PROS Holdings, Inc.
Form 10-K
February 26, 2009
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# UNITED STATES SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# Form 10-K

**(MARK ONE)**

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

**For the year ended December 31, 2008**

**OR**

| | |
|---|---|
| **o** | **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 333-141884**

# PROS HOLDINGS, INC.

(Exact name of registrant as specified in its charter)

| | |
|---|---|
| **Delaware** | **76-0168604** |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |
| **3100 Main Street, Suite 900**<br>**Houston, Texas**<br>(Address of principal executive offices) | **77002**<br>(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 o No x

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 o No x

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

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

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.

Accelerated Filer x Non-Accelerated Filer o

| Large Accelerated Filer | Smaller Reporting Company |
|---|---|
| o | o |

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

The aggregate market value of voting and non-voting common equity held by non-affiliates of the registrant was approximately $215,126,574 as of June 30, 2008 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 February 20, 2009, there were outstanding 25,691,735 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 2009 Annual Stockholders Meeting, to be filed subsequently are incorporated by reference into Part III.

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**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 ( 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, intends, likely, targets, p anticipates, estimates, or the negative version of those words and similar statements of future or 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 ( 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 ( 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, 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 software products have a single code base and a single integrated database.

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 after accounting for discounts, promotions, rebates and allowances. 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 ERP, SCM and CRM which automate a paper intensive current process or a people intensive current 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.

The PROS Pricing Solution Suite is our set of integrated software products that enables 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.

- *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 either 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

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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. 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.

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 customer s 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 27% of total revenue for the year ended December 31, 2008.

We employ 30 scientists, of which 16 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 54% of our total revenue came from customers outside the United States for the years ended December 31, 2008 and approximately 63% of our total revenue came from customers outside the United States for the year ended December 31, 2007 and 2006. In 2008, 2007 and 2006, we had no single customer that accounted for 10% or more of revenue.

**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;

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• 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 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 copyright, trade secret, confidentiality procedures, contractual provisions and other similar measures to protect our proprietary information.  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 $20.3 million, $16.8 million and $10.3 million for the years ended December 31, 2008, 2007 and 2006, respectively.

**Employees**

As of December 31, 2008, we had 381 full-time personnel which include 351 employees and 30 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.

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**Where you can find additional information**

Our website address is www.prospricing.com. We make available free of charge through our website our Annual Reports on Form10-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 9, 2008.

**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.

**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.***

The implementation of our software products, which is often accompanied by hardware purchases and other capital commitments, involves significant capital expenditure by our customers. Customers may reduce or defer their spending on technology during the current economic downturn. 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 adversely impact our business, quarterly or annual operating results and financial condition.

Periodic fluctuations in the U.S. Dollar, 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 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 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.

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***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.

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 perceive 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.

Revenue from customers in the airline industry accounted for 40%, 43% and 44% of our total revenue for the years ended December 31, 2008, 2007, and 2006, respectively. 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

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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.

***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.

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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 29%, 30% and 36% of our total revenue for the years ended December 31, 2008, 2007 and 2006, 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.

***Our Global Growth is Subject to a Number of Economic Risks***

As widely reported, global financial markets have been experiencing extreme disruption in recent months, including, among other things, extreme volatility in security prices, limited ability to raise capital in public 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. This global financial crisis and economic recessions will negatively affect our business although the extent to which it will do so and our ability to manage the business in the face of those challenges are uncertain. For example, a contraction in spending by our prospects or customers, including reduced spending on products such as ours, would have a negative effect on our operating results and our business would suffer.

***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.

***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

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condition and results of operations.

***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.

***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. Moreover, if we are not able to comply with the requirements of Section 404 in a timely manner, or 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.

***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

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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 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

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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.

We may also be required 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.

***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.

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As of the date of this filing, we have 2 issued U.S. patents and 7 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 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 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.

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***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 years ended December 31, 2008, 2007, and 2006, approximately 54%, 63% 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 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.

***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;

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• 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 growth 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 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.

**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 has 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;

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- 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.

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

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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 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.

