, our earnings, financial condition, capital requirements, level of indebtedness, statutory and contractual restrictions applying to the payment of dividends and other considerations that the board of directors deems relevant. Investors seeking cash dividends should not purchase our common stock.



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**Item 1B. *Unresolved staff comments***

None.

**Item 2. *Properties***

We lease approximately 73,200 square feet of office space for our headquarters in Houston, Texas. This lease expires in July 2011. In July 2009, we began leasing approximately 3,300 square feet of office space in Austin, Texas. This lease expires June 2011. We believe our existing facilities are sufficient for our current needs. We may add new facilities and expand our existing facilities as we add employees, and we believe that suitable additional or substitute space will be available as needed to accommodate any such expansion of our operations.

**Item 3. *Legal proceedings***

In the ordinary course of our business, we regularly become involved in contract and other negotiations and, in more limited circumstances, become involved in legal proceedings, claims and litigation. We periodically assess our liabilities and contingencies in connection with these matters, based upon the latest information available. Should it be probable that we have incurred a loss and the loss, or range of loss, can be reasonably estimated, we will record reserves in the consolidated financial statements. In other instances, because of the uncertainties related to the probable outcome and/or amount or range of loss, we are unable to make a reasonable estimate of a liability, and therefore no reserve will be recorded. As additional information becomes available, we adjust our assessment and estimates of such liabilities accordingly. It is possible that the ultimate resolution of our liabilities and contingencies could be at amounts that are different from any recorded reserves and that such differences could be material.

In April 2008, a customer brought suit against us alleging that we failed to deliver contracted-for software. The customer's claims, as amended, include breach of contract, fraud and negligent misrepresentation. In May 2008, we filed an answer and have brought counterclaims, as amended, for breach of contract, violation of the duty of good faith and fair dealing, breach of confidentiality and misappropriation of trade secrets. We believe the customer's attempted termination of the contract is wrongful, and we are vigorously defending this matter and seeking payment of remaining amounts owed under the contract. Certain management and key personnel are devoting significant time to this matter. Given the inherent uncertainties in any litigation, we are unable to make any predictions as to the ultimate outcome and no provision for loss or other costs has been recorded. We had \$1.1 million of capitalized implementation costs included in other assets, \$0.2 million in accounts receivable and \$6.1 million of long-term deferred revenue related to this customer's contract as of March 31, 2008. In April 2008, these amounts were netted and \$4.9 million was classified as other current liabilities. This amount has not changed since April 2008 and will continue to be presented in the consolidated balance sheets as other current liabilities. Unless the matter is resolved earlier, the trial date is currently scheduled for the first quarter of 2011.

Based on our review of the latest information available, we do not believe any liability, in connection with current contract and other negotiations or pending or threatened legal proceedings, claims and litigation would have a material effect on our consolidated financial statements.

**Item 4. *Submission of matters to a vote of security holders***

No matter was submitted to a vote of our shareholders during the fourth quarter of the year ended December 31, 2009.

**Table of Contents****Part II****Item 5. Market for registrant's common equity, related stockholders matters and issuer purchases of equity securities****Market information and dividends**

Our common stock is listed on the New York Stock Exchange, or NYSE, under the symbol PRO. The following table sets forth the high and low prices for shares of our common stock, as reported by the NYSE for the periods indicated.

	<b>Price Range of Common Stock</b>	
	<b>Low</b>	<b>High</b>
<b>For the year ended December 31, 2008</b>		
First Quarter	\$ 10.40	\$ 15.51
Second Quarter	\$ 9.53	\$ 13.50
Third Quarter	\$ 6.50	\$ 12.45
Fourth Quarter	\$ 3.13	\$ 9.40
<b>For the year ended December 31, 2009</b>		
First Quarter	\$ 3.03	\$ 7.10
Second Quarter	\$ 3.96	\$ 8.89
Third Quarter	\$ 6.70	\$ 8.55
Fourth Quarter	\$ 7.22	\$ 10.64

On March 3, 2010 there were 104 stockholders of record of our common stock. On March 29, 2007, we paid a one-time cash dividend on our common stock of \$2.00 per share, totaling \$41.3 million. We currently expect to retain all remaining available funds and any future earnings for use in the operation and development of our business. Accordingly, we do not anticipate declaring or paying cash dividends on our common stock in the foreseeable future.

**Table of Contents****Performance graph**

The following performance graph and related information shall not be deemed soliciting material or to be filed with the Securities and Exchange Commission, nor shall such information be incorporated by reference into any future filing under the Securities Act of 1933 or Securities Exchange Act of 1934, each as amended, except to the extent that we specifically incorporate it by reference into such filing.

The graph below presents the relative investment performance of our common stock, the Standard & Poor's 500 Stock Index ( S&P 500 ) and the NASDAQ Computer Index for the period commencing on June 28, 2007, the date of our initial public offering, and ending December 31, 2009. The graph is presented pursuant to the SEC rules and is not meant to be an indication of our future performance.

- (1) The graph assumes that \$100 was invested on June 28, 2007, in our common stock (at the closing price on the date of our initial public offering), the S&P 500 and the NASDAQ Computer Index and further assumes all dividends were reinvested. No cash dividends have been paid on our common stock for the periods presented above.

	6/28/2007	6/30/2007	9/30/2007	12/31/2007	3/31/2008	6/30/2008	9/30/2008	12/31/2008	3/31/2009	6/30/2009	9/30/2009	12/31/2009
PRO	\$100.00	\$101.95	\$ 92.14	\$149.77	\$95.80	\$85.73	\$71.68	\$43.89	\$35.50	\$61.98	\$64.27	\$ 79.01
S&P 500	\$100.00	\$ 99.84	\$101.56	\$ 97.67	\$87.98	\$85.14	\$77.48	\$60.08	\$53.07	\$61.15	\$70.31	\$ 74.17
NASDAQ												
Computer												
Index	\$100.00	\$ 99.51	\$105.33	\$111.31	\$88.88	\$93.22	\$78.74	\$59.34	\$62.20	\$77.17	\$90.17	\$101.37

**Issuer purchase of equity securities**

On August 25, 2008, we announced that the Board of Directors of the Company authorized a stock repurchase program for the purchase of up to \$15.0 million of our common stock. Under the board-approved repurchase program, share purchases may be made from time to time in the open market or through privately negotiated transactions depending on market conditions, share price, trading volume and other factors, and such purchases, if any, will be made in accordance with applicable insider trading and other securities laws and regulations. These repurchases may be commenced or suspended at any time or from time to time without prior notice.



During 2009, we did not make any purchases of our common stock under this program. As of December 31, 2009, \$10.0 million remains available under the stock repurchase program.

**Table of Contents****Equity Compensation Plan Information**

The following table sets forth information as of December 31, 2009 with respect to compensation plans under which equity securities of the Company are authorized for issuance. For additional information on our equity compensation plans, see Note 8 of the Notes to the Consolidated Financial Statements.

	I	II	III
	Number of securities to be issued upon exercise of outstanding options	Weighted-average exercise price of outstanding options	Number of securities remaining available for future issuance under plans (excluding securities listed in Column (I))
Plan Category			
Equity compensation plans approved by security holders		\$	
Equity compensation plans not approved by security holders	3,687,527	8.52	35,857
Total	3,687,527	\$ 8.52	35,857

Our 2007 equity incentive plan, adopted in March 2007, provides a formula for automatic increases in the number of securities available for issuance under such plan. The maximum aggregate number of securities that may be issued under the 2007 equity incentive plan cumulatively increases by a number of shares equal to the lesser of (i) 3.5% of the number of securities issued and outstanding on the immediately preceding December 31, (ii) Nine Hundred Thousand (900,000) shares and (iii) an amount determined by our Board.

**Item 6. Selected financial data**

The following selected consolidated financial data presented under the captions Selected Statement of Operations Data and Balance Sheet Data for, and as of the end of, each of the five years in the five year period ended December 31, 2009 are derived from the Consolidated Financial Statements of PROS Holdings, Inc. The selected consolidated financial data set forth below should be read in conjunction with Management's discussion and analysis of financial condition and result of operations and our consolidated financial statements and the related notes included elsewhere in this report. As presented in the table, amounts are in thousands (except per share data).

	Year Ended December 31,				
	2009	2008	2007	2006	2005
<b>Selected consolidated statement of operations data:</b>					
Total revenue	\$68,783	\$75,588	\$62,079	\$46,027	\$35,130
Gross profit	50,138	56,336	44,135	30,422	21,749
Income from operations	7,367	13,933	11,006	6,829	3,339
Net income	5,516	10,757	10,517	7,025	3,440
Accretion of preferred stock			(82)	(460)	(852)
Net earnings attributable to common stockholders	\$ 5,516	\$10,757	\$10,435	\$ 6,565	\$ 2,587

Net earnings attributable to common  
stockholders per share:

Basic	\$ 0.21	\$ 0.41	\$ 0.45	\$ 0.33	\$ 0.19
Diluted	\$ 0.21	\$ 0.40	\$ 0.45	\$ 0.32	\$ 0.16

Weighted average number of shares:

Basic	25,711	26,121	23,026	19,649	13,891
Diluted	26,431	26,569	23,434	20,604	20,012

			December 31,		
	2009	2008	2007	2006	2005
<b>Selected consolidated balance sheet data:</b>					
Cash and cash equivalents	\$62,449	\$51,979	\$44,378	\$42,540	\$38,490
Working capital	50,755	41,741	33,917	27,575	27,079
Total assets	85,329	76,967	68,980	63,046	50,290
Redeemable preferred stock				17,283	25,269
Total stockholders' equity	\$55,039	\$43,752	\$33,688	\$10,677	\$ 4,044

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### **Item 7. Management's discussion and analysis of financial condition and results of operations**

#### **Overview**

We are a leading provider of pricing and margin optimization software, an emerging category of enterprise applications designed to allow companies to improve financial performance by implementing pricing excellence best practices through the use of our software products. By using our software products, our customers gain insight into their pricing strategies, identify detrimental pricing practices, optimize their pricing decision-making and improve their business processes and financial performance. Our software products incorporate advanced pricing science, which includes operations research, forecasting and statistics. Our innovative science-based software products analyze, execute and optimize pricing strategies using data from traditional enterprise applications, often augmenting it with real-time and historical data. Our software also uses data elements that are determined using advanced pricing science and are stored in our database. Our high performance software architecture supports real-time high volume transaction processing and allows us to handle the processing and database requirements of the most sophisticated and largest customers, including customers with hundreds of simultaneous users and sub-second electronic transactions. We provide professional services to configure our software products to meet the specific pricing needs of each customer, they do not write custom code for each implementation.

Many of our customers process large volumes of individually priced business-to-consumer and business-to-business transactions every day. Our high-performance, real-time, dynamic pricing products differ from static retail pricing products by delivering the relevant pricing information at the time the price is quoted, the deal is negotiated and the sale transaction is made. Our software products are also used to provide optimized price lists and goal-driven price guidance. While companies in our target industries differ in the wide range of business-to-business and business-to-customer products and services that they provide, many are similar in their need to optimally and dynamically price each individual transaction. We have installed over 200 solutions for over 100 customers across a range of industries in more than 40 countries.

We recorded revenue of \$68.8 million, \$75.6 million and \$62.1 million for the years ended December 31, 2009, 2008, and 2007, respectively, and have achieved eleven consecutive years of profitability. Approximately 59%, 54% and 63% of our total revenue came from customers outside the United States for the years ended December 31, 2009, 2008, and 2007, respectively.

Generally, we recognize a substantial majority of our license and implementation revenue on a percentage-of-completion basis because we consider implementation services to be essential to our customers usability of our licensed software. Under this recognition policy, the revenue we recognize during a reporting period is based on the total man-days expended on an implementation of our software products during the reporting period as a percentage of the total man-days estimated to be necessary to complete the implementation of our software products. As a result of our revenue recognition policy, revenue from license arrangements is recognized over the implementation period, which typically ranges from six months to several years.

Our revenue recognition policy provides visibility into a significant portion of our revenue in the near-term quarters, although the actual timing of recognition of revenue will vary based on the nature and requirements of our contracts. We do not recognize license and implementation revenue upon signing a new contract with a customer. Our revenue recognition only begins when efforts are expended toward implementation, which alleviates pressure to enter into license agreements by the end of any particular quarter as we would not be able to recognize the corresponding revenue during the period in which the agreement is signed except, typically, to the extent we provide implementation services during the period.

#### **Background**

We were founded in 1985 and initially focused our efforts on providing complex, science-based revenue management solutions to the global airline industry. In 1999, we began to consider ways to diversify our product offering to include a broader suite of pricing and margin optimization functionality. We expanded our focus beyond the airline industry to include other industries that we believed to have similar pricing challenges and a need for advanced pricing and margin optimization solutions. Our efforts toward diversification of products and customers intensified following September 11, 2001 as a result of the ensuing challenges faced by many airlines following those events. Despite the events of September 11, 2001 and the resulting decline in our revenue, we remained profitable as

we sought additional ways to grow our business, and we have had eleven consecutive years of profitability.

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Our future revenue growth and profitability will depend on the continued acceptance of our pricing and margin optimization software products, further penetration of our target industries and the increased adoption of pricing and margin optimization software generally.

In July 2007, we completed our initial public offering ( IPO ) of our common stock in which we sold and issued 5,118,750 shares of common stock and the selling stockholders sold an additional 1,706,250 shares of common stock. As a result of the IPO, we raised \$56.3 million in gross proceeds, before deducting underwriter's discounts and commission of \$3.9 million and offering costs of \$1.8 million. In addition, in December 2007, we completed a follow on offering of 5,000,000 shares of our common stock in which we sold and issued 65,000 shares of common stock and the selling stockholders sold an additional 4,935,000 shares of common stock. As a result of the follow on offering, we raised \$1.0 million in gross proceeds before deducting offering costs of \$0.4 million.

### **Trends and uncertainties**

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

*Difficult economic conditions.* We believe the market for pricing and margin optimization software is underpenetrated and in the early innovator stage of adoption. The world economies were in a recession for the past year. Prior to the recession, the market demand for our software products had been increasing over the past several years; however, the current economy continues to be challenging which may have a negative impact on the adoption of pricing and margin optimization software. We believe our solutions provide value to our customers during periods of growth as well as in recessions, but it is uncertain the extent to which a slowdown in technology investment will effect our business.

