

NETSUITE INC
Form 10-Q
October 31, 2012
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark one)

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

For the quarterly period ended September 30, 2012

OR

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

For the transition period from _____ to _____.

Commission file number 001-33870

NetSuite Inc.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of
incorporation or organization)

2955 Campus Drive, Suite 100

94-3310471

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

San Mateo, California

94403-2511

(Address of principal executive offices)

(Zip Code)

(650) 627-1000

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes ☒ No ☐

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definition of "large accelerated filer", "accelerated filer" and "smaller reporting

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company” in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ☒

Accelerated filer

☐

Non-accelerated filer ☐ (do not check if a smaller reporting company)

Smaller reporting
company

☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes ☐ No ☒

On October 29, 2012, 71,652,312 shares of the registrant’s Common Stock, \$0.01 par value, were issued and outstanding.

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PART I – Financial Information

ITEM 1. Financial Statements

NetSuite Inc.

Condensed Consolidated Balance Sheets

(dollars in thousands)

(unaudited)

| | September 30, 2012 | December 31, 2011 |
|--|-----------------------|----------------------|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 178,452 | \$ 141,448 |
| Accounts receivable, net of allowances of \$520 and \$396 as of September 30, 2012 and December 31, 2011, respectively | 48,171 | 39,105 |
| Deferred commissions | 22,033 | 22,968 |
| Other current assets | 8,714 | 8,693 |
| Total current assets | 257,370 | 212,214 |
| Property and equipment, net | 24,220 | 21,823 |
| Deferred commissions, non-current | 4,125 | 3,585 |
| Goodwill | 31,809 | 27,564 |
| Other intangible assets, net | 10,421 | 12,162 |
| Other assets | 3,002 | 3,832 |
| Total assets | \$ 330,947 | \$ 281,180 |
| Liabilities and total equity | | |
| Current liabilities: | | |
| Accounts payable | \$ 6,005 | \$ 1,905 |
| Deferred revenue | 129,575 | 105,800 |
| Accrued compensation | 16,441 | 17,748 |
| Accrued expenses | 9,215 | 8,285 |
| Other current liabilities (including note payable to related party of \$1,575 and \$2,145 as of September 30, 2012 and December 31, 2011, respectively) | 8,470 | 7,829 |
| Total current liabilities | 169,706 | 141,567 |
| Long-term liabilities: | | |
| Deferred revenue, non-current | 5,960 | 5,898 |
| Other long-term liabilities (including note payable to related party of \$800 and \$1,985 as of September 30, 2012 and December 31, 2011, respectively) | 5,661 | 5,705 |
| Total long-term liabilities | 11,621 | 11,603 |
| Total liabilities | 181,327 | 153,170 |
| Commitments and contingencies (Note 4) | | |
| Total equity: | | |
| Common stock, par value \$0.01, 500,000,000 shares authorized; 71,591,988 and 68,785,296 shares issued and outstanding at September 30, 2012 and December 31, 2011, respectively | | 688 |
| Additional paid-in capital | 517,588 | 470,485 |
| Accumulated other comprehensive income | 455 | 369 |
| Accumulated deficit | (369,139) | (343,532) |
| Total equity | 149,620 | 128,010 |
| Total liabilities and total equity | \$ 330,947 | \$ 281,180 |

See accompanying Notes to Condensed Consolidated Financial Statements.

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NetSuite Inc.

Condensed Consolidated Statements of Operations and Comprehensive Loss

(dollars and shares in thousands, except per share data)

(unaudited)

| | Nine Months Ended September 30, | | Three Months Ended September 30, | |
|--|---------------------------------|-------------|----------------------------------|------------|
| | 2012 | 2011 | 2012 | 2011 |
| Revenue: | | | | |
| Subscription and support | \$184,368 | \$145,388 | \$65,329 | \$51,334 |
| Professional services and other | 39,451 | 26,845 | 14,462 | 9,625 |
| Total revenue | 223,819 | 172,233 | 79,791 | 60,959 |
| Cost of revenue: | | | | |
| Subscription and support | 30,722 | 24,342 | 10,880 | 8,627 |
| Professional services and other | 38,218 | 27,450 | 14,211 | 9,658 |
| Total cost of revenue | 68,940 | 51,792 | 25,091 | 18,285 |
| Gross profit | 154,879 | 120,441 | 54,700 | 42,674 |
| Operating expenses: | | | | |
| Product development | 38,311 | 31,615 | 13,943 | 11,257 |
| Sales and marketing | 111,731 | 88,209 | 38,591 | 30,279 |
| General and administrative | 28,334 | 23,839 | 9,458 | 7,622 |
| Total operating expenses | 178,376 | 143,663 | 61,992 | 49,158 |
| Operating loss | (23,497) | (23,222) | (7,292) | (6,484) |
| Other income / (expense), net: | | | | |
| Interest income | 127 | 127 | 36 | 36 |
| Interest expense | (156) | (104) | (52) | (39) |
| Other expense, net | (185) | (130) | (73) | (114) |
| Total other income / (expense), net | (214) | (107) | (89) | (117) |
| Loss before income taxes | (23,711) | (23,329) | (7,381) | (6,601) |
| Provision for income taxes | 1,896 | 1,063 | 603 | 328 |
| Net loss | \$(25,607) | \$(24,392) | (7,984) | (6,929) |
| Net loss per common share, basic and diluted | \$(0.36) | \$(0.37) | \$(0.11) | \$(0.10) |
| Weighted average number of shares used in computing net loss per share | 70,288 | 66,459 | 71,161 | 67,477 |
| Comprehensive loss: | | | | |
| Foreign currency translation gains / (loss), net of taxes | 83 | (105) | 295 | (322) |
| Accumulated pension liability | 3 | (127) | 1 | (127) |
| Comprehensive loss | \$(25,521) | \$(24,624) | \$(7,688) | \$(7,378) |

See accompanying Notes to Condensed Consolidated Financial Statements.

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NetSuite Inc.