## **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 addition, we lease approximately 4,300 square feet of office space in Austin, Texas. This lease expires June 2009. 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, no reserve will be recorded. As additional information becomes available, we will 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 delivered a notice of termination of its contract and filed a breach of contract complaint alleging failure to deliver software the customer purchased. In May 2008, we filed a counterclaim. We believe the customer s termination is wrongful and intend to vigorously defend this matter and to seek payment of remaining amounts owed under the contract. 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. For additional information, see Note 10 to our Notes to the Consolidated Financial Statements.

Based on our review of the latest information available, we do 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 our 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, 2008.

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## 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 began trading on the NYSE under symbol PRO on June 28, 2007. 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.

| | Price Range of Common Stock | | | |
|---|---|---|---|---|
| | | Low | | High |
| **For the year ended December 31, 2007** | | | | |
| Second Quarter (commencing June 28, 2007) | $ | 11.32 | $ | 13.64 |
| Third Quarter | $ | 10.40 | $ | 14.69 |
| Fourth Quarter | $ | 12.02 | $ | 20.71 |
| **For the year ended December 31, 2008** | | | | |
| First Quarter | $ | 10.40 | $ | 15.51 |
| Second Quarter | $ | 9.53 | $ | 13.50 |
| Third Quarter | $ | 6.50 | $ | 12.45 |
| Fourth Quarter | $ | 3.13 | $ | 9.40 |

On February 20, 2008 there were 102 stockholders of record of our common stock. 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. 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.

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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, 2008. The graph is presented pursuant to the SEC rules and is not meant to be an indication of our performance.

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

| | 6/28/2007 | 6/30/2007 | 9/30/2007 | 12/31/2007 | 3/31/2008 | 6/30/2008 | 9/30/2008 | 12/31/2008 |
|---|---|---|---|---|---|---|---|---|
| PRO | $ 100.00 | $ 101.95 | $ 92.14 | $ 149.77 | $ 95.80 | $ 85.73 | $ 71.68 | $ 43.89 |
| S&P 500 | $ 100.00 | $ 99.84 | $ 101.56 | $ 97.67 | $ 87.98 | $ 85.14 | $ 77.48 | $ 60.08 |
| NASDAQ Computer Index | $ 100.00 | $ 99.51 | $ 105.33 | $ 111.31 | $ 88.88 | $ 93.22 | $ 78.74 | $ 59.34 |

**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.

The table below presents information about shares of common stock repurchased during the three months ended December 31, 2008 under the stock repurchase program.

| Period | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of a Publicly Announced Plan or Program | Total Dollar Value of Shares Purchased as Part of a Publicly Annopunced Program | Approximate Dollar Value of Shares that may yet be Purchased Under the Plan of Program |
|---|---|---|---|---|---|
| Beginning balance, October 1, 2008 | 286,100 | $ 9.41 | 286,100 | $ 2,700,808 | $ 12,299,920 |
| October 1, 2008 through October 31, 2008 | 284,445 | 8.46 | 284,445 | 2,299,857 | 10,000,063 |
| November 1, 2008 through November 30, 2008 | | | | | 10,000,063 |
| December 1, 2008 through December 31, 2008 | | | | | 10,000,063 |
| Total for the three months ended December 31, 2008 | 284,445 | | 284,445 | 2,299,857 | 10,000,063 |
| Total for the year ended December 31, 2008 | 570,545 | | 570,545 | $ 5,000,665 | $ 10,000,063 |

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**Equity Compensation Plan Information**

The following table sets forth information as of December 31, 2008 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.

| Plan Category | I<br>Number of securities to be issued upon exercise of equity securities | | II<br>Weighted-average exercise price of equity securities | III<br>Number of securities remaining available for future issuance under plans (excluding securities listed in Column (I)) |
|---|---|---|---|---|
| Equity compensation plans approved by security holders | | $ | | |
| Equity compensation plans not approved by security holders | 2,732,488 | | 10.15 | 8,451 |
| Total | 2,732,488 | $ | | 8,451 |