*Variability in revenue among industries and geography.* Historically a substantial portion of our revenue has come from the airline industry. However, as we began to diversify our product offering, we saw our revenue growth driven by increases in sales to non-airline industry customers in manufacturing, distribution, services and hotel and cruise. From a geographical standpoint, we have diversification in revenue with 59% of revenue in 2009 outside the United States. The current economic environment could change our trends of revenue within industries and across geographies if certain industries or geographies are more impacted than others.

*Research and experimentation tax credit.* At the end of 2009, Congress recessed without reinstating the Research & Experimentation, or R&E, tax credit beyond the current expiration date of December 31, 2009. Since its enactment in 1981, Congress has reinstated on a retroactive basis the R&E tax credit several times. However, unless the R&E tax credit is reinstated, we will record Federal income taxes in 2010 at the enacted federal rate of 35%, net of other tax credits that may benefit us, if any.

### **Discussion of consolidated financial information**

#### ***Revenue:***

We derive our revenue from license fees, implementation services and maintenance and support services. Our arrangements with customers typically include: (a) license fees paid for the use of our products either in perpetuity or over a specified term and implementation fees for configuration, implementation and training services and (b) maintenance and support fees related to technical support and software updates. We consider our implementation services essential to our customers' usability of our licensed software products, and therefore, we recognize revenue from perpetual software license and implementation services together as the services are performed provided other revenue recognition criteria have been met. For certain arrangements, we engage an independent contractor to assist in the implementation of our software products. These arrangements are analyzed based on numerous factors to determine the amount of revenue to be recognized.

*License and implementation revenue.* We derive the majority of our license and implementation revenue from the sale of perpetual licenses for our software products and related implementation services. Revenue from our perpetual licenses and implementation services are generally recognized as implementation services are performed using the percentage-of-completion accounting method. 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 products. Under our fixed-fee arrangements, should a loss be anticipated on a contract, the full amount is recorded when the loss is determinable.

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We also license software products under term licenses agreements that typically include maintenance during the license term. The term license agreements range from two to five years. Revenue and the associated costs are deferred until the delivery of the product and recognized ratably over the remaining license term. Revenue from term licenses, which is included in license and implementation revenue in the Consolidated Statements of Operations, represented approximately 5.5%, 4.2% and 5.2%, of total revenue for the years ended December 31, 2009, 2008 and 2007, respectively.

**Maintenance and support revenue.** We generate maintenance and support revenue from the sale of maintenance and support services for our software products. Our maintenance and support arrangements are sold with terms generally ranging from one to two years. Maintenance and support fees are invoiced to our customers either monthly, quarterly or on an annual basis. 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. Maintenance and support renewals by customers continues to be greater than 90%.

Software license and implementation revenue that has been recognized, but for which the Company has not invoiced the customer, is recorded as unbilled receivables. Invoices that have been issued before the software license, implementation and maintenance and support revenue has been recognized is recorded as deferred revenue in the accompanying Consolidated Balance Sheets.

### ***Revenue distribution***

Our revenue is geographically dispersed as we sell our solutions to a global customer base. We do not believe there are significant trends or uncertainties among our customers based on geography, and the percentages of revenue among geographic areas fluctuate from year to year. The substantial majority of our customer arrangements are denominated in U.S. dollars. We believe that we are geographically diversified. For the year ended December 31, 2009, 41% of our revenue was from the United States.

### ***Cost of revenue***

**Cost of license and implementation revenue.** Cost of license and implementation revenue includes those costs related to the implementation of our solutions. Cost of license and implementation revenue consists of (a) compensation and benefits related to personnel and contractors providing professional services, (b) billable and non-billable travel, lodging and other out-of-pocket expenses and (c) facilities and other overhead costs. License and implementation costs may vary from period to period depending on a number of factors, including the amount of implementation services required to deploy our products.

**Cost of maintenance and support revenue.** Cost of maintenance and support revenue includes those costs related to post-contract support on our deployed solutions. Cost of maintenance and support revenue consists of (a) compensation and benefits related to personnel providing customer support and (b) facilities and other overhead costs.

### ***Operating expenses***

**Selling, general and administrative.** Selling, general and administrative expenses consist of (a) compensation and benefits related to selling, general and administrative activities; (b) travel, lodging and other out-of-pocket expenses; (c) marketing programs such as our conferences and participating in industry trade shows; (d) accounting, legal and other professional fees and (e) facilities and other related overhead.

**Research and development.** Research and development expenses consist of (a) compensation and benefits of software developers, scientists and product managers working on the development of our new products, enhancements of existing products, scientific research, quality assurance and testing and (b) facilities and other related overhead. We expense all of our research and development costs as incurred, and we expect to continue to do so in the foreseeable future.



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### ***Income taxes***

We are subject to income taxes in the United States and abroad, and we use estimates in determining our provision for income taxes. We estimate separately our deferred tax assets, related valuation allowances, current tax liabilities and deferred tax liabilities. At December 31, 2009, our deferred tax assets consisted primarily of temporary differences related to the deferral of compensation deductions for federal income tax purposes and the deferral of revenue on certain contracts for financial reporting purposes. We assess the likelihood that deferred tax assets will be realized and we recognize a valuation allowance if it is more likely than not that some portion of the deferred tax assets will not be realized. This assessment requires judgment as to the likelihood and amounts of future taxable income. Although we believe that our tax estimates are reasonable, the ultimate tax determination involves significant judgment that is subject to audit by tax authorities in the ordinary course of business.

Our effective tax rates were 27%, 28% and 11% for the years ended December 31, 2009, 2008 and 2007, respectively. In the third quarter of 2007, we recognized a tax benefit of \$1.1 million upon the reversal of a valuation allowance previously recorded against the deferred tax asset on our R&E, tax credit carryforwards. This reversal was the result of our determination during the third quarter that it was more likely than not that our R&E tax credit carryforwards would be utilized. Without this reversal, our effective tax rate would have been 20%.

Our Federal effective tax rate historically has been lower than the statutory rate of 35% largely due to the application of general business tax credits. However, at the end of 2009, Congress recessed without reinstating the R&E tax credit beyond the current expiration date of December 31, 2009. Since its enactment in 1981, Congress has reinstated on a retroactive basis the R&E tax credit several times. However, unless the R&E tax credit is reinstated, we will record Federal income taxes in 2010 at the enacted federal rate of 35%, net of other tax credits that may benefit us, if any.

### ***Deferred revenue and unbilled receivables***

For our license fees and implementation services, we invoice and are paid based upon negotiated milestones in each customer arrangement with an initial payment due upon execution and remaining payments due throughout the implementation period. We record as deferred revenue any invoices that have been issued before implementation services have been performed and before the corresponding license and implementation revenue is recognized. We record as unbilled receivables any recognized license and implementation revenue in excess of the amount invoiced to the customer. We generally invoice for our maintenance and support services on a monthly, quarterly or annual basis through the maintenance and support period. Deferred revenue does not reflect the total contract value of our customer arrangements at any point in time because we only record deferred revenue as amounts are invoiced ahead of the performance of implementation services. As a result, there is little correlation between the timing of our revenue recognition, the timing of our invoicing and the amount of deferred revenue.

### ***Critical accounting policies and estimates***

We make estimates and assumptions in the preparation of our consolidated financial statements, and our 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 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 of our 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 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. Our management has reviewed these critical accounting policies, our use of estimates and the related disclosures with our Audit Committee.

We believe the critical accounting policies listed below affect significant judgment and estimates used in the preparation of our consolidated financial statements.

### ***Revenue recognition***

*License and implementation.* We consider our implementation services essential to our customers' usability of our licensed software products, and therefore, we recognize revenue from perpetual software licenses and implementation services together as the services are performed provided other revenue recognition criteria have been

met. Generally, we do so using the percentage-of-completion method. 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 products. The period over which we recognize license and implementation revenue depends on the number of licensed software products and the scope and complexity of the implementation requirements. Our revenue recognition period for an arrangement generally ranges from six months to several years. For certain arrangements, we engage an independent contractor to assist in the implementation of our software products. These arrangements are analyzed based on numerous factors to determine the amount of revenue to be recognized.

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We also license software products under term licenses agreements that typically include maintenance during the license term. The term license agreements range from two to five years. Revenue and the associated costs are deferred until the delivery of the product and recognized ratably over the remaining license term. Revenue from term licenses, which is included in license and implementation revenue in the Consolidated Statements of Operations, represented approximately 5.5%, 4.2% and 5.2% of total revenue for the years ended December 31, 2009, 2008 and 2007, respectively.

**Maintenance and support.** Maintenance and support revenue includes post-contract customer support and the right to unspecified software updates and enhancements on a when and if available basis. Once an implementation is completed and other revenue recognition criteria have been met, maintenance and support revenue is recognized ratably over the term of the maintenance and support arrangement.

### **Allowance for doubtful accounts**

In addition to our initial credit evaluations at the inception of arrangements, we regularly assess our ability to collect outstanding customer invoices. To do so, we make estimates of the collectability of accounts receivable. We provide an allowance for doubtful accounts when we determine that the collection of an outstanding customer receivable is not probable. We also analyze accounts receivable and historical bad debt experience, customer creditworthiness, changes in our customer payment history and industry concentration on an aggregate basis when evaluating the adequacy of the allowance for doubtful accounts. If any of these factors change, our estimates may also change, which could affect the level of our future provision for doubtful accounts.

### **Share-based compensation**

We have two share-based compensation plans, the 1999 equity incentive plan and the 2007 equity incentive plan, which authorize the discretionary granting of various types of stock awards to key employees, officers, directors and consultants. Our 1999 equity incentive plan was terminated in March 2007 for purposes of granting any future equity awards. Our 2007 equity incentive plan was adopted in March 2007. We may provide share-based compensation through the grant of: (i) restricted stock awards; (ii) restricted stock unit awards; (iii) stock options; (iv) stock appreciation rights; (v) phantom stock; and (vii) performance awards. To date, we have granted stock options and restricted stock units.

**Stock options.** The fair value of each share-based payment award is estimated on the date of grant using an option pricing model that meets certain requirements. For stock options granted in 2008 and 2007, we used the Black-Scholes option pricing model to estimate the fair value of our share-based payment awards. The determination of the fair value of share-based payment awards utilizing the Black-Scholes model is affected by our stock price and a number of assumptions, including expected volatility, expected life, risk-free interest rate and expected dividends. The expected life of the stock option share-based payment awards is a historical weighted average of the expected lives of similar securities of comparable public companies. The risk-free interest rate assumption is based on observed interest rates appropriate for the terms of our awards. The dividend yield assumption is based on our expectation of paying no dividends. We estimated volatility using historical volatilities of similar public companies given our limited public stock price history as of the date of grant.

We evaluate the assumptions used to value our stock option awards as we issue options. If factors change and we employ different assumptions, share-based compensation expense may differ significantly from what we have recorded in the past. If there are any modifications or cancellations of the underlying unvested securities, we may be required to accelerate, increase or cancel any remaining unearned share-based compensation expense. Future share-based compensation expense and unearned share-based compensation will increase to the extent that we grant additional equity awards to employees.

**Restricted stock units.** The fair value of the restricted stock units is based on the closing price of our stock on the date of grant and is amortized over the vesting period.

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At December 31, 2009, we had \$11.6 million of total unrecognized compensation costs related to share-based compensation arrangements for stock options and restricted stock units granted. These costs will be recognized over a weighted-average period of 1.8 years.

**Accounting for income taxes**

We use the asset and liability method to account for income taxes, including recognition of deferred tax assets and liabilities for the anticipated future tax consequences attributable to differences between financial statement amounts and their respective tax basis. A valuation allowance is established when we believe that it is more likely than not that some portion of our deferred tax assets will not be realized. Changes in the valuation allowance from period to period are included in our tax provision in the period of change.

We account for uncertain income tax positions recognized in an enterprise's financial statements in accordance with the Income Tax Topic of the Accounting Standards Codification, or ASC, issued by FASB. This interpretation requires companies to use a prescribed model for assessing the financial recognition and measurement of all tax positions taken or expected to be taken in its tax returns. This guidance provides clarification on derecognition, classification, interest and penalties, accounting in interim periods, disclosures and transition. We adopted this guidance on January 1, 2007. Please see Note 9 to the Consolidated Financial Statements for more information.

Our Federal effective tax rate historically has been lower than the statutory rate of 35% largely due to the application of general business tax credits. At the end of 2009, Congress recessed without reinstating the R&E tax credit beyond the current expiration date of December 31, 2009. Since its enactment in 1981, Congress has reinstated on a retroactive basis the R&E tax credit several times. However, unless the R&E tax credit is reinstated, we will record Federal income taxes in 2010 at the enacted federal rate of 35%, net of other tax credits that may benefit us, if any.

**Results of operations****Comparison of year ended December 31, 2009 with year ended December 31, 2008***Revenue:*

	Year Ended December 31, 2009		2008		Variance \$	Variance %
	Amount	As a percentage of total revenue	Amount	As a percentage of total revenue		
<b>(Dollars in thousands)</b>						
License and implementation	\$ 43,684	64%	\$ 53,923	71%	\$ (10,239)	(19)%
Maintenance and support	25,099	36%	21,665	29%	3,434	16%
Total	\$ 68,783	100%	\$ 75,588	100%	\$ (6,805)	(9)%

License and implementation. License and implementation revenue decreased \$10.2 million to \$43.7 million for the year ended December 31, 2009 from \$53.9 million for the year ended December 31, 2008, representing a 19% decrease. Generally, revenue is recognized using the percentage-of-completion method over the implementation period, which typically ranges from six months to several years. For 2009, the number of implementations for which services were provided during the period remained relatively unchanged compared to 2008. Implementation periods can vary depending on numerous factors including, but not limited to, the number of licensed software products and the scope and complexity of the implementation requirements in relation to the number of man-days estimated to be necessary to complete the implementation. The decrease in license and implementation revenue was attributed to a decrease of 11% in license and implementation revenue recognized per man-day as a result of several projects during 2009 in which the value of the contracts was lower in relationship to the number of man-days needed to implement than in 2008 and a 9% decrease in the number of man-days that generated revenue.