Condensed Consolidated Statements of Cash Flows

(dollars in thousands)

(unaudited)

| | Nine Months Ended September 30, | |
|--|---------------------------------|---------------|
| | 2012 | 2011 |
| Cash flows from operating activities: | | |
| Net loss | \$(25,607 |) \$(24,392) |
| Adjustments to reconcile net loss to net cash provided by operating activities: | | |
| Depreciation and amortization | 8,048 | 6,745 |
| Amortization of other intangible assets | 3,393 | 2,884 |
| Provision for accounts receivable allowances | 505 | 243 |
| Stock-based compensation | 35,939 | 28,166 |
| Amortization of deferred commissions | 33,269 | 24,954 |
| Excess tax benefit on stock-based compensation | (259 |) — |
| Changes in operating assets and liabilities, net of acquired assets and assumed liabilities: | | |
| Accounts receivable | (9,476 |) (3,003) |
| Deferred commissions | (32,876 |) (29,300) |
| Other current assets | (137 |) 146 |
| Other assets | 797 | 247 |
| Accounts payable | 3,241 | 911 |
| Accrued compensation | (1,398 |) 1,821 |
| Deferred revenue | 23,842 | 15,864 |
| Other current liabilities | 1,790 | (18) |
| Other long-term liabilities | (181 |) (691) |
| Net cash provided by operating activities | 40,890 | 24,577 |
| Cash flows from investing activities: | | |
| Purchases of property and equipment | (7,730 |) (7,156) |
| Capitalized internal use software | (1,172 |) (406) |
| Cash paid in business combination, net of amounts received | (4,227 |) (1,775) |
| Net cash used in investing activities | (13,129 |) (9,337) |
| Cash flows from financing activities: | | |
| Payments under capital leases | (542 |) (734) |
| Payments under capital leases and long-term debt - related party | (1,160 |) (346) |
| RSUs acquired to settle employee withholding liability | (191 |) (205) |
| Excess tax benefit on stock-based compensation | 259 | — |
| Proceeds from issuance of common stock | 10,523 | 8,662 |
| Net cash provided by financing activities | 8,889 | 7,377 |
| Effect of exchange rate changes on cash and cash equivalents | 354 | (138) |
| Net change in cash and cash equivalents | 37,004 | 22,479 |
| Cash and cash equivalents at beginning of period | 141,448 | 104,298 |
| Cash and cash equivalents at end of period | \$178,452 | \$126,777 |
| Supplemental cash flow disclosure: | | |
| Cash paid for interest to related parties | \$63 | \$82 |
| Cash paid for interest to other parties | \$29 | \$22 |
| Cash paid for income taxes, net of tax refunds | \$924 | \$900 |
| Noncash financing and investing activities: | | |

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| | | |
|--|-----|---------|
| Fixed assets and other acquired under capital lease | \$— | \$1,791 |
| Common stock issued in connection with business combination | \$— | \$1,400 |
| See accompanying Notes to Condensed Consolidated Financial Statements. | | |

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NetSuite Inc.

Notes to Condensed Consolidated Financial Statements
(unaudited)

Note 1. Organization

NetSuite Inc. (the “Company”) provides cloud-based financials/ Enterprise Resource Planning (“ERP”) software suites. In addition to financials/ERP software suites, the Company offers a broad suite of applications, including accounting, Customer Relationship Management (“CRM”), Professional Services Automation (“PSA”) and Ecommerce that enable companies to manage most of their core business operations in its single integrated suite. The Company delivers its suite over the Internet as a subscription service using the software-as-a-service (“SaaS”) model. The Company’s headquarters are located in San Mateo, California. The Company conducts its business worldwide, with international locations in Canada, Europe, Asia, South America and Australia.

Note 2. Basis of Presentation

The Condensed Consolidated Financial Statements as of and for the nine and three month periods ended September 30, 2012 included in this Quarterly Report on Form 10-Q have been prepared by the Company, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (the “SEC”). The condensed consolidated balance sheet data as of December 31, 2011 was derived from the audited consolidated financial statements included in the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2011 filed on February 28, 2012. Certain information and footnote disclosures normally included in consolidated financial statements prepared in accordance with generally accepted accounting principles in the United States of America (“GAAP”) have been condensed or omitted pursuant to such rules and regulations. However, the Company believes that the disclosures contained in this Quarterly Report comply with the requirements of Section 13(a) of the Securities Exchange Act of 1934, as amended, for a Quarterly Report on Form 10-Q and are adequate to make the information presented not misleading. These Condensed Consolidated Financial Statements are meant to be, and should be, read in conjunction with the Consolidated Financial Statements and the notes thereto included in the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2011 filed on February 28, 2012.

The unaudited Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q reflect all adjustments (which include only normal, recurring adjustments and those items discussed in these Notes) that are, in the opinion of management, necessary to state fairly the financial position and results for the dates and periods presented. The results for such periods are not necessarily indicative of the results to be expected for the full fiscal year.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its majority- and wholly-owned subsidiaries. Intercompany balances and transactions have been eliminated.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make certain estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, as well as reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Recent Accounting Pronouncements

In September 2011, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update, Testing Goodwill for Impairment (the revised standard). The revised standard is intended to reduce the cost and complexity of the annual goodwill impairment test by providing entities an option to perform a "qualitative" assessment to determine whether further impairment testing is necessary. The revised standard is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. Early adoption is permitted provided that the entity has not yet performed its 2011 annual impairment test or issued its financial statements. An entity has the option to first assess qualitative factors to determine whether it is necessary to perform the current two-step test. If an entity believes, as a result of its qualitative assessment, that it is more-likely-than-not that the fair value of a reporting unit is less than its carrying amount, the quantitative impairment test is required. Otherwise, no further testing is required. The Company plans to adopt this update in the fourth quarter of fiscal year 2012 when it performs its annual goodwill impairment analysis. The Company does not expect the adoption of this update to have an impact on its consolidated results of operations and financial position.

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Revenue Recognition

The Company generates revenue from two sources: (1) subscription and support; and (2) professional services and other. Subscription and support revenue includes subscription fees from customers accessing its on-demand application suite and support fees from customers purchasing support. Arrangements with customers do not provide the customer with the right to take possession of the software supporting the on-demand application service at any time. Professional services and other revenue includes fees generated from training and consulting services such as business process mapping, configuration, data migration and integration. Amounts that have been invoiced are recorded in accounts receivable and in deferred revenue or revenue, depending on whether the revenue recognition criteria have been met.