**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, 2008 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).

**PROS Holdings, Inc.**

**Condensed Consolidated Statements of Income**

| | Year Ended December 31, | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | 2008 | | 2007 | | 2006 | | 2005 | | 2004 |
| **Selected statement of operations data:** | | | | | | | | | | |
| Total revenue | $ | 75,588 | $ | 62,079 | $ | 46,027 | $ | 35,130 | $ | 32,446 |
| Gross profit | | 56,336 | | 44,135 | | 30,422 | | 21,749 | | 19,057 |
| Income from operations | | 13,933 | | 11,006 | | 6,829 | | 3,339 | | 3,826 |
| Net income | | 10,757 | | 10,517 | | 7,025 | | 3,440 | | 3,656 |
| Accretion of preferred stock | | | | (82) | | (460) | | (852) | | (1,256) |
| Net earnings attributable to common stockholders | $ | 10,757 | $ | 10,435 | $ | 6,565 | $ | 2,587 | $ | 2,400 |
| | | | | | | | | | | |
| Net earnings attributable to common stockholders per share: | | | | | | | | | | |

| | | | | |
|---|---|---|---|---|
| Basic | $ 0.41 | $ 0.45 | $ 0.33 | $ 0.19 | $ 0.24 |
| Diluted | $ 0.40 | $ 0.45 | $ 0.32 | $ 0.16 | $ 0.19 |
| | | | | | |
| Weighted average number of shares: | | | | | |
| Basic | 26,121 | 23,026 | 19,649 | 13,891 | 9,822 |
| Diluted | 26,569 | 23,434 | 20,604 | 20,012 | 19,618 |

| | December 31, | | | | |
|---|---|---|---|---|---|
| | 2008 | 2007 | 2006 | 2005 | 2004 |
| **Balance sheet data:** | | | | | |
| Cash and cash equivalents | $ 51,979 | $ 44,378 | $ 42,540 | $ 38,490 | $ 32,314 |
| Working capital | 41,741 | 33,917 | 27,575 | 27,079 | 22,218 |
| Total assets | 76,594 | 68,980 | 63,046 | 50,290 | 45,373 |
| Redeemable preferred stock | | | 17,283 | 25,269 | |
| Convertible redeemable preferred stock | | | | | 31,913 |
| Total stockholders equity (deficit) | $ 43,752 | $ 33,688 | $ 10,677 | $ 4,044 | $ (6,057) |

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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 $75.6 million, $62.1 million and $46.0 million for the years ended December 31, 2008, 2007, and 2006, respectively, and have achieved ten consecutive years of profitability. Approximately 54% of our total revenue came from customers outside the United States for the year ended December 31, 2008 and approximately 63% of our total revenue came from customers outside the United States for the years ended December 31, 2007 and December 31, 2006.

Generally, we recognize the 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 are 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 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 ten 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**

We have noted several trends 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 market demand had been increasing over the past several years; however the world economies are in a recession 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 our revenue with 54% of our revenue in 2008 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.

**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. For certain of our arrangements, we engage an independent contractor to assist in the implementation. We recognize revenue from these engagements net of the fees owed to the independent contractor.

*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.

We also recognize revenue from the sale of a limited number of fixed-term licenses, which have terms ranging from two to five years, and related implementation services. Revenue from fixed-term licenses, which is included in License and implementation revenue in the Consolidated Statements of Operations, represented approximately 4.2%, 5.2% and 7.7%, of total revenue for the years ended December 31, 2008, 2007 and 2006, respectively. Revenue from fixed-term licenses, which includes maintenance and support during the license period, are recognized ratably over the license term.

In addition, we also license software products through subscriptions. Similar to fixed term license arrangements, revenue and costs for subscription licenses are deferred until the delivery of the product and then recognized ratably over the subscription term. Revenue from subscriptions, which is included in License and implementation revenue in the Consolidated Statements of Operations, represented approximately 5.5%, 6.6% and 2.5%, of total revenue for the years ended December 31, 2008, 2007 and 2006, respectively. Maintenance revenue

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from subscriptions, which is stated separately in the agreement, is recognized in accordance with the terms of the agreements and is included in Maintenance revenue and represented approximately 1.1%, 1.5% and 0.9%, of total revenue for the years ended December 31, 2008, 2007 and 2006, respectively.