Maintenance and support. Maintenance and support revenue increased \$3.4 million to \$25.1 million for the year ended December 31, 2009 from \$21.7 million for the year ended December 31, 2008, representing a 16% increase.

The increase was a result of the completion of a number of implementations of our software products following which we recognize maintenance and support revenue partially offset by \$0.6 million of temporary reductions.

**Table of Contents***Cost of revenue and gross profit:*

(Dollars in thousands)	Year Ended December 31,					
	2009	As a percentage of related revenue	2008	As a percentage of related revenue	Variance \$	Variance %
Cost of license and implementation	\$ 13,893	32%	\$ 14,894	28%	\$ (1,001)	(7)%
Cost of maintenance and support	4,752	19%	4,358	20%	394	9%
Total cost of revenue	\$ 18,645	27%	\$ 19,252	25%	\$ (607)	(3)%
Gross profit	\$ 50,138	73%	\$ 56,336	75%	\$ (6,198)	(11)%

*Cost of license and implementation.* Cost of license and implementation revenue decreased \$1.0 million to \$13.9 million for the year ended December 31, 2009 from \$14.9 million for the year ended December 31, 2008, representing a 7% decrease. The decrease in cost of license and implementation revenue is attributable to a \$0.6 million decrease in amortized costs related to a limited number of contracts, a decrease of \$0.3 million in personnel costs, a \$0.2 million beneficial change in foreign currency exchange and a decrease of \$0.2 million in travel and other expenses. These decreases were partially offset by a \$0.3 million increase in share-based compensation expenses. Due primarily to lower license and implementation revenue of \$10.2 million partially offset by a \$1.0 million reduction of license and implementation costs for the year ended December 31, 2009, license and implementation gross margins were 68% for the year ended December 31, 2009 as compared to 72% for the year ended December 31, 2008. License and implementation gross margins vary from period to period depending on the amount of implementation services required to deploy our products relative to the total value of contracts for which implementation services were provided during the period.

*Cost of maintenance and support.* Cost of maintenance and support revenue increased \$0.4 million to \$4.8 million for the year ended December 31, 2009 from \$4.4 million for the year ended December 31, 2008, representing a 9% increase. The increase in cost of maintenance and support is primarily attributable to the increased levels of effort required to support our higher installed customer base. Maintenance and support gross margins were 81% for the year ended December 31, 2009 compared to 80% for the year ended December 31, 2008.

*Gross profit.* Gross profit decreased \$6.2 million to \$50.1 million for the year ended December 31, 2009 from \$56.3 million for the year ended December 31, 2008, representing an 11% decrease. The decrease in our overall gross profit was attributable to the decrease in overall revenue and a decrease in our license and implementation gross margins.

*Operating expenses:*

(Dollars in thousands)	Year Ended December 31,					
	2009	As a percentage of total revenue	2008	As a percentage of total revenue	Variance \$	Variance %
Selling, general and administrative	\$ 22,635	33%	\$ 22,094	29%	\$ 541	2%
Research and development	20,136	29%	20,309	27%	(173)	(1)%

Total operating expenses	\$ 42,771	62%	\$ 42,403	56%	\$ 368	1%
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*Selling, general and administrative expenses.* Selling, general and administrative expenses increased \$0.5 million to \$22.6 million for the year ended December 31, 2009 from \$22.1 million for the year ended December 31, 2008, representing a 2% increase. The increase is primarily attributable to an increase in sales personnel and related expenses of \$1.2 million and an increase of \$0.8 million of share-based compensation expense. These increases were partially offset by a change of \$0.9 million in bad debt expense as a result of a decrease in our allowance for doubtful accounts in 2009 of \$0.6 million and an increase in our allowance for doubtful accounts of \$0.3 million in 2008. In addition, these increases were partially offset by a decrease of \$0.5 million in general and administrative expenses related to professional fees and a decrease of \$0.2 million in marketing expenses related to lower conference expenses.

*Research and development expenses.* Research and development expenses decreased \$0.2 million to \$20.1 million for the year ended December 31, 2009 from \$20.3 million for the year ended December 31, 2008, representing a 1% decrease. The decrease in research and development expenses is attributable a decrease of \$0.8 million resulting from research and development personnel with specific technical expertise assisting with implementation tasks during 2009. Although we don't consider this a trend, we may choose to use technical personnel on implementation tasks on future projects. In addition, there was a decrease of \$0.6 million in travel expense and other expenses. These decreases were partially offset by an increase of \$0.9 million of personnel

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expenses as a result of an increase in research and development personnel in 2009 and an increase of \$0.4 million of share-based compensation expense resulting from the granting of restricted stock units and stock options.

*Other income (expense):*

(Dollars in thousands)	Year Ended December 31,		Variance	Variance
	2009	2008	\$	%
Interest income	\$ 196	\$ 1,112	\$ (916)	(82)%
Other income	\$ 196	\$ 1,112	\$ (916)	(82)%

Interest income. Interest income decreased \$0.9 million from \$1.1 million for the year ended December 31, 2008 to \$0.2 million for the year ended December 31, 2009, representing an 82% decrease. The decrease was the result of lower interest rates earned on higher invested cash and short-term investments. Interest income is generated from the investments of cash balances in short-term interest bearing obligations with original maturities less than 90 days.

*Income tax provision:*

(Dollars in thousands)	Year Ended December 31,		Variance	Variance
	2009	2008	\$	%
Effective tax rate	27%	28%	n/a	1%
Income tax provision	\$ 2,047	\$ 4,288	\$ (2,241)	(52)%

Income tax provision. Our income tax provision decreased \$2.2 million from \$4.3 million for the year ended December 31, 2008 to \$2.0 million for the year ended December 31, 2009, representing a 52% decrease. The effective tax rate was 27% and 28% for the year ended December 31, 2009 and 2008, respectively. The income tax provision of \$2.0 million for the year ended December 31, 2009 was primarily the result of a decrease of \$7.5 million in pre-tax income compared to the year ended December 31, 2008.

***Comparison of year ended December 31, 2008 with year ended December 31, 2007***

*Revenue:*

(Dollars in thousands)	Year Ended December 31,				Variance	Variance
	2008	As a percentage of total revenue	2007	As a percentage of total revenue	\$	%
License and implementation	\$ 53,923	71%	\$ 43,159	70%	\$ 10,764	25%
Maintenance and support	21,665	29%	18,920	30%	2,745	15%
Total	\$ 75,588	100%	\$ 62,079	100%	\$ 13,509	22%

License and implementation. License and implementation revenue increased \$10.8 million to \$53.9 million for the year ended December 31, 2008 from \$43.2 million for the year ended December 31, 2007, representing a 25% increase. Generally, revenue is recognized using the percentage-of-completion method over the implementation period, which typically ranges from six months to several years. For 2008, the number of implementations for which services were provided during the period increased 19% compared to 2007. Implementation periods can vary



depending on numerous factors including, but not limited to, the number of licensed software products and the scope and complexity of the implementation requirements in relation to the number of man-days estimated to be necessary to complete the implementation. The increase in license and implementation revenue was attributed to an increase of 29% in license and implementation revenue recognized per man-day as a result of several projects during 2008 in which the value of the contracts was higher in relationship to the number of man-days needed to implement than in 2007 and a 3% decrease in the number of man-days that generated revenue.

Maintenance and support. Maintenance and support revenue increased \$2.7 million to \$21.7 million for the year ended December 31, 2008 from \$18.9 million for the year ended December 31, 2007, representing a 15% increase. The increase was the result of the completion of a number of implementations of our software products following which we are able to begin recognizing maintenance and support revenue.

**Table of Contents***Cost of revenue and gross profit:*

	Year Ended December 31, 2008		2007		Variance \$	Variance %
	Amount	As a percentage of related revenue	Amount	As a percentage of related revenue		
<b>(Dollars in thousands)</b>						
Cost of license and implementation	\$ 14,894	28%	\$ 13,227	31%	\$ 1,667	13%
Cost of maintenance and support	4,358	20%	4,717	25%	(359)	(8)%
Total cost of revenue	\$ 19,252	25%	\$ 17,944	29%	\$ 1,308	7%
Gross profit	\$ 56,336	75%	\$ 44,135	71%	\$ 12,201	28%

*Cost of license and implementation.* Cost of license and implementation increased \$1.7 million to \$14.9 million for the year ended December 31, 2008 from \$13.2 million for the year ended December 31, 2007, representing a 13% increase. The increase in cost of license and implementation is attributable to an increase of \$0.8 million in amortized costs related to certain contracts, an increase of \$0.4 million in share-based compensation expenses, an increase of \$0.3 million from a foreign currency loss resulting from currency exchange, and an increase of \$0.3 million in travel expense offset by a decrease of \$0.1 million of personnel resources required to implement our software products. License and implementation gross margins increased from 69% to 72% for the year ended December 31, 2008 primarily due to an increase in license and implementation revenue and improvements in our implementation processes and the standardization of software products. License and implementation costs may vary from period to period depending on 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 decreased by \$0.4 million to \$4.4 million for the year ended December 31, 2008 from \$4.7 million for the year ended December 31, 2007, representing an 8% decrease. The decrease in cost of maintenance and support is primarily attributed to a decrease of \$0.3 million as a result of a reduction in resources associated with specific maintenance projects. Maintenance and support margins increased from 75% to 80% for the year ended December 31, 2008 due to an increase in maintenance and support revenue as a result of the completion of a number of implementations of our software products as well as a decrease in cost of maintenance and support resulting from the reduced resources required to provide support during the period.

*Gross profit.* Gross profit increased \$12.2 million to \$56.3 million for the year ended December 31, 2008 from \$44.1 million for the year ended December 31, 2007, representing a 28% increase. The increase in our overall gross profit was attributable to the increase in overall revenue and the improvement in our license and implementation and maintenance and support gross margins.

*Operating expenses:*

	Year Ended December 31, 2008		2007		Variance \$	Variance %
	Amount	As a percentage of total revenue	Amount	As a percentage of total revenue		
<b>(Dollars in thousands)</b>						
Selling, general and administrative	\$ 22,094	29%	\$ 16,292	26%	\$ 5,802	36%

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Research and development	20,309	27%	16,837	27%	3,472	21%
Total operating expenses	\$ 42,403	56%	\$ 33,129	53%	\$ 9,274	28%

*Selling, general and administrative expenses.* Selling, general and administrative expenses increased \$5.8 million to \$22.1 million for the year ended December 31, 2008 from \$16.3 million for the year ended December 31, 2007, representing a 36% increase. The increase in selling, general and administrative expenses is primarily attributable to an increase of \$1.9 million in personnel expenses principally as a result of an increase in selling and marketing personnel, an increase of \$1.3 million in share-based compensation expenses, an increase of \$1.0 million in travel expense associated with sales activities, an increase of \$0.9 million in professional fees, directors and officer insurance and directors fees associated with being a publicly traded company and \$0.4 million of marketing expenses.

*Research and development expenses.* Research and development expenses increased \$3.5 million to \$20.3 million for the year ended December 31, 2008 from \$16.8 million for the year ended December 31, 2007, representing a 21% increase. The increase in research and development expenses is attributable to an increase of \$2.6 million in personnel expenses resulting from an increase in our products and product management activities and \$0.7 in share-based compensation expenses.

**Table of Contents***Other income (expense):*

	Year Ended December 31,		Variance	Variance
(Dollars in thousands)	2008	2007	\$	%
Interest income	\$ 1,112	\$ 1,623	\$ (511)	(31)%
Interest expense		(869)	869	(100)%
Other income (expense), net	\$ 1,112	\$ 754	\$ 358	47%

Interest income. Interest income decreased \$0.5 million to \$1.1 million for the year ended December 31, 2008 from \$1.6 million for the year ended December 31, 2007, representing a 31% decrease. The decrease was the result of lower interest rates earned on higher invested cash and short-term investments. Interest income is generated from the investments of cash balances in short term interest bearing obligations with original maturities less than 90 days.

Interest expense. Interest expense of \$0.9 million for the year ended December 31, 2007 is the result of interest incurred on a \$20.0 million credit facility and the expensing of \$0.4 million of deferred financing costs. In July 2007, we used the proceeds from our initial public offering to retire and terminate the credit facility.

*Income tax provision:*

	Year Ended December 31,		Variance	Variance
(Dollars in thousands)	2008	2007	\$	%
Effective tax rate	28%	11%	n/a	17%
Income tax provision	\$ 4,288	\$ 1,243	\$ 3,045	

Income tax provision. Our income tax provision increased \$3.0 million to \$4.3 million for the year ended December 31, 2008 from \$1.2 million for the year ended December 31, 2007. Included in our income tax provision of \$1.2 million for the year ended December 31, 2007 is a benefit of \$1.1 million due to the reversal of a valuation allowance previously recorded against the deferred tax asset on our R&E tax credit carryforwards. The reversal is the result of our conclusion that it is more likely than not that our R&E tax credit carryforwards would be utilized. The income tax provision of \$4.3 million for the year ended December 31, 2008 was the result of an increase of \$3.3 million in pre-tax income compared to the year ended December 31, 2007. The reversal of the valuation allowance in 2007 was the result of our conclusion that it is more likely than not that the associated deferred tax asset would be realized.

**Liquidity and capital resources:**

At December 31, 2009, we had \$62.4 million of cash and cash equivalents and \$50.8 million of working capital as compared to \$52.0 million of cash and cash equivalents and \$41.7 million of working capital at December 31, 2008. Our principal source of liquidity is our net cash flows provided by operating activities. Our material drivers or variants of operating cash flow are net income, non-cash expenses (principally share-based compensation) and the timing of periodic billings and collections related to the sales of our software and related services.

Our working capital was \$50.8 million at December 31, 2009 compared to \$41.7 million at December 31, 2008, an increase of \$9.1 million, or 22%. The increase in working capital was principally attributable to an increase in our cash balances of \$10.5 million and partially offset by a decrease of \$4.5 million in accounts receivable balances. In addition to the increase in current assets, there was a decrease in short term deferred revenue of \$2.2 million.

Based on existing cash and cash equivalents balances 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. However, at some future date we may need to seek additional sources of capital to meet our requirements. If such need arises, we may be required to raise additional funds through equity or

debt financing. We do not currently have a bank line of credit. We can provide no assurance that bank lines of credit or other financing will be available on terms acceptable to us. If available, such financing may result in dilution to our shareholders or higher interest expense.