Generally, the Company enters into subscription and support agreements for 12 months. In aggregate, more than 90% of the professional services component of the arrangements with customers is performed within 300 days of entering into a contract with the customer.

The subscription agreements provide service level commitments of 99.5% uptime per period, excluding scheduled maintenance. The failure to meet this level of service availability may require the Company to credit qualifying customers up to the value of an entire month of their subscription and support fees. In light of the Company's historical experience with meeting its service level commitments, the Company has not accrued any liabilities on its balance sheet for these commitments.

The Company commences revenue recognition when all of the following conditions are met:

- There is persuasive evidence of an arrangement;
- The service is being provided to the customer;
- The collection of the fees is reasonably assured; and
- The amount of fees to be paid by the customer is fixed or determinable.

In most instances, revenue from new customer acquisition is generated under sales agreements with multiple elements, comprised of subscription and support fees from customers accessing the Company's on-demand application suite and professional services associated with consultation services. The Company evaluates each element in a multiple-element arrangement to determine whether it represents a separate unit of accounting. An element constitutes a separate unit of accounting when the delivered item has standalone value and delivery of the undelivered element is probable and within the Company's control. Subscription and support have standalone value because they are routinely sold separately by the Company. Professional services have standalone value because the Company has sold professional services separately and there are several third party vendors that routinely provide similar professional services to its customers on a standalone basis.

The Company allocates revenue to each element in an arrangement based on a selling price hierarchy. The selling price for a deliverable is based on its vendor-specific objective evidence ("VSOE"), if available, third-party evidence ("TPE"), if VSOE is not available, or estimated selling price ("ESP"), if neither VSOE nor TPE is available. As the Company has been unable to establish VSOE or TPE for the elements of its arrangements, the Company establishes the ESP for each element primarily by considering the weighted average of actual sales prices of professional services sold on a standalone basis and subscription and support including various add-on modules when sold together without professional services, and other factors such as gross margin objectives, pricing practices and growth strategy. The consideration allocated to subscription and support is recognized as revenue over the contract period commencing when the subscription service is made available to the customer. The consideration allocated to professional services is recognized as revenue using the percentage-of-completion method.

The total arrangement fee for a multiple element arrangement is allocated based on the relative ESP of each element. However, since the professional services are generally completed prior to completion of delivery of subscription and

support services, the revenue recognized for professional services in a given reporting period does not include fees subject to delivery of subscription and support services. This results in the recognition of revenue for professional services that is generally no greater than the contractual fees for those professional services.

For single element sales agreements, subscription and support revenue is recognized ratably over the contract term beginning on the provisioning date of the contract. The Company recognizes professional services revenue using the percentage-of-completion method for single element arrangements.

Sales and other taxes collected from customers to be remitted to government authorities are excluded from revenues.

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Concentration of Credit Risk and Significant Customers

Financial instruments potentially exposing the Company to concentration of credit risk consist primarily of cash and cash equivalents, restricted cash and trade accounts receivable. The Company maintains an allowance for doubtful accounts receivable balances. The allowance is based upon historical loss patterns and an evaluation of the potential risk of loss associated with problem accounts. The Company generally charges off the receivable balances of uncollectible accounts when accounts are 120 days past-due based on the account's contractual terms. Credit risk arising from accounts receivable is mitigated due to the large number of customers comprising the Company's customer base and their dispersion across various industries. As of September 30, 2012 and December 31, 2011, there were no customers that represented more than 10% of the net accounts receivable balance. There were no customers that individually exceeded 10% of the Company's revenue in any of the periods presented. As of September 30, 2012 and December 31, 2011, long-lived assets located outside the United States were not significant.

Revenue by geographic region, based on the billing address of the customer, was as follows for the periods presented:

| | Nine Months Ended September 30, | | Three Months Ended September 30, | |
|---------------|---------------------------------|-----------|----------------------------------|----------|
| | 2012 | 2011 | 2012 | 2011 |
| | (dollars in thousands) | | | |
| United States | \$164,609 | \$126,031 | \$58,668 | \$45,210 |
| International | 59,210 | 46,202 | 21,123 | 15,749 |
| Total revenue | \$223,819 | \$172,233 | \$79,791 | \$60,959 |

| | | | | | | | | |
|--|----|---|----|---|----|---|----|---|
| Percentage of revenue generated outside of the United States | 26 | % | 27 | % | 26 | % | 26 | % |
|--|----|---|----|---|----|---|----|---|

No single country outside the United States represented more than 10% of revenue during the nine and three months ended September 30, 2012 or 2011.

The Company maintains cash balances at several banks. Accounts located in the United States are insured by the Federal Deposit Insurance Corporation ("FDIC"), up to \$250,000. Certain operating cash accounts may exceed the FDIC limits.

Intellectual Property Rights Indemnification

The Company's arrangements include provisions indemnifying customers against liabilities if our products infringe a third-party's intellectual property rights. The Company has not incurred any costs as a result of such indemnifications and has not accrued any liabilities related to such obligations in the accompanying condensed consolidated financial statements.

Qualified Operating Expense Reimbursements

At the Company's product development facility in the Czech Republic, the Company participates in a government subsidy program for employing local residents. Under the program, the Czech government will reimburse the Company for certain operating expenses it incurs. In the period the Company incurs the reimbursable operating expense, it records a reduction in product development expense and a receivable from the Czech government. During the nine and three months ended September 30, 2012, the Company's product development operating expenses were reduced by approximately \$1.4 million and \$421,000, respectively, for reimbursements of eligible operating expenses incurred during the period from November 2010 to September 30, 2012. The Company received approximately \$652,000 and \$353,000 in payments from the Czech Republic government during the nine and three months ended September 30, 2012, respectively. As of September 30, 2012, \$757,000 in reimbursements, adjusted for foreign

currency valuations, are due the Company and included in other current assets. The Company accrues for the reimbursements as the eligible operating expenses are incurred.