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 a subscription contract from a customer that delivered a notice of contract termination in April 2008. These amounts have been netted and are classified as other current liabilities as future recognition of revenue has been discontinued due to the uncertainty of its realization. This amount has not changed since April 2008 and will continue to be presented in the Consolidated Balance Sheet as Other current liabilities until the matter is resolved.

*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-contract 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 services that have been performed, but for which we have not invoiced the customer, are recorded as unbilled receivables, and invoices that have been issued before the software license and implementation services have been performed are recorded as deferred revenue in the accompanying Condensed Balance Sheets. We generally invoice for maintenance and support services on a monthly, quarterly or on an annual basis through the maintenance and support period.

***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. For the year ended December 31, 2008, 46% of our revenue was from the United States. We believe that we are diversified, both geographically and across industries.

***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 providing professional services, (b) billable and non-billable travel, lodging and other out-of-pocket expenses and (c) facilities and other overhead costs. Since 2003, we have seen improvement in our license and implementation gross margin as a result of improvements in our implementation processes and the standardization of our software products. This trend may not continue if the economy negatively impacts our revenue and we are unable to reduce 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. Maintenance and support gross margin increased during 2008 due to (i) an increase in maintenance and support revenue following the completion of a number of implementations of our software products and an inflationary index increase in the rate charged on maintenance renewals and (ii) a decrease in cost of maintenance and support resulting from the reduced resources required to provide support during the period. This trend may not continue if the economy negatively impacts our revenue and we are unable to reduce 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.

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*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.

***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, 2008, our deferred tax assets consisted primarily of temporary differences related to the timing of deductions for federal income tax and financial reporting purposes and the deferral of revenue on subscription 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 for the years ended December 31, 2008, 2007 and 2006 were 28%, 11% and 20% 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 Research & Experimentation ( 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. In December 2007, Congress recessed without reinstating the Research and Experimentation ( R&E ) tax credit. However, on October 3, 2008, Congress passed and the President of the United States of America enacted H. R. 1424, the Emergency Economic Stabilization Act of 2008, which included, among other items, the extension of the R&E tax credit. The passage of this legislation makes the R&E tax credit retroactive to January 1, 2008 and extends the R&E tax credit until December 2009. As a result of the retroactive reinstatement of the R&E tax credit, we recorded the full benefit of the R&E tax credit 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.

***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 prepare our Consolidated Financial Statements in accordance with GAAP. 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

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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. We do so using the percentage-of-completion method in accordance with the provisions contained within American Institute of Certified Public Accountants Statement of Position ( SOP ) 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts*. The percentage-of-completion is measured as the total number of man-days expended on an implementation of our software products during a reporting period as a percentage of the total man-days estimated to be necessary to complete the implementation. 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.

*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, 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 must 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.

***Stock based compensation***

On January 1, 2006, we adopted the provisions of FASB Statement of Financial Accounting Standards No. 123(R), *Share-Based Payment* ( SFAS No.123(R) ). Under this standard, 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. We currently use 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. We do not have an established history of market prices of our common stock as we only recently became a public company, and as such we estimate volatility in accordance with Staff Accounting Bulletin No. 107, using historical volatilities of similar public entities. The expected life of the 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. Stock-based compensation expense recorded in our financial statements under SFAS No.123(R) is based on awards that are ultimately expected to vest.

We evaluate the assumptions used to value our awards as we issue options. If factors change and we employ different assumptions, stock-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 stock-based compensation expense. Future stock-based compensation expense and unearned stock-based compensation will increase to the extent that we grant additional equity awards to employees.

We account for stock options granted to non-employees in accordance with Emerging Issues Task Force No. 96-18, *Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services*, ( EITF No. 96-18 ), and related interpretations. We grant stock options to certain consultants and advisory board members for a fixed number of shares with an exercise price equal

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to the fair value of our common stock at the date of grant. Under EITF No. 96-18, compensation expense on non-employee stock options is calculated using the Black-Scholes option-pricing model.