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The following table presents key components of our Consolidated Statements of Cash Flows for the years ended December 31, 2009, 2008 and 2007.

(Dollars in thousands)	For the Year Ended December 31,		
	2009	2008	2007
Net cash provided by operating activities	\$11,463	\$13,823	\$10,024
Net cash used in investing activities	(1,111)	(1,208)	(1,678)
Net cash provided by (used in) financing activities	118	(5,014)	(6,508)
Cash and cash equivalents (end of period)	\$62,449	\$51,979	\$44,378

***Cash flow analysis:***

Our operating activities provided net cash of \$11.5 million for the year ended December 31, 2009. Net cash provided from operations is primarily attributable to net income, adjusted for non-cash charges totaling approximately \$4.8 million. Increased milestone billings and strong cash collections in 2009 provided cash from operations of approximately \$6.6 million, offset partially by an increase in deferred tax assets and prepaid expenses. Uses of cash from investing activities for the year ended December 31, 2009 consisted of \$1.1 million of purchases of property and equipment. Net sources of cash from financing activities consisted of \$0.1 million from the exercise of stock options.

Our operating activities provided net cash of \$13.8 million in 2008, due mainly to net income, adjusted for non-cash charges, and a decrease in prepaid expenses, offset partly increases in unbilled receivables, deferred tax assets and accounts receivable. Uses of cash from investing activities for the year ended December 31, 2008 consisted of \$1.2 million of purchases of property and equipment. Net uses of cash from financing activities consisted of (a) \$5.0 million as a result of the stock repurchase program and (b) \$0.3 million of costs associated with the secondary offering. Sources of cash from financing activities consisted of \$0.3 million from the exercise of options.

Our operating activities provided net cash of \$10.0 million in 2007, due mainly to net income, adjusted for non-cash charges, provision for doubtful accounts, and non-cash expense of deferred financing costs, offset partly by deferred tax assets, unbilled receivables, and prepaid expenses and other. Uses of cash from investing activities for the year ended December 31, 2007 consisted of \$1.7 million of purchases of property and equipment. Our cash outflows from financing activities consist primarily of the redemption of preferred stock, one-time cash dividend payments, and initial public offering costs, while cash inflows from financing activities consist primarily of proceeds received from our initial public offering and follow on offering. In 2007, our financing activities used net cash of \$6.5 million, due mainly to the redemption of preferred stock and cash dividend payments, offset by proceeds received from our initial public offering and follow on offering.

***Stock repurchases***

On August 25, 2008, we announced our Board of Directors authorized a stock repurchase program for the purchase of up to \$15.0 million of our common stock. No shares were repurchased during the year ended December 31, 2009. During the year ended December 31, 2008, we purchased 570,545 shares for \$5.0 million. As of December 31, 2009, \$10.0 million remained available in the stock repurchase program. The repurchase of stock if continued will be funded primarily with existing cash balances. The timing of any repurchases will depend upon various factors including but not limited to market conditions, the market price of our common stock and management's assessment of our liquidity and cash flow needs. For additional information on the stock repurchase program see Market for registrant's common equity, related stockholder matters and issuer purchases of equity securities.

**Table of Contents*****Contractual obligations***

The following table sets forth our contractual obligations as of December 31, 2009:

(Dollars in thousands)	Less than  1 year	Payment due by period		Total
		1 to 3 years	3 to 5 years	
Operating leases	\$ 1,282	\$ 746	\$	\$ 2,028
Total contractual obligations	\$ 1,282	\$ 746	\$	\$ 2,028

Our only significant operating lease obligation relates to our corporate headquarters in Houston, Texas which we lease under a single non-cancelable operating lease agreement. In March 2006, we executed an amendment to the lease that extended the lease term until July 31, 2011. In addition, we lease approximately 3,300 square feet in Austin, Texas. This lease expires June 2011.

***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.

***Recently issued accounting pronouncements***

In October 2009, the Financial Accounting Standards Board ( FASB ) issued authoritative guidance on revenue arrangements with multiple deliverables that are outside the scope of the software revenue recognition guidance. Under the new guidance, when vendor specific objective evidence or third party evidence for deliverables in an arrangement cannot be determined, a best estimate of the selling price is required to separate deliverables and allocate arrangement consideration using the relative selling price method. The new guidance no longer permits the residual method of allocating arrangement considerations. This authoritative guidance is effective for fiscal years beginning on or after June 15, 2010 (early adoption is permitted). We are currently assessing the impact on its consolidated financial position and results of operations.

***Item 7A. Quantitative and qualitative disclosures about market risk******Foreign currency risk***

Historically, some of our contracts are denominated in foreign currencies and therefore a portion of our revenue is subject to foreign currency risks. Our cash flows are subject to fluctuations due to changes in foreign currency exchange rates. The effect of an immediate 10% adverse change in exchange rates on foreign denominated receivables as of December 31, 2009 would result in a \$0.1 million loss. Fluctuations in currency exchange rates could harm our business in the future. To date, we have not entered into any hedging contracts although we may do so in the future.

***Item 8. Financial statements and supplementary data***

The response to this section is submitted as a separate section of this Report. See Item 15 (a)(1) and (2).

***Item 9. Change in and disagreements with accountants on accounting and financial disclosure***

None.

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### **Item 9A. Controls and procedures**

#### **Evaluation of Disclosure Controls and Procedures**

As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer ( CEO ) and Chief Financial Officer ( CFO ), of 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 ( Exchange Act ). As described below, our management has identified a material weakness in our internal control over financial reporting. As a result, our CEO and CFO have concluded that our disclosure controls and procedures were not effective (i) to provide reasonable assurance that information required to be disclosed by us in the reports filed or submitted by us under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and (ii) ensure that information required to be disclosed is accumulated and communicated to our management, including our CEO and CFO, to allow timely decisions regarding required disclosures.

#### **Management's Report on Internal Control over Financial Reporting**

Management, under the supervision of our CEO and CFO, is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting, as defined in Rules 13a-15(f) or 15d-15(f) under the Exchange Act, refers to a process designed by, or under the supervision of, our chief executive officer and chief financial officer, and effected by our board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external reporting purposes in accordance with GAAP and includes those policies and procedures that:

- pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of our assets;

- provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with GAAP and that our receipts and expenditures are being made only in accordance with authorizations of our management and members of our board of directors; and

- provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on our financial statements.

Internal control over financial reporting cannot provide absolute assurance of achieving financial reporting objectives because of its inherent limitations. Internal control over financial reporting is a process that involves human diligence and compliance and is subject to lapses in judgment and breakdowns resulting from human failures. Also, projections of any evaluation of effectiveness to future period are subject to the risk that controls may also become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. Because of such limitations, there is a risk that material misstatements will not be prevented or detected on a timely basis by internal control over financial reporting.

Management, with the participation of our CEO and CFO, assessed the effectiveness of our internal control over financial reporting as of December 31, 2009 based on the framework in Internal Control - Integrated Framework, issued by the Committee of Sponsoring Organizations of the Treadway Commission ( COSO Framework ).

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the company's annual or interim financial statements will not be prevented or detected on a timely basis. We did not maintain effective controls over the identification and proper GAAP accounting treatment of certain terms and conditions in our new sales contracts. Specifically, our internal controls over the recognition of revenue were not operating effectively to ensure that certain terms and conditions relevant to new sales contracts were identified and evaluated for accurate revenue recognition. This control deficiency resulted in the recording of an audit adjustment to revenue and deferred revenue in the fourth quarter of 2009. This adjustment was recorded prior to our earnings release on February 11, 2010 and has been reflected in our Form 10-K. We are not restating any prior period financial statements. This control deficiency, if not remediated, could materially affect our revenue and deferred revenue accounts and related disclosures which would result in a material misstatement of our consolidated financial statements that would not be prevented or detected on a



timely basis. Our management has determined this control deficiency constitutes a material weakness. Based on this assessment and due to the material weakness described above, management concluded that our internal control over financial reporting were not effective as of December 31, 2009.

The effectiveness of our internal control over financial reporting as of December 31, 2009 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report, which is included herein.

#### **Management's plan for remediation**

Management has developed a remediation plan, which it is in the process of implementing, to address the above-described material weakness and to improve our system of internal control over financial reporting. These measures include:

- formalize and document the existing contract review by the legal department in which non-standard terms and conditions for each new sales contract are identified;

- implement a new checklist to enhance the documentation and evaluation of revenue recognition criteria for each new sales contract to provide for more in-depth analysis and ensure appropriate revenue recognition for each contract; and

- design and implement additional training programs to provide our personnel with an improved level of knowledge of the complexities related to software revenue recognition and the application of GAAP commensurate with their responsibilities and our financial reporting requirements.

Our audit committee has overseen the development of management's plan and will be monitoring the implementation and timetable for the execution of the above-referenced remedial measures, to the extent not already complete.

#### **Changes in Internal Control over Financial Reporting**

There have been no changes in the Company's internal control over financial reporting that occurred during the three months ended December 31, 2009 that have materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

#### **Item 9B. Other information**

None.

### **Part III**

#### **Item 10. Directors, executive officers and corporate governance**

The information required by this item will be included in our definitive Proxy Statement in connection with our 2010 Annual Meeting of Stockholders which will be held on June 10, 2010 and is incorporated herein by reference.

#### **Item 11. Executive compensation**

The information required by this item will be included in our definitive Proxy Statement in connection with our 2010 Annual Meeting of Stockholders which will be held on June 10, 2010 and is incorporated herein by reference.

#### **Item 12. Security ownership of certain beneficial owners and management and related stockholder matters**

The information required by this item will be included in our definitive Proxy Statement in connection with our 2010 Annual Meeting of Stockholders which will be held on June 10, 2010 and is incorporated herein by reference.

#### **Item 13. Certain relationships, related transactions and director independence**

The information required by this item will be included in our definitive Proxy Statement in connection with our 2010 Annual Meeting of Stockholders which will be held on June 10, 2010 and is incorporated herein by reference.

#### **Item 14. Principal accountant fees and services**

The information required by this item will be included in our definitive Proxy Statement in connection with our 2010 Annual Meeting of Stockholders which will be held on June 10, 2010 and is incorporated herein by reference.

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**Part IV**

**Item 15. Exhibits and financial statements schedules**

**(a)(1) Financial Statements**

The consolidated financial statements of PROS Holdings, Inc. and Report of PricewaterhouseCoopers LLP, Independent Registered Public Accounting Firm are included in a separate section of this Annual Report beginning on page F-1.

**(a)(2) Financial Statement Schedules**

Refer to Schedule II, Valuation and Qualifying Accounts, hereto.

Schedules not listed above have been omitted because they are not applicable or are not required or the information required to be set forth therein is included in the consolidated financial statements or Notes thereto.

**(a)(3) Exhibits**

Index to Exhibits

- 3.1 Amended and Restated Certificate of Incorporation (incorporated by reference to Exhibit 3.1.1 of the Registrant's Form S-1 Registration Statement (Registration No. 333-141884), declared effective by the Securities and Exchange Commission on June 27, 2007).
- 3.2 Amended and Restated Bylaws (incorporated by reference to Exhibit 3.3 of the Registrant's Form 8-K filed with the Securities and Exchange Commission on August 27, 2008).
- 4.1 Specimen certificate for shares of common stock (incorporated by reference to the exhibit of the same number to the Registrant's Form S-1 Registration Statement (Registration No. 333-141884), declared effective by the Securities and Exchange Commission on June 27, 2007).
- 10.1 1999 Equity Incentive Plan, as amended to date, and form of stock option agreement (incorporated by reference to the exhibit 10.2 to the Registrant's Form S-1 Registration Statement (Registration No. 333-141884), declared effective by the Securities and Exchange Commission on June 27, 2007).
- 10.2 2007 Equity Incentive Plan and form of stock option agreement (incorporated by reference to the exhibit 10.3 to the Registrant's Form S-1 Registration Statement (Registration No. 333-141884), declared effective by the Securities and Exchange Commission on June 27, 2007).
- 10.3 Stock Purchase and Stockholders Agreement, dated June 8, 1998, by and among Registrant (as successor in interest to PROS Strategic Solutions, Inc.) and certain stockholders (incorporated by reference to the exhibit 10.4 to the Registrant's Form S-1 Registration Statement (Registration No. 333-141884), declared effective by the Securities and Exchange Commission on June 27, 2007).
- 10.3.1 Amendment to Stock Purchase and Stockholders Agreement dated March 26, 2007 by and among Registrant (as successor in interest to PROS Strategic Solutions, Inc.) and certain stockholders. (incorporated by reference to the exhibit 10.4.1 to the Registrant's Form S-1 Registration Statement (Registration No. 333-141884), declared effective by the Securities and Exchange Commission on June 27, 2007).
- 10.5 Registration Rights Agreement, dated May 25, 1999, by and between Registrant (as successor in interest to PROS Strategic Solutions, Inc.) and David Samuel Coats (incorporated by reference to the exhibit 10.6 to the Registrant's Form S-1 Registration Statement (Registration No. 333-141884), declared effective by the Securities and Exchange Commission on June 27, 2007).

- 10.6 Registration Rights Agreement, dated April 13, 2000, by and between Registrant (as successor in interest to PROS Strategic Solutions, Inc.) and Robert Salter (incorporated by reference to the exhibit 10.7 to the Registrant's Form S-1 Registration Statement (Registration No. 333-141884), declared effective by the Securities and Exchange Commission on June 27, 2007).
- 10.7 Registration Rights Agreement, dated June 8, 2007, by and among Registrant, Mariette M. Woestemeyer and Ronald F. Woestemeyer (incorporated by reference to the exhibit 10.8 to the Registrant's Form S-1 Registration Statement (Registration No. 333-141884), declared effective by the Securities and Exchange Commission on June 27, 2007).