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Impairment of Intangible Asset

In 2009, the Company acquired QuickArrow ("QA") for approximately \$19.4 million and assigned \$3.3 million to the developed technology intangible asset. The QA developed technology was being amortized over a four year period to cost of revenue. In the second quarter of 2012, certain QA customers transitioned from the QA service offering to a NetSuite service offering or terminated their service completely resulting in the carrying value of the QA developed technology assets exceeding the revised undiscounted expected future cash flows for the service. As a result, the Company recorded a \$401,000 impairment charge based on the excess of the carrying amount of the QA developed technology over the fair value of such asset as of June 30, 2012. The QA developed technology fair value at June 30, 2012 was derived from the expected QA future cash flows which are based on revenue generated by customers using the QA service, a Level 3 unobservable input as described in note 3. The Company is amortizing the remaining \$481,000 net carrying value of the asset over the second half of 2012, which is the period the intangible asset is expected to generate revenue.

Business Combination

In May 2012, the Company completed the purchase of all the outstanding equity of two small South American companies ("SAC") that specialize in Ecommerce technology and services. The Company also purchased certain assets from two entities related to the SAC. The SAC workforce augments the Company's existing professional services and product development teams which allows the Company to expand its business capabilities in Ecommerce technology and services. The assets and operating results of the SAC are reflected in the Company's condensed consolidated financial statements from the date of acquisition. On the closing dates, the Company paid \$4.0 million in cash. Additional consideration of \$2.2 million in cash is being withheld for various periods up to the next 10 years following the close of the transaction as protection against certain losses the Company may incur in the event of certain breaches of representations and warranties covered in the purchase agreement. During the second quarter of 2012, the Company recorded \$736,000 in operating expenses related to transaction costs associated with this business combination.

Under the acquisition method of accounting, the Company allocated the purchase price to the identifiable assets and liabilities based on their estimated fair value at the date of acquisition. To determine the value of the intangible assets, the Company made various estimates and assumptions. Critical estimates in valuing the intangible assets include but are not limited to the expected costs to recreate the assets, present value of future payments, relief of royalty and multiple period excess earnings. The excess of the purchase price over the total identifiable assets has been recorded as goodwill which includes synergies expected from the expanded service capabilities and the value of the assembled work force in accordance with generally accepted accounting principles. The Company did not record any in-process research and development charges in connection with the acquisition.

The allocation of the SAC consideration to the assets acquired and obligations assumed was as follows:

| | (dollars in thousands) | |
|---------------------------------|------------------------|---|
| Cash | \$ 179 | |
| Accounts receivable | 95 | |
| Developed technology | 82 | |
| Customer relationships | 169 | |
| Non-compete agreements | 883 | |
| Trademarks | 487 | |
| Goodwill | 4,446 | |
| Other assets / liabilities, net | (128 |) |

| | |
|----------------------|---------|
| Total purchase price | \$6,213 |
|----------------------|---------|

During the third quarter of 2012, the Company completed an analysis of the tax attributes of the assets acquired and liabilities assumed and, as a result, the initial asset allocation prepared in the second quarter remained unchanged. The Company will amortize the intangible assets on a straight-line basis over the following periods: non-compete agreements, three years; trademarks, five years; customer relationships, one year to three years and developed technology, one year. The SAC's operating results are not material for pro forma disclosure.

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The following table details the Company's goodwill activity during the nine months ended September 30, 2012:

| | (dollars in thousands) | |
|---|------------------------|---|
| Beginning balance as of January 1, 2012 | \$27,564 | |
| Acquisition of SAC in May 2012 | 4,446 | |
| Foreign currency adjustment | (201 |) |
| Ending balance as of September 30, 2012 | \$31,809 | |

The Company does not have a history of goodwill impairments.

Note 3. Financial Instruments

Fair Value Measurements

The Company measures certain financial assets at fair value on a recurring basis based on a fair value hierarchy that requires us to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. A financial instrument's categorization within the fair value hierarchy is based upon the lowest level of input that is significant to the fair value measurement. The three levels of inputs that may be used to measure fair value are:

Level 1 - Quoted prices in active markets for identical assets or liabilities.

Level 2 - Observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets with insufficient volume or infrequent transactions (less active markets); or model-derived valuations in which all significant inputs are observable or can be derived principally from or corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 - Unobservable inputs to the valuation methodology that are significant to the measurement of fair value of assets or liabilities.

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

The fair value of the Company's foreign currency forward contracts is based on foreign currency rates quoted by banks or foreign currency dealers and other public data sources. Such instruments are classified as Level 2 and are included in other current assets and liabilities.

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As of September 30, 2012, financial assets stated at fair value on a recurring basis were comprised of money market funds included within cash and equivalents and foreign exchange forward contracts included within other current assets and liabilities. The fair value of these financial assets was determined using the following inputs as of September 30, 2012 and December 31, 2011:

| | September 30, 2012 | | | | December 31, 2011 | | | |
|----------------------------|---|---------|---------|----------|---|---------|---------|----------|
| | Fair value measurements at reporting date using | | | | Fair value measurements at reporting date using | | | |
| | Level 1 | Level 2 | Level 3 | Total | Level 1 | Level 2 | Level 3 | Total |
| | (in thousands) | | | | (in thousands) | | | |
| Assets: | | | | | | | | |
| Money market funds | \$72,441 | \$— | \$— | \$72,441 | \$72,352 | \$— | \$— | \$72,352 |
| Foreign exchange contracts | — | 6 | \$— | 6 | \$— | \$15 | \$— | 15 |
| Total | \$72,441 | \$6 | \$— | \$72,447 | \$72,352 | \$15 | \$— | \$72,367 |
| Liabilities: | | | | | | | | |
| Foreign exchange contracts | \$— | \$350 | \$— | \$350 | \$— | \$242 | \$— | \$242 |
| Total | \$— | \$350 | \$— | \$350 | \$— | \$242 | \$— | \$242 |

Restricted Cash

As of September 30, 2012, restricted cash consists of \$266,000 in current other assets and \$276,000 in long-term other assets. As of December 31, 2011, \$494,000 in total restricted cash was included in long-term other assets. These restricted cash accounts secure letters of credit applied against certain of the Company's facility lease agreements.