The fair value of our common stock for options granted before our initial public offering was estimated by our board, with input from management. Determining the fair value of our common stock requires making complex and subjective judgments. Our board considered objective and subjective factors including our financial results and financial condition, and discussions with the underwriters related to our potential initial public offering.

At December 31, 2008, there were an estimated $13.1 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 2.6 years.

In November 2008, we issued restricted stock units to employees, directors, and consultants. We account for the issuance of restricted stock units under SFAS 123(R). The fair value of the restricted stock units is based on the closing price of our stock on the date of grant. The expected life of the restricted stock units is a historical weighted average of the expected lives of similar securities of comparable public companies. The restricted stock units are amortized over the vesting period. Stock based compensation expense recorded in our financial statements under SFAS No.123(R) is based on awards that are ultimately expected to vest.

***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. We review our deferred tax assets for recovery. 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.

In June 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109,* ( FIN 48 ). FIN 48 clarifies the accounting for uncertainties in income taxes recognized in an enterprise s financial statements. FIN 48 requires us to determine whether it is more likely than not that a tax position will be sustained upon examination by the appropriate taxing authority. If a tax position meets the more likely than not recognition criteria, FIN 48 requires the tax position be measured at the largest amount of benefit greater than 50% likely of being realized upon ultimate settlement. We adopted the provisions of FIN 48 on January 1, 2007. The adoption of FIN 48 did not have a material effect on our consolidated financial position, results of operations or cash flows.

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. In December 2007, Congress recessed without reinstating the Research and Experimentation ( R&E ) tax credit. However, on October 3, 2008, Congress passed, the Emergency Economic Stabilization Act of 2008, which included, among other items, the extension of the R&E tax credit. The passage of this legislation makes the R&E tax credit retroactive to January 1, 2008 and extends the R&E tax credit until December 2009. As a result of the retroactive reinstatement of the R&E tax credit, we recorded the full benefit of the R&E tax credit 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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**Results of operations**

The following table sets forth our statements of operations data expressed as a percentage of total revenues for the periods indicated.

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

*Revenue:*

| | Year Ended December 31, | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 2008 | | | 2007 | | | | |
| (Dollars in thousands) | | Amount | As a percentage of total revenue | | Amount | As a percentage of total revenue | Variance $ | Variance % |
| 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 over the implementation period using the percentage of completion accounting method. The increase was principally the result of an increase in the number of implementations and the current mix of business.

*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 and an inflationary index increase in the rate charged on maintenance renewals.

*Total revenue.* For the year ended December 31, 2008, approximately 54% of our total revenue was generated outside the United States, compared with 63% for the year ended December 31, 2007. For the year ended December 31, 2008 and 2007, approximately 97% and 96%, respectively, of our airline revenue was generated outside the United States.

*Cost of revenue and gross profit:*

| | Year Ended December 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2008 | | 2007 | | | |
| (Dollars in thousands) | Amount | As a percentage of related revenue | Amount | As a percentage of related revenue | Variance $ | Variance % |
| 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 subscription contracts, an increase of $0.4 million in stock based compensation expenses, an increase of $0.3 million from a foreign currency loss resulting from currency exchange rates, 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 improvements in our implementation processes, the standardization of software products and our current mix of business. 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

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products and an inflationary index increase in the rate charged on maintenance renewals 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. License and implementation gross margins may vary from period to period depending on factors, including the amount of implementation services required to deploy our products relative to the total contracted price. Maintenance and support gross margins may vary from period to period depending on factors, including the cost of providing maintenance and support relative to maintenance and support revenue.

*Operating expenses:*

| | Year Ended December 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2008 | | 2007 | | | |
| (Dollars in thousands) | Amount | As a percentage of total revenue | Amount | As a percentage of total revenue | Variance $ | Variance % |
| Selling, general and administrative | $ 22,094 | 29% | $ 16,292 | 26% | $ 5,802 | 36% |
| 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 stock 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 stock based compensation expenses.

*Other income (expense):*

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