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- 10.8 Office Lease, dated January 31, 2001, by and between PROS Revenue Management L.P. and Houston Community College System (incorporated by reference to the exhibit 10.10 to the Registrant's Form S-1 Registration Statement (Registration No. 333-141884), declared effective by the Securities and Exchange Commission on June 27, 2007).
- 10.8.1 First Amendment to Office Lease, dated May 31, 2006, by and between PROS Revenue Management L.P. and Houston Community College System (incorporated by reference to the exhibit 10.10.1 to the Registrant's Form S-1 Registration Statement (Registration No. 333-141884), declared effective by the Securities and Exchange Commission on June 27, 2007).
- 10.9\* Employment Agreement, dated September 30, 2005, by and between PROS Revenue Management L.P. and Albert E. Winemiller (incorporated by reference to the exhibit 10.11 to the Registrant's Form S-1 Registration Statement (Registration No. 333-141884), declared effective by the Securities and Exchange Commission on June 27, 2007).
- 10.9.1\* Immediately Exercisable Stock Option Grant, dated April 2, 2007, by and between Registrant and Albert E. Winemiller (incorporated by reference to the exhibit 10.11.1 to the Registrant's Form S-1 Registration Statement (Registration No. 333-141884), declared effective by the Securities and Exchange Commission on June 27, 2007).
- 10.9.2\* Amendment No.1 to Employment Agreement, dated April 2, 2007, by and between Registrant and Albert E. Winemiller (incorporated by reference to the exhibit 10.11.2 to the Registrant's Form S-1 Registration Statement (Registration No. 333-141884), declared effective by the Securities and Exchange Commission on June 27, 2007).
- 10.9.3\* Amendment No. 2 to Employment Agreement, dated March 24, 2009, by and between PROS Revenue Management L.P. and Albert E. Winemiller (incorporated by reference to the exhibit 10.4 to the Registrant's Form 8-K filed the Securities and Exchange Commission on March 26, 2009).
- 10.10\* Employment Agreement, dated September 30, 2005, by and between PROS Revenue Management L.P. and Charles H. Murphy (incorporated by reference to the exhibit 10.12 to the Registrant's Form S-1 Registration Statement (Registration No. 333-141884), declared effective by the Securities and Exchange Commission on June 27, 2007).
- 10.10.1\* Immediately Exercisable Incentive Stock Option Grant, dated September 30, 2005, by and between Registrant and Charles H. Murphy (incorporated by reference to the exhibit 10.12.1 to the Registrant's Form S-1 Registration Statement (Registration No. 333-141884), declared effective by the Securities and Exchange Commission on June 27, 2007).
- 10.10.2\* Immediately Exercisable Stock Option Grant, dated April 2, 2007, by and between Registrant and Charles H. Murphy (incorporated by reference to the exhibit 10.12.2 to the Registrant's Form S-1 Registration Statement (Registration No. 333-141884), declared effective by the Securities and Exchange Commission on June 27, 2007).
- 10.10.3\* Amendment No.1 to Employment Agreement, dated April 2, 2007, by and between Registrant and Charles H. Murphy (incorporated by reference to the exhibit 10.12.3 to the Registrant's

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Form S-1 Registration Statement (Registration No. 333-141884), declared effective by the Securities and Exchange Commission on June 27, 2007).

- 10.10.4\* Amendment No. 2 to Employment Agreement, dated March 24, 2009, by and between PROS Revenue Management L.P. and Charles H. Murphy. (incorporated by reference to the exhibit 10.4 to the Registrant's Form 8-K filed the Securities and Exchange Commission on March 26, 2009).
- 10.11\* Employment Agreement, dated January 15, 1999, by and between PROS Revenue Management L.P. and Ronald F. Woestemeyer (incorporated by reference to the exhibit 10.12 to the Registrant's Form S-1 Registration Statement (Registration No. 333-141884), declared effective by the Securities and Exchange Commission on June 27, 2007).
- 10.11.1\* Amendment No. 1 to Employment Agreement, dated February 2, 2004, by and between PROS Revenue Management L.P. and Ronald F. Woestemeyer (incorporated by reference to the exhibit 10.13.1 to the Registrant's Form S-1 Registration Statement (Registration No. 333-141884), declared effective by the Securities and Exchange Commission on June 27, 2007).
- 10.12\* Form of Indemnification Agreement entered into among Registrant, its affiliates and its directors and officers (incorporated by reference to the exhibit number 10.16 to the Registrant's Form S-1 Registration Statement (Registration No. 333-141884), declared effective by the Securities and Exchange Commission on June 27, 2007).
- 10.13\* Employment Agreement, dated April 24, 2008, by and between PROS Revenue Management L.P. and Andres Reiner - Senior Vice-President Product Development. (incorporated by reference to the exhibit 10.17 to the Registrant's Form 10-Q filed the Securities and Exchange Commission on August 7, 2008).
- 10.13.1\* Amendment No. 1 to Employment Agreement, dated March 24, 2009, by and between PROS Revenue Management L.P. and Andres Reiner - Senior Vice-President Product Development. (incorporated by reference to the exhibit 10.1 to the Registrant's Form 8-K filed the Securities and Exchange Commission on March 26, 2009).

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21.1	List of Subsidiaries (incorporated by reference to the exhibit of the same number to the Registrant's Form S-1 Registration Statement (Registration No. 333-141884), declared effective by the Securities and Exchange Commission on June 27, 2007).
23.1#	Consent of PricewaterhouseCoopers LLP (filed herewith).
31.1#	Certification of Chief Executive Officer pursuant to Exchange Act Rule 13a-14(a) or 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes Oxley Act of 2002(filed herewith).
31.2#	Certification of Chief Financial Officer pursuant to Exchange Act Rule 13a-14(a) or 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002(filed herewith).
32.1#	Certifications of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002(filed herewith).
	Constitutes management contracts or compensatory arrangements
#	Filed with this report.

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Pursuant to the requirements of Section 13 or 15(d) of the Securities and Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, on March 9, 2010.

PROS Holdings Inc.

By: /s/ Albert E. Winemiller

Albert E. Winemiller

*President and Chief Executive Officer*

KNOW BY THESE PRESENT, that each person whose signature appears below constitutes and appoints each of Albert E. Winemiller and Charles H. Murphy, his attorney-in-fact, with the power of substitution, for him in any and all capacities, to sign any amendments to this report on Form 10-K and to file the same, with exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, hereby ratifying and confirming all that each of the attorney-in-fact, or his substitute or substitutes, may do or cause to be done by virtue hereof.

Pursuant to the requirement of the Securities and Exchange Act of 1934, this report has been signed by the following persons on behalf of the Registrant and in the capacity and on the date indicated.

<b>Signatures</b>	<b>Title</b>	<b>Date</b>
/s/ Albert E. Winemiller	President, Chief Executive Officer	March 9, 2010
Albert E. Winemiller	And Chairman of the Board(Principal Executive Officer)	
/s/ Charles H. Murphy	Executive Vice President and	March 9, 2010
Charles H. Murphy	Chief Financial Officer (Principal Accounting Officer)	
/s/ Ronald F. Woestemeyer	Executive Vice President, Strategic	March 9, 2010
Ronald Woestemeyer	Business Planning and Director	
/s/ Ellen Keszler	Director	March 9, 2010
Ellen Keszler		
/s/ Greg B. Petersen	Director	March 9, 2010
Greg B. Petersen		
/s/ William Russell	Director	March 9, 2010
William Russell		
/s/ Timothy V. Williams	Director	March 9, 2010
Timothy V. Williams		
/s/ Mariette M. Woestemeyer	Director	March 9, 2010

Mariette M. Woestemeyer

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**Report of Independent Registered Public Accounting Firm**

To the Board of Directors and Stockholders of  
PROS Holdings, Inc.

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, of redeemable preferred stock and stockholders' equity and cash flows present fairly, in all material respects, the financial position of PROS Holdings, Inc. and its subsidiaries at December 31, 2009 and 2008, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2009 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in the index appearing under Item 15(a)(2) presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. Also in our opinion, the Company did not maintain, in all material respects, effective internal control over financial reporting as of December 31, 2009, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) because a material weakness in internal control over financial reporting related to revenue recognition existed as of that date. A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the annual or interim financial statements will not be prevented or detected on a timely basis. The material weakness referred to above is described in Management's Report on Internal Control over Financial Reporting under Item 9A. We considered this material weakness in determining the nature, timing, and extent of audit tests applied in our audit of the December 31, 2009 consolidated financial statements and our opinion regarding the effectiveness of the Company's internal control over financial reporting does not affect our opinion on those consolidated financial statements. The Company's management is responsible for these financial statements and financial statement schedule, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in management's report referred to above. Our responsibility is to express opinions on these financial statements, on the financial statement schedule, and on the Company's internal control over financial reporting based on our audits (which were integrated audits in 2009 and 2008). We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may

deteriorate.

/s/ PricewaterhouseCoopers LLP

Houston, Texas

March 9, 2010

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**PROS Holdings, Inc.**  
**Consolidated Balance Sheets**  
(In thousands, except share amounts)

	<b>December 31,</b>	
	<b>2009</b>	<b>2008</b>
<b>Assets:</b>		
Current assets:		
Cash and cash equivalents	\$ 62,449	\$ 51,979
Accounts and unbilled receivables, net of allowance of \$1,300 and \$1,900, respectively	12,035	16,552
Prepaid and other current assets	4,143	3,238
Total current assets	78,627	71,769
Property and equipment, net	2,959	2,901
Other long term assets, net	3,743	2,297
Total assets	\$ 85,329	\$ 76,967
<b>Liabilities and Stockholders Equity:</b>		
Current liabilities:		
Accounts payable	\$ 1,198	\$ 1,088
Accrued liabilities	3,199	3,293
Accrued payroll and other employee benefits	4,510	4,493
Deferred revenue	14,099	16,288
Other current liabilities	4,866	4,866
Total current liabilities	27,872	30,028
Long-term deferred revenue	2,418	3,187
Commitments and contingencies (Note 10)		
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, 30,163,508 and 30,095,846 shares issued, respectively, 25,745,923 and 25,678,261 shares outstanding, respectively	30	30
Additional paid-in capital	63,439	57,668
Treasury stock, 4,417,585 common shares, at cost	(13,938)	(13,938)
Retained earnings (deficit)	5,508	(8)
Total stockholders equity	55,039	43,752
Total liabilities and stockholders equity	\$ 85,329	\$ 76,967

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

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**PROS Holdings, Inc.**  
**Consolidated Statements of Operations**  
(In thousands, except share and per share data)

	Year Ended December 31,		
	2009	2008	2007
<b>Revenue:</b>			
License and implementation	\$ 43,684	\$ 53,923	\$ 43,159
Maintenance and support	25,099	21,665	18,920
Total revenue	68,783	75,588	62,079
<b>Cost of revenue:</b>			
License and implementation	13,893	14,894	13,227
Maintenance and support	4,752	4,358	4,717
Total cost of revenue	18,645	19,252	17,944
Gross profit	50,138	56,336	44,135
<b>Operating expenses:</b>			
Selling, general and administrative	22,635	22,094	16,292
Research and development	20,136	20,309	16,837
Income from operations	7,367	13,933	11,006
Other income:			
Interest income	196	1,112	1,623
Interest expense			(869)
Income before income tax provision	7,563	15,045	11,760
Income tax provision	2,047	4,288	1,243
Net income	5,516	10,757	10,517
Accretion of preferred stock			(82)
Net income attributable to common stockholders	\$ 5,516	\$ 10,757	\$ 10,435
Net earnings attributable to common stockholders per share:			
Basic	\$ 0.21	\$ 0.41	\$ 0.45
Diluted	\$ 0.21	\$ 0.40	\$ 0.45
Weighted average number of shares:			
Basic	25,710,569	26,120,613	23,026,163
Diluted	26,430,817	26,569,074	23,433,981

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

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**PROS Holdings, Inc.**  
**Consolidated Statements of Cash Flows**  
(In thousands)

	<b>Year Ended December 31,</b>		
	<b>2009</b>	<b>2008</b>	<b>2007</b>
<b>Operating activities:</b>			
Net income	\$ 5,516	\$ 10,757	\$ 10,517
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation	1,283	1,363	1,182
Stock based compensation	5,475	4,021	1,601
Deferred income taxes	(1,563)	(821)	(1,871)
Deferred financing costs			418
Provision for doubtful accounts	(566)	288	360
Amortization of capitalized costs	203	1,120	1,088
Changes in operating assets and liabilities:			
Accounts receivable	4,377	(669)	(183)
Unbilled receivables	1,932	(1,064)	(1,284)
Prepaid expenses and other	(639)	(260)	(1,515)
Accounts payable, accrued liabilities and accrued payroll	(1,597)	(340)	(221)
Deferred revenue	(2,958)	(572)	(68)
Net cash provided by operating activities	11,463	13,823	10,024
<b>Investing activities:</b>			
Purchases of property and equipment	(1,111)	(1,208)	(1,678)
Net cash used in investing activities	(1,111)	(1,208)	(1,678)
<b>Financing activities:</b>			
Proceeds from long-term debt			20,000
Payments on long-term debt			(20,000)
Proceeds from initial public offering, net of underwriters' costs			52,365
Dividend on common stock			(41,328)
Proceeds from follow on offering			1,028
Redemption of redeemable preferred stock			(17,365)
Exercise of stock options	118	286	709
Exercise of stock warrants			410
Initial public offering costs			(1,793)
Secondary offering costs		(300)	(116)
Purchase of treasury stock		(5,000)	
Deferred financing costs			(418)
Net cash provided by (used in) financing activities	118	(5,014)	(6,508)
Net increase in cash and cash equivalents	10,470	7,601	1,838
<b>Cash and cash equivalents:</b>			
Beginning of period	51,979	44,378	42,540

End of period	\$ 62,449	\$ 51,979	\$ 44,378
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**Supplemental disclosure of cash flow information:**

Cash paid during period for:

Taxes	\$ 4,407	\$ 4,895	\$ 3,412
Interest	\$	\$	\$ 869

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

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Share repurchase program income	(570,545)			570,545	(5,000)		(5,000)
Income at December 31,	25,678,261	30	57,668	4,417,585	(13,938)	(8)	43,757
Expense of stock options	67,662		118				
Impact of expense of qualified stock options			178				
Employee-based compensation income			5,475				5,475
Income at December 31,							5,516
	\$	\$	25,745,923	\$30	\$63,439	\$	4,417,585
						\$(13,938)	\$ 5,508
							\$ 55,263

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

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**PROS Holdings, Inc.**

**Notes to Consolidated Financial Statements**

**1. Organization and summary of significant accounting policies**

***Nature of operations***

PROS Holdings, Inc., a Delaware corporation and subsidiaries (the Company), is a provider of pricing and margin optimization software products, an emerging category of enterprise applications designed to allow companies to improve financial performance by implementing pricing excellence best-practices. Customers use the Company's software products to gain insight into their pricing strategies, identify detrimental pricing activities, optimize their pricing decision-making and improve their business processes and financial performance. The Company's software products incorporate advanced pricing science, which includes operations research, forecasting and statistics. These innovative science-based software products analyze, execute and optimize pricing strategies using data elements determined using advanced pricing science, including the pocket price, pocket margin, customer willingness-to-pay, customer cost-to-serve, win-loss ratios, market price, stretch price and other relevant information as well as data from traditional enterprise applications, often augmenting it with real-time and historical data and external market data sources. The Company also provides a range of services that include analyzing a company's current pricing processes and implementing the Company's software products to improve pricing performance. The Company provides its software products to enterprises across a range of industries, including manufacturing, distribution, services, hotel and cruise, and airline.