Balance Sheet Hedging - Hedging of Foreign Currency Assets and Liabilities

During the nine months ended September 30, 2012, the Company hedged certain of its nonfunctional currency denominated assets and liabilities to reduce the risk that earnings would be adversely affected by changes in exchange rates. Gains and losses from these forward contracts are recorded each period as a component of other income / (expense) in the consolidated statements of operations. The notional amount of derivative instruments acquired during the period was \$36.8 million. The Company accounts for derivative instruments as other current assets and liabilities on the balance sheet and measures them at fair value with changes in the fair value recorded as other income / (expense). These derivative instruments do not subject the Company to material balance sheet risk due to exchange rate movements because gains and losses on these derivatives are intended to offset gains and losses on the assets and liabilities being economically hedged.

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As of September 30, 2012 and December 31, 2011, the Company had the following outstanding foreign exchange forward contracts:

| | September 30, 2012 | | December 31, 2011 | |
|--------------------|---|-----------------------------|---|-----------------------------|
| | Notional Value Sold (US dollars in thousands) | Notional Value Purchased | Notional Value Sold (US dollars in thousands) | Notional Value Purchased |
| British pound | \$6,486 | \$3,037 | \$5,998 | \$574 |
| Australian dollar | 7,288 | 3,998 | 3,873 | 80 |
| Philippines peso | 4,510 | 2,980 | — | — |
| Euro | 972 | 313 | 472 | — |
| Canadian dollar | 1,421 | 906 | 881 | 934 |
| Japanese yen | 860 | — | 390 | — |
| Czech crown | 2,420 | 1,410 | 250 | — |
| Mexican peso | 155 | — | — | — |
| New Zealand dollar | 71 | — | — | — |
| Total | \$24,183 | \$12,644 | \$11,864 | \$1,588 |

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The fair value of the derivative instruments reported on the Company's Condensed Consolidated Balance Sheet were as follows:

| | Asset Derivatives | | | Liability Derivatives | | |
|-----------------------------------|--|----------------------------------|---------------------------------|-------------------------------------|----------------------------------|---------------------------------|
| | Balance Sheet Location | September 30, 2012 Fair Value | December 31, 2011 Fair Value | Balance Sheet Location | September 30, 2012 Fair Value | December 31, 2011 Fair Value |
| Derivatives and forward contracts | (in thousands) Other current assets | | | (in thousands) Other liabilities | | |
| Foreign exchange contracts | | \$6 | 15 | | \$350 | \$242 |
| Total | | \$6 | 15 | | \$350 | \$242 |

The effect of derivative instruments on the Statement of Operations and Comprehensive Loss was as follows for the periods presented:

| | Location of net gain (loss) recognized in income on derivatives | Amount of net gain (loss) recognized in income on derivatives during the | | | |
|-----------------------------------|---|--|------|----------------------------------|---------|
| | | Nine Months Ended September 30, | | Three Months Ended September 30, | |
| Derivatives and forward contracts | | 2012 | 2011 | 2012 | 2011 |
| | | (in thousands) | | | |
| Foreign exchange contracts | Other income/ (expense), net | \$56 | \$65 | \$(361) |) \$373 |
| Total | | \$56 | \$65 | \$(361) |) \$373 |

The Company has entered into all of its foreign exchange contracts with a single counterparty. During the periods such contracts are open, the Company is subject to a potential maximum amount of loss due to credit risk equal to the gross fair value of the derivative instrument, if the counterparty to the instruments failed completely to perform according to the terms of the contracts. Generally, we have the right of offset for gains earned and losses incurred under these agreements. The agreements with the counterparty do not require either party to provide collateral to mitigate the credit risk of the agreements.

Note 4. Commitments and Contingencies

The Company is involved in various legal proceedings and receives claims from time to time, arising from the normal course of business activities. The Company has accrued for estimated losses in the accompanying condensed consolidated financial statements for matters with respect to which it believes the likelihood of an adverse outcome is probable and the amount of the loss is reasonably estimable.

Note 5. Stock-based Compensation

In connection with the SAC acquisitions, the Company entered into employment agreements with certain former SAC stockholders and granted them 51,606 restricted stock units in total. The restricted stock units vest over the next three to four years in accordance with the terms of the Company's equity compensation plan. The total fair value of the restricted stock units on the date of grant was \$2.3 million. The cost of these equity grants will be recognized as cost

of professional services and other in the Company's statement of operations over the three to four year vesting period.

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During the first quarter of 2012, the Company granted 341,750 performance shares ("PS"), with a fair value of \$50.38 per share, to selected executives and other key employees. These PS grants were equally divided into two tranches: shares that vest based on the Company's performance in 2012 and 2014. The PS vesting is contingent upon the Company meeting certain company-wide revenue and non-GAAP operating margin performance goals (performance-based) in 2012 and certain company-wide revenue performance goals in 2014. These shares are subject to term vesting conditions. The PS fair value and the related stock-based compensation expense are determined based on the value of the underlying shares on the date of grant and is recognized over the vesting term. During the interim financial periods, management estimates the probable number of PS that will be granted until the achievement of the performance goals will be known at or after December 31, 2012 and December 31, 2014, respectively. The Company also awarded PS for 2013 and an additional PS award for 2014 for which the performance metrics have not been set by the Company's Board of Directors. As such, there is no accounting impact for these awards until the period the performance metrics are set.

Note 6. Income Taxes

The Company has incurred annual operating losses since inception. As a result of those continuing losses, management has determined insufficient evidence exists to support that it is more likely than not that the Company will realize the benefits of its U.S. net deferred tax assets and therefore has recorded a valuation allowance to reduce the net carrying value of these deferred tax assets to zero. Accordingly, the Company has not recorded a provision for income taxes for any of the periods presented other than provisions for state and foreign income taxes.

As of September 30, 2012, the Company had net deferred tax assets in certain foreign jurisdictions of approximately \$349,000 included primarily in other assets. Based on all available evidence, both positive and negative, management believes that it is more likely than not that the benefits of those foreign deferred tax assets will be realized in full. The Company also had deferred tax assets of \$4.7 million for Japan where it had a full valuation allowance as of September 30, 2012, reducing its carrying value to zero.

The Company does not anticipate a material change in the total amount or composition of its unrecognized tax benefits within 12 months of the reporting date.