***Initial public offering***

In July 2007, the Company completed its initial public offering of common stock (the IPO) in which the Company sold and issued 5,118,750 shares of common stock and selling stockholders sold an additional 1,706,250 shares of common stock. The Company's Certificate of Incorporation, as restated on June 22, 2007, authorizes the issuance of 75,000,000 shares of common stock and 5,000,000 shares of preferred stock, each with \$0.001 par value per share.

As a result of the IPO, the Company raised a total of \$56.3 million in gross proceeds, and \$52.4 million in net proceeds after deducting underwriting discounts and commissions of \$3.9 million. In addition, the Company incurred \$1.8 million of offering costs associated with the IPO that were recorded to additional paid-in capital and netted against the IPO proceeds. The Company did not receive any proceeds from the sale of shares in the IPO by the selling stockholders. In addition, the underwriters of its initial public offering have exercised in full their over-allotment option to purchase an additional 1,023,750 shares of common stock from selling stockholders at the initial public offering price of \$11.00 per share. The over-allotment option was granted to the underwriters by the selling stockholders and the Company did not issue any new shares of common stock or receive any proceeds from the sale of these shares.

***Follow on offering***

On December 11, 2007, the Company completed a follow on offering of 5,000,000 shares of common stock in which the Company sold and issued 65,000 shares of common stock and selling stockholders sold an additional 4,935,000 shares of common stock at an offering price of \$16.75 per share. As a result of the follow on offering, the Company raised \$1.0 million in gross proceeds and approximately \$0.6 million in net proceeds after deducting offering costs of approximately \$0.4 million. The Company did not receive any proceeds from the sale of shares in the follow on offering by the selling stockholders.

***Principles of consolidation and basis of presentation***

The consolidated financial statements include the accounts of PROS Holdings, Inc., and its wholly-owned subsidiaries. All significant intercompany transactions and balances have been eliminated in consolidation. The Consolidated financial statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States (GAAP).

In June 2009, the Financial Accounting Standards Board (FASB) established the FASB Accounting Standards Codification (ASC) or (Codification) as the source of authoritative U.S. GAAP recognized by the FASB to be applied by non-governmental entities. Following the Codification, the FASB will not issue new standards in the form of Statements, FASB Staff Positions or EITF Abstracts. Instead, it will issue Accounting Standards Updates to update



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the Codification. The Codification is effective for interim or annual financial periods ending after September 15, 2009. We adopted the Codification in the third quarter of 2009, and its adoption did not impact our consolidated financial statements.

We have revised the December 31, 2008 balance sheet to reflect an increase in accrued liabilities and accounts receivable of \$0.4 million. Such increase represents an accrual of legal fees, and the corresponding receivable balance for reimbursement of those legal fees by the Company's insurance carrier, associated with ongoing litigation. This revision had no impact to the Company's consolidated statement of operations or consolidated statement of cash flows as of or for the year ended December 31, 2008.

### ***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 makes estimates and assumptions in the preparation of its consolidated financial statements in conformity with GAAP. These estimates and assumptions may affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting periods. Actual results could differ from those estimates. The complexity of the estimation process and issues related to the assumptions, risks and uncertainties inherent in the application of the percentage-of-completion method of revenue recognition affects the amounts of revenue, expenses, unbilled receivables and deferred revenue. Numerous internal and external factors can affect estimates. 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 and accrued liabilities.

### ***Cash and cash equivalents***

The Company considers all highly liquid investments with an original maturity of three months or less at the time of purchase to be cash equivalents. The Company has a cash management program that provides for the investment of excess cash balances, primarily in short-term money market instruments.

### ***Financial instruments***

The carrying amount of the Company's financial instruments, which include cash equivalents, receivables and accounts payable, approximates their fair values at December 31, 2009 and 2008.

### ***Prepaid expenses and other assets***

Prepaid expenses and other assets consist primarily of short-term deferred tax assets, deferred project costs and prepaid third-party license fees.

### ***Property and equipment, net***

Property and equipment are recorded at cost, less accumulated depreciation. Maintenance, repairs and minor replacements are charged to expense as incurred. Significant renewals and betterments are capitalized. Depreciation on property and equipment, with the exception of leasehold improvements, is recorded using the straight-line method over the estimated useful lives of the assets. Depreciation on leasehold improvements is recorded using the shorter of the lease term or useful life. When property is retired or disposed of, the cost and related accumulated depreciation are removed from the accounts and any resulting gains or losses are reflected in the Consolidated Statements of Operations in the period of disposal.

### ***Treasury stock***

The Company makes treasury stock purchases in the open market pursuant to the share repurchase program, which was approved by its Board of Directors on August 28, 2008. The Company accounts for the purchase of treasury stock under the cost method. For additional information on the Company's stock repurchase program, see Note 7 to the Consolidated Financial Statements.

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### ***Revenue recognition***

The Company derives its revenue from license fees, implementation services and maintenance and support services. Our arrangements with customers typically include: (a) license fees paid for the use of our products either in perpetuity or over a specified term and implementation fees for configuration, implementation and training services and (b) maintenance and support fees 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 and determinable. For certain arrangements, we engage an independent contractor to assist in the implementation of our software products. These arrangements are analyzed based on numerous factors to determine the amount of revenue to be recognized.

Our customer arrangements typically contain multiple elements that include software licenses, implementation services and post-implementation maintenance and support. The Company allocates revenue using the residual value method based on vendor-specific evidence of fair value ( VSOE ) of the undelivered elements. For multiple element arrangements containing both license and implementation and maintenance and support, maintenance and support has VSOE based on specific renewal pricing contained therein and is recognized ratably over the period in which the maintenance services are provided. Generally, the Company does not have VSOE for other elements within a contract.

The Company's software license arrangements typically include implementation services that are considered essential to the customer's usability of the licensed software products and therefore new perpetual software license revenue is generally recognized with the implementation services using the percentage-of-completion method. 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 products. 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 products under term license agreements that typically include maintenance during the license term. When maintenance is included for the entire term of the term license, there is no renewal rate and therefore, there is no VSOE of fair value for the maintenance. For term license agreements, revenue and the associated costs are deferred until the delivery of the product and recognized ratably over the remaining license term. Revenue from term licenses, which is included in license and implementation revenue in the Consolidated Statement of Operations, represented approximately 5.5%, 4.2% and 5.2% of total revenue for the years ended December 31, 2009, 2008 and 2007, respectively.

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 has been recognized, but for which the Company has not invoiced the customer, is 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 Consolidated Balance Sheets.

### ***Foreign currency***

The Company has contracts denominated in foreign currencies and therefore a portion of the Company's revenue is subject to foreign currency risks. Gains and losses from foreign currency transactions, such as those resulting from the settlement of receivables, are classified in license and implementation cost of revenue included in the accompanying Consolidated Statements of Operations.

### ***Research and development***

Research and development costs are expensed as incurred. They include salaries and human resources costs, third-party contractor expenses, software development tools, an allocation of facilities and depreciation expenses and other expenses in developing new products and upgrading and enhancing existing products.



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### ***Impairment of long-lived assets***

Property and equipment are reviewed for impairment whenever an event or change in circumstances indicates that the carrying amount of an asset or group of assets may not be recoverable. The impairment review includes comparison of future cash flows expected to be generated by the asset or group of assets with the associated assets carrying value. If the carrying value of the asset or group of assets exceeds its expected future cash flows (undiscounted and without interest charges), an impairment loss is recognized to the extent that the carrying amount of the asset exceeds its fair value. The Company has not recorded any impairment charges in any of the years ended December 31, 2009, 2008 and 2007.

### ***Software development costs***

Software development costs associated with new products and enhancements to existing software products are expensed as incurred until technological feasibility, in the form of a working model, has been established. To date, the time period between the establishment of technological feasibility and the completion of software development has been short, and no significant development costs have been incurred during this period. Accordingly, the Company has not capitalized any software development costs to date.

### ***Share-based compensation***

The Company has two share-based compensation plans, the 1999 equity incentive plan and the 2007 equity incentive plan, which authorize the discretionary granting of various types of stock awards to key employees, officers, directors and consultants. The Company's 1999 equity incentive plan ( 1999 plan ) was terminated in March 2007 for purposes of granting any future equity awards. The Company's 2007 equity incentive plan ( 2007 plan ) was adopted in March 2007. The Company may provide share-based compensation through the grant of: (i) restricted stock awards; (ii) restricted stock unit awards; (iii) stock options; (iv) stock appreciation rights; (v) phantom stock; and (vii) performance awards. To date, the Company has only granted stock options and restricted stock units.

**Stock options.** The fair value of each share-based payment award is estimated on the date of grant using an option pricing model that meets certain requirements. The Company did not grant stock options during 2009. For stock options granted in 2008 and 2007, the Company used the Black-Scholes option pricing model to estimate the fair value of its share-based payment awards. The determination of the fair value of share-based payment awards utilizing the Black-Scholes model is affected by the Company's stock price and a number of assumptions, including expected volatility, expected life, risk-free interest rate and expected dividends. The expected life of the stock option share-based payment awards is a historical weighted average of the expected lives of similar securities of comparable public companies. The risk-free interest rate assumption is based on observed interest rates appropriate for the terms of the Company's awards. The dividend yield assumption is based on our expectation of paying no dividends. The Company estimate volatility using historical volatilities of similar public companies, given the Company's limited public stock price history as of the date of the grant.

The Company evaluates the assumptions used to value our stock option awards as options are issued. If factors change and the Company employs different assumptions, share-based compensation expense may differ significantly from what has been recorded in the past. If there are any modifications or cancellations of the underlying unvested securities, the Company may be required to accelerate, increase or cancel any remaining unearned share-based compensation expense. Future share-based compensation expense and unearned share-based compensation will increase to the extent that the Company grants additional equity awards to employees.

**Restricted stock units.** The fair value of the restricted stock units is based on the closing price of our stock on the date of grant and is amortized over the vesting period.

At December 31, 2009, there were an estimated \$11.6 million of total unrecognized compensation costs related to share-based compensation arrangements for options and restricted stock units granted. These costs will be recognized over a weighted average period of 1.8 years. For further discussion of the Company's share-based compensation plans, see Note 8 to the Consolidated Financial Statements.

### ***Product warranties***

The Company generally issues warranties for 90 days from the completion of implementation, depending on the contract, for software licenses and implementation services. In the Company's experience, warranty costs have been insignificant.





**Table of Contents*****Income taxes***

The Company uses the asset and liability method to account for income taxes, including recognition of deferred tax assets and liabilities for the anticipated future tax consequences attributable to differences between financial statement amounts and their respective tax basis. The Company reviews its deferred tax assets for recovery. A valuation allowance is established when the Company believes that it is more likely than not that some portion of its deferred tax assets will not be realized. Changes in the valuation allowance from period to period are included in the Company's tax provision in the period of change.

We account for uncertain income tax positions recognized in an enterprise's financial statements in accordance with the Income Tax Topic of the ASC issued by the FASB. This interpretation requires companies to use a prescribed model for assessing the financial recognition and measurement of all tax positions taken or expected to be taken in its tax returns. This guidance provides clarification on derecognition, classification, interest and penalties, accounting in interim periods, disclosures and transition. We adopted this guidance on January 1, 2007. For additional information regarding the Company's income taxes, see Note 9 to the Consolidated Financial Statements.

***Earnings per share***

Basic earnings per share is computed by dividing net earnings attributable to common stockholders by the weighted average number of common shares outstanding for the period. Diluted earnings per share is computed using the weighted average number of common shares outstanding and, when dilutive, potential common shares from options and warrants (using the treasury-stock method) and potential common shares from convertible securities (using the if-converted method).

***Recent accounting pronouncements***

In October 2009, the Financial Accounting Standards Board (FASB) issued authoritative guidance on revenue arrangements with multiple deliverables that are outside the scope of the software revenue recognition guidance. Under the new guidance, when vendor specific objective evidence or third party evidence for deliverables in an arrangement cannot be determined, a best estimate of the selling price is required to separate deliverables and allocate arrangement consideration using the relative selling price method. The new guidance no longer permits the residual method of allocating arrangement considerations. This authoritative guidance is effective for fiscal years beginning on or after June 15, 2010 (early adoption is permitted). The Company is currently assessing the impact on its consolidated financial position and results of operations.

**2. Accounts receivable and contracts in progress**

Accounts receivable at December 31, 2009 and 2008, consist of the following:

	<b>December 31,</b>	
	<b>2009</b>	<b>2008</b>
Accounts receivable	\$ 11,112	\$ 14,297
Unbilled receivables	2,223	4,155
Total receivables	13,335	18,452
Less: allowance for doubtful accounts	(1,300)	(1,900)
Accounts receivable, net	\$ 12,035	\$ 16,552

The bad debt expense reflected in selling, general and administrative expenses in the accompanying Consolidated Statements of Operations for the years ended December 31, 2009, 2008 and 2007, totaled approximately (\$0.6) million, \$0.3 million and \$0.4 million, respectively.

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Activity related to contracts in progress at December 31, 2009 and 2008, is summarized as follows:

	<b>December 31,</b>	
	<b>2009</b>	<b>2008</b>
Costs and estimated earnings recognized to date	\$ 67,549	\$ 79,436
Progress billings to date	(81,843)	(94,756)
Total	\$ (14,294)	\$ (15,320)

The foregoing table reflects the aggregate invoiced amount of all contracts in progress as of the respective dates, including amounts that have already been collected.

These amounts are included in the accompanying Consolidated Balance Sheets at December 31, 2009 and 2008, as follows:

	<b>December 31,</b>	
	<b>2009</b>	<b>2008</b>
Unbilled receivables	\$ 2,223	\$ 4,155
Deferred revenue	(16,517)	(19,475)
Total	\$ (14,294)	\$ (15,320)

At December 31, 2009 and 2008, the Company had approximately \$4.5 million and \$3.7 million, respectively, in deferred maintenance and support revenue, which is reflected above within deferred revenue.

**3. Earnings per share**

The following table sets forth the computation of basic and diluted earnings per share:

	<b>For the Year Ended December 31,</b>		
	<b>2009</b>	<b>2008</b>	<b>2007</b>
Numerator:			
Net income attributable to common stockholders	\$ 5,516	\$ 10,757	\$ 10,435
Denominator:			
Weighted average shares (basic)	25,711	26,121	23,026
Dilutive effect of stock options and restricted stock units	720	448	408
Weighted average shares (diluted)	26,431	26,569	23,434
Basic earnings per share	\$ 0.21	\$ 0.41	\$ 0.45
Diluted earnings per share	\$ 0.21	\$ 0.40	\$ 0.45

Approximately 2,376,417, 1,297,916 and 652,500 of potential common shares have not been considered in the diluted earnings per calculation for the years ended December 31, 2009, 2008 and 2007 as the effect would be anti-dilutive.

**4. Property and equipment, net**

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Property and equipment, net as of December 31, 2009 and 2008 consist of the following:

	<b>Estimated useful life</b>	<b>December 31, 2009</b>	<b>2008</b>
Furniture and fixtures	7-10 years	\$ 1,909	\$ 1,947
Computers and equipment	3-10 years	7,560	6,639
Software	2-5 years	1,720	1,688
	Shorter of lease term or useful life		
Leasehold improvements		1,038	1,038
Less: accumulated depreciation		(9,268)	(8,411)
Property and equipment, net		\$ 2,959	\$ 2,901

Depreciation was \$1.3 million, \$1.4 million and \$1.2 million for the years ended December 31, 2009, 2008 and 2007, respectively. During the years ended December 31, 2009, 2008 and 2007, the Company disposed of approximately \$0.4 million, \$1.0 million and \$0.7 million, respectively, of fully depreciated assets. As of December 31, 2009 and 2008, the Company had approximately \$6.0 million and \$5.8 million, respectively, of fully depreciated assets in use.

**5. Fair value measurements**

The Company adopted fair value measurements guidance for financial and non financial assets and liabilities. The guidance defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements.

The guidance defines fair value as the price that would be received to sell an asset, or paid to transfer a liability, in an orderly transaction between market participants. The guidance establishes a fair value hierarchy for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The fair value hierarchy is as follows:

Level 1: Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities;

Level 2: Quoted prices in markets that are not active or inputs which are observable, either directly or indirectly, for substantially the full term of the asset or liability;

Level 3: Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e., supported by little or no market activity).

The Company's existing investments are short-term interest bearing obligations with original maturities less than 90 days, primarily various types of money market funds. The Company does not enter into investments for trading or speculative purposes.

At December 31, 2009, the Company had \$45.4 million invested in diversified money market funds and \$14.5 million invested in treasury money market fund. At December 31, 2008, the Company had \$27.8 million invested in diversified money market funds and \$22.6 million invested in treasury money market fund. These investments are required to be measured at fair value on a recurring basis. The Company has determined that the treasury money market funds and diversified money market funds are defined as Level 1 in the fair value hierarchy.

**6. Debt**

On March 23, 2007, the Company entered into a \$28.0 million credit facility with a commercial bank, consisting of a \$20.0 million term loan and an \$8.0 million line of credit. The term loan required repayment of principal of \$50,000 plus interest every three months for five years, with all unpaid principal due on March 23, 2012. On July 3, 2007, the Company used \$20.1 million of proceeds from its initial public offering to retire the remaining \$20.0 million principal balance of the credit facility and related accrued interest totaling \$0.1 million. In addition, on July 3, 2007, the Company terminated the credit facility. In connection with the payoff and termination of the credit facility on July 3, 2007, financing fees in the amount of \$0.4 million, were expensed in the third quarter of 2007.



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### **7. Stockholders equity**

#### ***Preferred stock financing***

On June 8, 1998, the Company entered into a stock purchase and stockholders agreement (the Purchase Agreement ) with certain investment partnerships and individuals. The Company sold 3,921,312 shares of its authorized Series A convertible redeemable preferred stock, par value \$0.001 per share ( Series A Preferred Stock ) for \$25.0 million. The Company incurred approximately \$1.5 million in transaction fees in connection with the financing. The Company also designated another 3,921,312 shares of its preferred stock to be issued as redeemable preferred stock ( Redeemable Preferred Stock ) with a par value of \$0.001 per share, upon the conversion of the Series A Preferred Stock.

#### ***Series A preferred stock***

On August 15, 2005 ( Conversion Date ), the holders of the Series A Preferred Stock elected to convert the Series A Preferred Stock into 9,750,000 shares of common stock at a defined conversion rate of 2.486 per share plus 3,921,312 shares of Redeemable Preferred Stock. There were no shares of Series A Preferred Stock outstanding after this transaction, as all shares were cancelled upon the conversion.

#### ***Redeemable preferred stock***

In August 2006, the holders of the Redeemable Preferred Stock elected to redeem 33% of the Redeemable Preferred Stock and on August 15, 2006 a redemption payment of \$8.4 million was made, consisting of \$5.8 million representing the liquidation value of the surrendered shares, \$0.2 million of accreted dividends on the Redeemable Preferred Stock and \$2.5 million of accreted dividends on the Series A Preferred Stock.

As of December 31, 2006, the redemption amount for the Redeemable Preferred Stock was \$17.3 million. The Redeemable Preferred Stock had a liquidation value of \$4.463 per share plus accrued and unpaid dividends on the Redeemable Preferred Stock, plus accrued and unpaid dividends on the Series A Preferred Stock as of the Conversion Date. Included in the Redeemable Preferred Stock are cumulative unpaid dividends on the Series A Preferred Stock in the amount of \$5.1 million, cumulative unpaid dividends on the Redeemable Preferred Stock in the amount of \$0.5 million, and the liquidation value of remaining outstanding Redeemable Preferred Stock, in the amount of \$11.7 million.

On March 27, 2007, by mutual consent of the Company and the holders of Redeemable Preferred Stock, the Company redeemed its remaining outstanding Redeemable Preferred Stock for approximately \$17.4 million.

#### ***Common stock dividends***

On March 29, 2007, the Company paid a one-time cash dividend on its common stock of \$2.00 per share, totaling \$41.3 million.

#### ***Common stock warrants***

In December 1998, the Company granted warrants to purchase 100,000 shares of common stock (the Warrants ) to each of the Company s two founders. In October 2007, the Company s two founders exercised warrants to purchase an aggregate of 200,000 shares of the Company s common stock at a price of \$2.05 per share.

#### ***Stock repurchase***

On August 25, 2008, the Company s Board of Directors approved a stock repurchase program that authorized the Company to purchase up to \$15.0 million of the Company s outstanding shares of common stock. Under the board-approved repurchase program, share purchases may be made from time to time in the open market or through privately negotiated transactions depending on market conditions, share price, trading volume and other factors, and such purchases, if any, will be made in accordance with applicable insider trading and other securities laws and regulations. These repurchases may be commenced or suspended at any time or from time to time without prior notice.

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The Company did not repurchase any shares under this plan for the year ended December 31, 2009. For the year ended December 31, 2008, the Company repurchased 570,545 shares under this plan with an average price per share of \$8.74. The Company accounts for the purchase of treasury stock under the cost method, which resulted in an increase to the treasury stock balance of \$5.0 million as of December 31, 2008. The remaining amount available to purchase common stock under this plan was \$10.0 million as of December 31, 2009.

**8. Share-based compensation*****Employee share-based compensation plans:***

The Company has two share-based compensation plans; the 1999 plan and the 2007 plan. These plans authorize the discretionary granting of various types of stock awards to key employees, officers, directors and consultants. The discretionary issuance of stock awards generally contains vesting provisions ranging from one to four years.

The Company issues or has issued two types of stock awards under these two plans: stock options and restricted stock units. The following table presents the number of awards outstanding for each award type as of December 31, 2009 and 2008.

<b>Award type</b>	<b>For the Year Ended December 31,</b>	
	<b>2009</b>	<b>2008</b>
Stock option	2,356	2,537
Restricted stock unit	1,332	350

1999 plan. The Company's 1999 plan authorized the Company to grant options to purchase shares of common stock to its employees, directors and consultants at the Company's discretion. The Company's 1999 plan was terminated in March 2007 for purposes of granting any future equity awards. There were issued and outstanding stock options to purchase 99,610 shares of the Company's common stock under this plan on December 31, 2009. None of these options were held by the Company's executive officers.

2007 plan. The Company's 2007 plan was adopted in March 2007. The purpose of the 2007 plan is to promote the Company's long-term growth and profitability. The 2007 plan is intended to make available incentives that will help the Company to attract, retain and reward employees whose contributions are essential to its success. Under the 2007 plan, the Company's employees, officers, directors and other individuals providing services to the Company or any of its affiliates are eligible to receive awards. The 2007 plan has an evergreen provision that allows for an annual increase equal to the lesser of (i) 3.5% of the Company's outstanding shares (ii) 900,000 shares or (iii) any lesser amount determined by the Compensation Committee of the Board of Directors. The Company may provide these incentives through the grant of: (i) restricted stock awards; (ii) restricted stock unit awards; (iii) stock options; (iv) stock appreciation rights; (v) phantom stock; and (vii) performance awards.

In February 2009, the Company increased the number of shares available to grant by 898,000 under the evergreen provision in the Company's 2007 plan increasing the number shares reserved for issuance to 3,668,000. As of December 31, 2009, the Company had outstanding equity awards to acquire 3,587,917 shares of its common stock held by the Company's employees, directors and consultants under the 2007 plan. Included in the outstanding equity awards is 1,331,500 restricted stock units held by the Company's employees, directors and consultants. As of December 31, 2009, 35,857 shares remain available for grant under the 2007 plan. As of December 31, 2009, there has not been any issuance of restricted stock awards, stock appreciation rights, phantom stock or performance awards under this plan.

Stock options generally have a ten-year term and typically vest over four years of which 99,610 are related to the 1999 plan and 2,256,417 is related to the 2007 plan. At December 31, 2009, there was an estimated \$11.6 million of total unrecognized compensation costs related to share-based compensation arrangements for stock options and restricted stock units granted. These costs will be recognized over a weighted average period of 1.8 years.

**Table of Contents*****Stock Options:***

The following is a summary of the Company's option activity for the year ended December 31, 2009:

	<b>Number of shares</b>	<b>Weighted average</b>	<b>Aggregate intrinsic value</b>
(in thousands)	<b>under option</b>	<b>exercise price</b>	<b>(1)</b>
Outstanding, December 31, 2008	2,522	\$ 10.18	
Granted			
Forfeited	(103)	11.10	
Exercised	(63)	1.89	
Outstanding, December 31, 2009	2,356	\$ 10.34	\$ 5,337
Exercisable December 31, 2009	1,411	\$ 9.31	\$ 3,892

(1) The aggregate intrinsic value was calculated based on the positive difference between the estimated fair value of the Company's common stock on December 31, 2009 of \$10.35 and the exercise price of the underlying options.

For the year ended December 31, 2009, the Company did not grant any options. The Company utilizes the Black-Scholes option valuation model for estimating the fair value of our stock options. This model allows the use of a range of assumptions related to volatility, risk-free interest rate, expected holding period and the dividend yield. Significant assumptions used in that model for stock options granted in 2008 are as follows:

	<b>2008</b>
Volatility	48.0%
Risk-free interest rate	3.0%
Expected option life in years	4.6
Dividend yield	

In 2007 and 2008, the Company estimated volatility using historical volatilities of similar public companies, given the Company's limited public stock price history as of the date of grant. The dividend yield is based on the adopted dividend policy in effect at the time of grant. The risk free rate is based on observed interest rates appropriate



for the weighted average expected life of the options. The expected option life in years is based on the historical weighted average of the expected lives of similar securities of comparable public entities.

The weighted average grant date fair value of the options granted was \$6.22 and \$5.76 for the years ended December 31, 2008 and 2007, respectively. For the year ended December 31, 2008, compensation expense for the fair value of stock options granted to non-employees totaled \$0.1 million. For the year ended December 31, 2009, the Company did not grant any options. The total intrinsic value of options exercised for the years ended December 31, 2009, 2008 and 2007 was \$0.4 million, \$1.8 million and \$7.4 million, respectively.

The following table summarizes information about stock options outstanding at December 31, 2009:

	Options outstanding			Options exercisable		
	Outstanding as of December 31, 2009 (in thousands)	Weighted average remaining contractual life (in years)	Weighted average exercise price	Exercisable as of December 31, 2009 (in thousands)	Weighted average remaining contractual life (in years)	Weighted average exercise price
Range of exercise prices						
\$0.26-\$1.00	87	5.8	\$ 0.61	87	5.8	\$ 0.61
\$1.01-\$3.00	13	1.2	\$ 2.95	13	1.2	\$ 2.95
\$3.01-\$6.00	979	7.2	\$ 6.00	665	7.2	\$ 6.00
\$6.01-\$11.00	191	7.8	\$ 10.08	125	7.8	\$ 10.45
\$11.01-\$16.73	1,086	8.1	\$ 15.19	521	8.1	\$ 14.88
	2,356	7.6	\$ 10.34	1,411	7.6	\$ 9.31

#### ***Restricted Stock Units:***

The Company has also granted restricted stock units under the 2007 plan. Generally, restricted stock units granted to employees, directors and consultants vest in equal annual installments over a one to four year period from the grant date. The fair value of the restricted stock units on the grant date is amortized on a straight-line basis and expensed over the period of vesting. At December 31, 2009, there were 1,331,500 shares related to restricted stock units outstanding and unvested. The Company did not grant restricted stock units in 2007.