The Company files federal, state and foreign income tax returns in jurisdictions with varying statutes of limitations. Due to its net operating loss carryforwards, the Company's income tax returns generally remain subject to examination by federal and most state tax authorities. In most of the Company's significant foreign jurisdictions, the 2006 through 2011 tax years remain subject to examination by their respective tax authorities. In addition, the 2004 and 2005 tax years remain open to examination in Canada.

Note 7. Net Loss Per Share of Common Stock

Basic net loss per common share is computed by dividing net loss by the weighted-average number of shares of common stock outstanding during the period. Diluted net loss per share of common stock is computed by giving effect to all potential dilutive shares of common stock, including options, restricted stock units ("RSUs"), performance share units ("PSUs") and PS. Basic and diluted net loss per share of common stock were the same for all periods presented as the impact of all potentially dilutive securities outstanding was anti-dilutive.

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The following table presents the calculation of the numerator and denominator used in the basic and diluted net loss per share of common stock:

| | Nine Months Ended September 30, | | Three Months Ended September 30, | |
|--|---|-------------|----------------------------------|------------|
| | 2012 | 2011 | 2012 | 2011 |
| | (dollars and shares in thousands, except per share amounts) | | | |
| Numerator: | | | | |
| Net loss | \$(25,607 |) \$(24,392 |) \$(7,984 |) \$(6,929 |
| Denominator: | | | | |
| Weighted-average number of shares of common stock outstanding used in computing basic and diluted net loss per share of common stock | 70,288 | 66,459 | 71,161 | 67,477 |
| Net loss per share of common stock, basic and diluted | \$(0.36 |) \$(0.37 |) \$(0.11 |) \$(0.10 |

The Company's unvested RSUs, PSUs and PS do not contain non-forfeitable rights to dividends and dividend equivalents. As such, unvested RSUs, PSUs and PS are not participating securities and the Company is not required to use the two-class method to calculate diluted earnings per share in periods when the Company has net income.

The following table presents the weighted average potential shares that are excluded from the computation of diluted net loss per common share for the periods presented because including them would have had an anti dilutive effect:

| | Nine Months Ended September 30, | | Three Months Ended September 30, | |
|--|---------------------------------|-------|----------------------------------|-------|
| | 2012 | 2011 | 2012 | 2011 |
| | (Shares in thousands) | | | |
| Options to purchase shares of common stock | 3,795 | 5,552 | 3,415 | 5,035 |
| Unvested RSUs, PSUs and PS awards | 3,796 | 4,243 | 3,623 | 4,204 |
| Total | 7,591 | 9,795 | 7,038 | 9,239 |

Note 8. Related Party Transactions

During the nine months ended September 30, 2012, the Company paid Oracle Financing \$3.0 million, which included \$1.8 million related to a support services agreement that renewed in May 2011, \$1.2 million related to software licenses and \$63,000 related to interest in connection with a related party note entered into in May 2010 to finance the software license and support services. During the three months ended September 30, 2012, the Company paid Oracle Financing \$1.0 million, which included \$589,000 related to support services, \$389,000 related to software licenses and \$24,000 related to interest. During the nine months ended September 30, 2011, the Company paid Oracle Financing \$2.0 million, which included \$1.2 million related to support services, \$734,000 related to software licenses and \$82,000 related to interest. During the three months ended September 30, 2011, the Company paid Oracle Financing \$1.0 million, which included \$589,000 related to support services, \$380,000 related to software licenses and \$32,000 related to interest.

In the third quarter of 2012, the Company incurred and paid \$318,000 in marketing fees related to an Oracle user conference, and paid Oracle \$550,000 in connection with an application processing engine purchased in May 2012. Additionally, during the three months ended September 30, 2012, the Company received \$86,000 from Oracle related to services for various Oracle subsidiaries. In May 2011, the Company purchased and paid for an integrated database storage system from Oracle USA, Inc., an affiliate of Oracle Corporation, for \$456,000. Lawrence J. Ellison, who beneficially owns a significant portion of the Company's common stock, is the Chief Executive Officer, a director and

a principal stockholder of Oracle Corporation.

The Company has entered into various software license agreements with RightNow Technologies. In October 2011, RightNow Technologies was acquired by Oracle Corporation. During the nine months ended September 30, 2012 and 2011, the Company received payments totaling \$112,000 and \$132,000, respectively, from RightNow Technologies for services it performed. Additionally, during the nine months ended September 30, 2012 and 2011, the Company purchased and paid RightNow Technologies \$214,000 and \$58,000, respectively, for services it received or expects to receive.

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In January 2011, the Company's Chief Technology Officer and Chairman of the Board, purchased property from an entity affiliated with a principal stockholder ("seller") for \$8.0 million. The seller financed the transaction with a nine year loan. The Company analyzed the transaction and determined that the fair value of the property approximated the fair value of the loan. Consequently, the Company determined there is no compensation expense or a related capital contribution associated with this transaction.

In addition to the companies affiliated with Lawrence J. Ellison, the Company enters into sales and purchases agreements with various companies that have a relationship with the Company's executive officers or members of the Company's board of directors. The relationships are typically an equity investment by the executive officer or board member in the customer / vendor company or the Company's executive officer or board member is a member of the customer / vendor company's board of directors. The Company has renewed the license agreement and sold additional services to these customers or purchased services from these vendors at various points in time. During the nine months ended September 30, 2012, the Company entered into \$1.1 million in license and professional service agreements for services it will provide to these customers and received \$2.1 million in payments for services performed or that will be performed. During the third quarter of 2012, the Company entered into \$168,000 in license and professional service agreements for services it will provide to these customers and received \$425,000 in payments for services performed or that will be performed. As of September 30, 2012, outstanding receivables from these customers totaled \$101,000. Additionally during the nine months ended September 30, 2012, the Company purchased \$191,000 in services from these vendors and paid \$539,000 for services it received. During the third quarter of 2012, the Company purchased \$61,000 in services from these vendors and paid \$457,000 for services it received. During the nine months ended September 30, 2011, the Company entered into \$1.9 million in license and professional service agreements for services it would provide to these customers and received \$1.4 million in payments for services performed or would be performed. During the third quarter of 2011, the Company entered into \$516,000 in license and professional service agreements for services it would provide to these customers and received \$242,000 in payments for services performed or that would be performed. As of September 30, 2011, outstanding receivables from these customers totaled \$447,000. Additionally during the nine months ended September 30, 2011, the Company purchased \$773,000 in services from these vendors and paid \$425,000 for services it received or expects to receive. During the third quarter of 2011, the Company purchased \$36,000 in services from these vendors and paid \$45,000 for services it received or expects to receive.