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A summary of unvested restricted stock as of December 31, 2009, and changes during the year then ended, is as follows:

	<b>Number of shares</b>	<b>Weighted average grant date fair value</b>
(in thousands)		
Unvested at December 31, 2008	350	\$ 5.51
Granted	991	5.32
Vested	(5)	
Forfeited	(4)	4.60
Unvested at December 31, 2009	1,332	\$ 5.27

The weighted average grant-date fair value of restricted stock granted during the years ended December 31, 2009 and 2008 was \$5.27 and \$5.51, respectively.

**9. Income taxes**

The income tax provision consisted of the following for the years ended December 31, 2009, 2008 and 2007:

	<b>Year Ended December 31,</b>		
	<b>2009</b>	<b>2008</b>	<b>2007</b>
Current:			
Federal	\$ 3,328	\$ 4,739	\$ 2,987
State and Foreign	282	370	127
	3,610	5,109	3,114
Deferred:			
Federal	(1,563)	(821)	(1,871)
Income tax provision	\$ 2,047	\$ 4,288	\$ 1,243

The differences between the effective tax rates reflected in the total provision for income taxes and the U.S. federal statutory rate of 35% for the years ended December 31, 2009, 2008 and 2007, respectively, were as follows:

	<b>Year Ended December 31,</b>		
	<b>2009</b>	<b>2008</b>	<b>2007</b>
Provision at the U.S. federal statutory rate	\$ 2,647	\$ 5,266	\$ 4,116
Increase (decrease) resulting from:			
State income taxes, net of federal taxes	119	177	58
Foreign income taxes, net of federal taxes	99	98	25
Nondeductible expenses	117	129	101
Domestic production activities	(98)	(178)	(144)
Incremental benefits for tax credits	(783)	(981)	(998)
Change in tax rate/income subject to lower tax rates and other	(109)	(259)	(111)
Change in valuation allowance	55	36	(1,804)
	\$ 2,047	\$ 4,288	\$ 1,243

The Company's effective tax rate historically has been lower than the statutory rate of 35% for the years ended December 31, 2009, 2008 and 2007, respectively, largely due to the application of general business tax credits. The Company's effective tax rates were 27%, 28% and 11% for the year ended December 31, 2009, 2008 and 2007, respectively.

In December 2007, Congress recessed without reinstating the Research and Experimentation ( R&E ) tax credit. In October 2008, Congress passed the Emergency Economic Stabilization Act of 2008 which included, among other items, the reinstatement of the R&E tax credit in the fourth quarter of 2008 that was applied retroactively to the beginning of 2008 with the full year effect applied in the fourth quarter of 2008. The full tax benefit of the R&E tax credit was recorded in the fourth quarter of 2008 which resulted in an estimated effective Federal effective tax rate of approximately 28% for the year ended December 31, 2008.

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In the third quarter of 2007, the Company recognized a tax benefit of \$1.1 million upon the reversal of a valuation allowance previously recorded against the deferred tax asset on its R&E tax credit carryforwards. This reversal was the result of the Company's determination during the third quarter that it was more likely than not that the R&E tax credit carryforwards would be utilized.

As of December 31, 2009, the Company had income taxes receivable of approximately \$0.7 million which is classified as prepaid and other current assets in the accompanying Consolidated Balance Sheet. As of December 31, 2008, the Company had income taxes payable of approximately \$0.6 million which is classified as accrued liabilities in the accompanying Consolidated Balance Sheet.

As of December 31, 2009, the Company had approximately \$0.2 million of foreign tax credit ( FTC ) carryforwards arising from foreign taxes paid. These FTC carryforwards may be carried forward for a period of five years and are available as an offset against any future regular tax liability if there is sufficient foreign source income in the year of use. The foreign tax credits begin to expire in 2012.

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and liabilities as of December 31, 2009 and 2008 are as follows:

	<b>2009</b>	<b>2008</b>
Current deferred tax asset:		
Accruals not currently deductible	\$ 2,313	\$ 2,216
Total current deferred tax asset	2,313	2,216
Noncurrent deferred tax asset:		
Property and equipment	(387)	(108)
Share-based compensation	3,801	2,056
FTC carryforwards	178	123
Total noncurrent deferred tax assets	3,592	2,071
Less: valuation allowance	(178)	(123)
Total non current deferred tax assets	3,414	1,948
Total net deferred tax asset	\$ 5,727	\$ 4,164

The current net deferred tax asset and noncurrent net deferred tax asset are classified as prepaids and other current assets, and other long term assets, respectively, in the accompanying Consolidated Balance Sheets.

The Company has a valuation allowance on its foreign tax credit carryforwards as it is unknown whether the Company will generate enough foreign source income to fully utilize the foreign tax credit carryforwards.

At December 31, 2009 and 2008, the Company has not recorded a material tax liability with respect to uncertainty in income taxes. The Company recognizes interest accrued related to unrecognized tax benefits and penalties in the income tax provision in the accompanying Consolidated Statement of Operations. For the years ended December 31, 2009, 2008 and 2007, the Company did not recognize any interest and penalties. In addition, the Company does not have any accruals for the payment of interest and penalties at December 31, 2009 and 2008.

**10. 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 Company periodically assesses its liabilities and contingencies in connection with these matters, based upon the latest information available. Should it be probable that the Company has incurred a loss and the loss, or range of loss,

can be reasonably estimated, the Company will record reserves in the consolidated financial statements. In other instances, because of the uncertainties related to the probable outcome and/or amount or range of loss, the Company is unable to make a reasonable estimate of a liability, and therefore no reserve will be recorded. As additional information becomes available, the Company will adjust its assessment and estimates of such liabilities accordingly. It is possible that the ultimate resolution of the Company's liabilities and contingencies could be at amounts that are different from any recorded reserves and that such differences could be material.

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In April 2008, a customer brought suit against the Company alleging that the Company failed to deliver contracted for software. The customer's claims, as amended, include breach of contract, fraud and negligent misrepresentation. In May 2008, the Company filed an answer and has brought counterclaims, as amended, for breach of contract, violation of the duty of good faith and fair dealing, breach of confidentiality and misappropriation of trade secrets. The Company believes the customer's attempted termination of the contract is wrongful, and the Company is vigorously defending this matter and seeking payment of remaining amounts owed under the contract. Certain management and key personnel in the Company are devoting significant time to this matter. Given the inherent uncertainties in any litigation, the Company is unable to make any predictions as to the ultimate outcome and no provision for loss or other costs has been recorded. The Company had \$1.1 million of capitalized implementation costs included in other assets, \$0.2 million in accounts receivable and \$6.1 million of long-term deferred revenue related to this customer's contract as of March 31, 2008. In April 2008, these amounts were netted and \$4.9 million was classified as other current liabilities. This amount has not changed since April 2008 and will continue to be presented in the accompanying Consolidated Balance Sheets as other current liabilities. Unless the matter is resolved earlier, the trial date is currently scheduled for the first quarter of 2011.

Based on the Company's review of the latest information available, it does not believe any liability, in connection with current contracts and other negotiations or pending or threatened legal proceedings, claims and litigation would have a material adverse effect on the Company's consolidated financial statements.

### ***Indemnification:***

The Company's software license agreements generally include certain provisions for indemnifying customers against liabilities if the Company's software products infringe a third party's intellectual property rights. To date, the Company has not incurred any losses as a result of such indemnifications and has not accrued any liabilities related to such obligations in the Company's consolidated financial statements.

### ***Lease commitments:***

The Company leases office space and office equipment under non-cancelable operating leases that expire at various dates through 2011. Total rent expense incurred during the years ended December 31, 2009, 2008 and 2007, was approximately \$1.2 million, \$1.2 million and \$1.1 million, respectively. The Company has future minimum payments relating to non-cancelable operating lease agreements of \$1.3 million in 2010 and \$0.7 million in 2011. The Company does not have any future minimum payments relating to non-cancelable operating leases extending further than 2011.

The Company had no capital leases at December 31, 2009 and 2008. In 2009, the Company leased approximately 3,300 square feet of office space in Austin, Texas. This lease expires June 2011. In 2006, the Company renegotiated its office lease which expired in May 2006. The new lease expires on July 31, 2011.

## **11. Segment and geographic information**

Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated on a regular basis by the chief operating decision-maker, or decision making group, in deciding how to allocate resources to an individual segment and in assessing performance of the segment. The Company operates in one segment, pricing and margin optimization software. In addition, the Company's assets are primarily located in its corporate office in the United States. Although the Company sells its pricing and revenue optimization software to customers in several industries and geographies, the Company does not produce reports for, assess the performance of, or allocate resources to these industries or regions based upon any asset-based metrics, or based upon income or expenses, operating income or net income. Therefore, the Company believes that it operates in one segment.

The Company evaluates the performance of its geographic regions based solely on revenue. The Company does not assess the profitability of its geographic regions and accordingly does not attempt to comprehensively assign or allocate costs to these regions. In addition, as the Company's assets are primarily located in its corporate office in the United States and not allocated to any specific region, the Company does not produce reports for, or measure the performance of, its geographic regions based on any asset-based metrics.

International revenue for the years ended December 31, 2009, 2008 and 2007, amounted to approximately \$40.5 million, \$40.5 million and \$39.3 million, respectively, representing 59%, 54% and 63%, respectively, of annual

revenue.

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The following geographic information is presented for the years ended December 31, 2009, 2008 and 2007. The Company categorizes geographic revenues based on the customer's headquarters.

	Year Ended December 31,					
	2009		2008		2007	
	Revenue	Percent	Revenue	Percent	Revenue	Percent
The Americas:						
United States of America	\$ 28,305	41%	\$ 35,091	46%	\$ 22,777	36%
Other	3,786	6%	3,751	5%	5,304	9%
Subtotal	32,091	47%	38,842	51%	28,081	45%
Europe, the Middle East and Africa:						
United Kingdom	3,708	6%	6,321	8%	7,135	12%
Germany	3,588	5%	3,469	5%	2,513	4%
Other	18,840	27%	17,070	23%	14,321	23%
Asia Pacific	10,556	15%	9,886	13%	10,029	16%
Subtotal	36,692	53%	36,746	49%	33,998	55%
Total revenue	\$ 68,783	100%	\$ 75,588	100%	\$ 62,079	100%

**12. Concentrations of credit risk**

For the years ended December 31, 2009, 2008 and 2007, no customer accounted for 10% or more of revenue. For the year ended December 31, 2009, no client accounted for 10% or more of accounts receivables. For the year ended December 31, 2008, one customer accounted for 10% or more of accounts receivables.

The Company's short-term investments on deposit with any one party and at any point in time may exceed federally insured limits. To date, the Company has not incurred any losses in connection with short-term investments.

**13. Related-party transactions**

The Company currently has employment agreements with its executive officers. The employment agreements provide for six months to one and one half years of salary upon termination without cause or, in some cases, for good reason and the vesting of certain stock options or other equity awards.

**14. Employee retirement savings plan**

The Company sponsors the PROS Holdings, Inc. 401(k) Plan. The 401(k) Plan is designed to provide eligible employees with an opportunity to make regular contributions to a long-term investment and savings program. All employees are eligible to participate in the 401(k) Plan following the completion of six consecutive months of service. Historically, the Company's matching contribution is defined as 50% of the first 6% of employee contributions. The Company may also make discretionary contributions. The company discontinued the matching contribution in 2009. Matching contributions by the Company in 2008 and 2007 totaled \$0.6 million and \$0.6 million, respectively.



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The following table presents certain unaudited quarterly financial data for the years ended December 31, 2009 and 2008. This information has been prepared on the same basis as the accompanying consolidated financial statements and all necessary adjustments have been included in the amounts below to state fairly the selected quarterly information when read in conjunction with the accompanying consolidated financial statements and notes thereto.

	Quarters Ended							
	December 31, 2009	September 30, 2009	June 30, 2009	March 31, 2009	December 31, 2008	September 30, 2008	June 30, 2008	March 31, 2008
<b>(Dollars in thousands, except per share data)</b>								
Total revenue	\$ 16,921	\$ 16,510	\$ 17,326	\$ 18,026	\$ 19,765	\$ 19,291	\$ 18,612	\$ 17,920
Gross profit	\$ 12,304	\$ 12,219	\$ 12,407	\$ 13,208	\$ 14,630	\$ 14,422	\$ 13,957	\$ 13,327
Income from operations	\$ 1,551	\$ 1,088	\$ 2,073	\$ 2,655	\$ 3,805	\$ 3,393	\$ 3,205	\$ 3,530
Net income	\$ 1,192	\$ 798	\$ 1,536	\$ 1,990	\$ 3,585	\$ 2,359	\$ 2,241	\$ 2,572
Net earnings attributable to common stockholders per share:								
Basic	\$ 0.05	\$ 0.03	\$ 0.06	\$ 0.08	\$ 0.14	\$ 0.09	\$ 0.09	\$ 0.10
Diluted	\$ 0.04	\$ 0.03	\$ 0.06	\$ 0.08	\$ 0.14	\$ 0.09	\$ 0.08	\$ 0.10

**16. Subsequent events**

The Company accounts for subsequent events by applying general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued and requires the disclosure of the date through which a company has evaluated subsequent events. The Company does not believe there are any material subsequent events that require disclosure.

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**Schedule II**  
**Valuation and Qualifying Accounts**

	Balance at beginning  of period	Additions charged to costs and expenses	Deductions (1)	Balance at end of period
<b>Allowance for doubtful accounts</b>				
<b>2009</b>	\$ 1,900	\$ (566)	\$ (34)	\$ 1,300
<b>2008</b>	\$ 1,550	\$ 288	\$ 62	\$ 1,900
<b>2007</b>	\$ 1,190	\$ 395	\$ (35)	\$ 1,550
<b>Valuation allowance</b>				
<b>2009</b>	\$ 123	\$ 99	\$ (44)	\$ 178
<b>2008</b>	\$ 87	\$ 99	\$ (63)	\$ 123
<b>2007</b>	\$ 1,891	\$	\$ (1,804)	\$ 87

- (1) Represents uncollectible accounts written off, net of recoveries for allowance for doubtful accounts, and the utilization of tax assets that previously had a valuation allowance for deferred tax assets

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