During the nine months ended September 30, 2012 and 2011, the Company recognized \$1.8 million and \$1.6 million, respectively, in revenue in connection with the subscription and professional services provided to related parties. During the three months ended September 30, 2012 and 2011, the Company recognized \$575,000 and \$530,000, respectively, in revenue in connection with the subscription and professional services provided to related parties.

Additional related party transactions entered into prior to December 31, 2011 are described in the Notes to Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2011 filed on February 28, 2012.

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ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis is intended to provide greater details of our results of operations and financial condition and should be read in conjunction with our condensed consolidated financial statements and the notes thereto included elsewhere in this document and the discussion contained in our Annual Report on Form 10-K for the year ended December 31, 2011 as filed with the SEC on February 28, 2012. Certain statements in this Quarterly Report constitute forward-looking statements and as such, involve risks and uncertainties, as well as assumptions that, if they never materialize or prove incorrect, could cause our results to differ materially from those expressed or implied by such forward-looking statements. Such forward-looking statements include any expectation of earnings, revenues or other financial items; any statements of the plans, strategies and objectives of management for future operations; factors that may affect our operating results; statements concerning new products or services; statements related to adding employees; statements related to future capital expenditures; statements related to future economic conditions or performance; statements related to the integration of acquired companies; statements as to industry trends and other matters that do not relate strictly to historical facts or statements of assumptions underlying any of the foregoing. These statements are often identified by the use of words such as "anticipate," "believe," "continue," "could," "estimate," "expect," "intend," "may," or "will," and similar expressions or variations. Such forward-looking statements are subject to risks, uncertainties and other factors that could cause actual results and the timing of certain events to differ materially from future results expressed or implied by such forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to those discussed in the section titled "Risk Factors" included in Item 1A of Part II of this Quarterly Report on Form 10-Q, and the risks discussed in our other SEC filings.

We urge you to consider these factors carefully in evaluating the forward-looking statements contained in this Quarterly Report on Form 10-Q. These statements are based on the beliefs and assumptions of our management based on information currently available to management. The forward-looking statements included in this Quarterly Report are made only as of the date of this Quarterly Report. All subsequent written or oral forward-looking statements attributable to our company or persons acting on our behalf are expressly qualified in their entirety by these cautionary statements. We do not undertake, and specifically disclaim, any obligation to update any forward-looking statements to reflect the occurrence of events or circumstances after the date of such statements except as required by law.

Overview

We are the industry's leading provider of cloud-based financials/ERP software suites. In addition to financials/ERP software suites, we offer a broad suite of applications, including accounting, CRM, PSA and Ecommerce that enable companies to manage most of their core business operations in our single integrated suite. Our "real-time dashboard" technology provides an easy-to-use view into up-to-date, role-specific business information. We also offer customer support and professional services related to supporting and implementing our suite of applications. We deliver our suite over the Internet as a subscription service using the software-as-a-service ("SaaS") model.

In 1999, we released our first application, NetLedger, focused on accounting applications. We then released Ecommerce functionality in 2000 and CRM and sales force automation functionality in 2001. In 2002, we released our next generation suite under the name NetSuite, and we have regularly added features and functionality. In 2008, we acquired OpenAir and in 2009 we acquired QuickArrow, both of which offer professional services automation and project portfolio management products.

Our headquarters are located in San Mateo, California. We were incorporated in California in September 1998 and reincorporated in Delaware in November 2007. We conduct our business worldwide, with international locations in Canada, Europe, Asia, South America and Australia.

During the second quarter of 2012, we completed the purchase all of the outstanding equity of two small South American companies ("SAC") that specialize in Ecommerce technology and services. We also purchased certain assets from two entities related to the SAC. The SAC workforce will augment our existing professional services and product development teams. On the closing dates, we paid \$4.0 million in cash. Additional consideration of \$2.2 million in cash is being withheld for various periods up to the next 10 years following the close of the transaction as protection against certain losses we may incur in the event of certain breaches of representations and warranties covered in the purchase agreement. During the second quarter of 2012, we recorded \$736,000 in operating expenses related to transaction costs associated with this business combination.

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Key Components of Our Results of Operations

Revenue

Our revenue has grown from \$17.7 million during the year ended December 31, 2004 to \$236.3 million during the year ended December 31, 2011.

We generate sales directly through our sales team and, to a lesser extent, indirectly through channel partners. We sell our service to customers across a broad spectrum of industries, and we have tailored our service for wholesalers/distributors, manufacturers, e-tailers, services companies and software companies. The primary target customers for our service are medium-sized businesses and divisions of large companies. An increasing percentage of our customers and our revenue have been derived from larger businesses within this market. For the nine months ended September 30, 2012, we did not have any single customer that accounted for more than 3% of our revenue.

We are pursuing a number of strategies that we believe will enable us to continue to grow. The goals of those strategic objectives are to continue to move up-market; to increase use of NetSuite as a platform; and to extend the verticalization of our product line. Although we have made progress towards our goals in recent periods, there are still many areas where we believe that we can continue to grow. To achieve these goals, we are focused on the following initiatives:

- Growth of sales of OneWorld, our platform for ERP, CRM and Ecommerce capabilities in multi-currency environments across multiple subsidiaries and legal entities, which supports the needs of large, standalone companies, and divisions of very large enterprises;
- Strengthening our offerings for targeted industries such as wholesale/distribution, manufacturing, e-tail, retail, technology and professional services by adding deeper verticalized functionality; and
- Developing our SuiteCloud ecosystem to enable third parties to extend our offerings with their vertical expertise or horizontal solution.

We experience competitive pricing pressure when our products are compared with solutions that address a narrower range of customer needs or are not fully integrated (for example, when compared with Ecommerce or CRM stand-alone solutions). In addition, since we sell primarily to medium-sized businesses, we also face pricing pressure in terms of the more limited financial resources or budgetary constraints of many of our target customers. We do not currently experience significant pricing pressure from competitors that offer a similar on-demand, integrated business management suite.

We sell our application suite pursuant to subscription agreements. The duration of these agreements is generally one year. We rely in part on a large percentage of our customers to renew their agreements to drive our revenue growth. Our customers have no obligation to renew their subscriptions after the expiration of their subscription period.

Our subscription agreements provide service level commitments of 99.5% uptime per period, excluding scheduled maintenance. The failure to meet this level of service availability may require us to credit qualifying customers up to the value of an entire month of their subscription and support fees. In light of our historical experience with meeting our service level commitments, we have not accrued any liabilities on our balance sheet for these commitments.

We generally invoice our customers in advance in annual or quarterly installments, and typical payment terms provide that our clients pay us within 30 to 60 days of invoice. Amounts that have been invoiced where the customer has a legal obligation to pay are recorded in accounts receivable and deferred revenue. As of September 30, 2012, we had deferred revenue of \$135.5 million.

During the second quarter of 2012, we updated the terms of our standard renewal agreement form so that the legal obligation to pay by our customers occurs upon execution of the renewal agreement rather than on their renewal date. Based on our existing policy of recording amounts that have been invoiced in accounts receivable and deferred revenue where the customer has a legal obligation to pay, invoices from these renewal agreements are now recorded in accounts receivable and deferred revenue upon execution of the renewal agreement rather than at the start of the renewal period. Had we not revised the terms of these renewal agreements, we would have recorded approximately \$4.3 million less in accounts receivable and deferred revenue as of September 30, 2012.

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As part of our overall growth, we expect the percentage of our revenue generated outside of the United States to increase as we invest in and enter new markets. Revenue by geographic region, based on the billing address of the customer, was as follows for the periods presented:

| | Nine Months Ended September 30, | | Three Months Ended September 30, | |
|--|---------------------------------|------------|----------------------------------|-----------|
| | 2012 | 2011 | 2012 | 2011 |
| | (dollars in thousands) | | | |
| United States | \$ 164,609 | \$ 126,031 | \$ 58,668 | \$ 45,210 |
| International | 59,210 | 46,202 | 21,123 | 15,749 |
| Total revenue | \$ 223,819 | \$ 172,233 | \$ 79,791 | \$ 60,959 |
| Percentage of revenue generated outside of the United States | 26 | % 27 | % 26 | % 26 |

Employees

The number of full-time employees as of September 30, 2012 was 1,630 as compared to 1,265 at December 31, 2011 and 1,243 at September 30, 2011. As of September 30, 2012, our headcount included 484 employees in sales and marketing; 639 employees in operations, professional services, training and customer support; 345 employees in product development; and 162 employees in a general and administrative capacity.

Cost of Revenue

Subscription and support cost of revenue primarily consists of costs related to hosting our application suite, providing customer support, data communications expenses, personnel and related costs of operations, stock-based compensation, software license fees, outsourced subscription services, costs associated with website development activities, allocated overhead, amortization expense associated with capitalized internal use software and acquired developed technology, and related plant and equipment depreciation and amortization expenses.

Professional services and other cost of revenue primarily consists of personnel and related costs for our professional services employees and executives, external consultants, stock-based compensation and allocated overhead.

We allocate overhead such as rent, information technology costs, employee benefit costs and recruiting costs to all departments based on headcount. As such, general overhead expenses are reflected in cost of revenue and each operating expense category.

We expect cost of revenue to remain flat as a percentage of revenue over the near term; however, it could fluctuate period to period depending on the growth of our professional services business and any associated increased costs relating to the delivery of professional services and the timing of significant expenditures.

Operating Expenses - Product Development

Product development expenses primarily consist of personnel and related costs for our product development employees and executives, including salaries, stock-based compensation, employee benefits and allocated overhead. Our product development efforts have been devoted primarily to increasing the functionality and enhancing the ease of use of our on-demand application suite, as well as localizing our product for international use. A key component of our strategy is to expand our business internationally. This will require us to conform our application suite to comply with local regulations and languages, causing us to incur additional expenses related to translation and localization of our application for use in other countries.

At our product development facility in the Czech Republic, we participate in a government program that subsidizes us for employing local residents. Under the program, the Czech government will reimburse us for certain operating expenses we incur. During the first nine months of 2012, we reduced our product development expense for eligible operational expenses we expect the Czech government to reimburse. On a quarterly basis, we will accrue our expected subsidies for the duration of the program.

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We expect product development expenses to increase in absolute dollars and increase slightly as a percentage of revenue as we continue to extend our service offerings internationally and as we expand and enhance our application suite technologies. Such expenses may vary due to the timing of these offerings and technologies.

Operating Expenses - Sales and Marketing

Sales and marketing expenses primarily consist of personnel and related costs for our sales and marketing employees and executives, including wages, benefits, bonuses, commissions and training, stock-based compensation, commissions paid to our channel partners, the cost of marketing programs such as on-line lead generation, promotional events, webinars and other meeting costs, amortization of intangible assets related to trade name and customer relationships and allocated overhead. We market and sell our application suite worldwide through our direct sales organization and indirect distribution channels such as strategic resellers. We capitalize and amortize our direct and channel sales commissions over the period the related revenue is recognized.

We believe we have sufficient sales and marketing staff to meet our revenue goals for the remainder of 2012. We expect to continue to invest in sales and marketing to pursue new customers and expand relationships with existing customers. As such, we expect our sales and marketing expenses to increase in terms of absolute dollars and increase slightly as a percentage of total revenue for the remainder of 2012.

Operating Expenses - General and Administrative

General and administrative expenses primarily consist of personnel and related costs for executive, finance, human resources and administrative personnel, stock-based compensation, legal and other professional fees, other corporate expenses and allocated overhead.

We expect our general and administrative expenses to increase in terms of absolute dollars and remain constant as a percentage of total revenue for the remainder of 2012.

Income Taxes

Since inception, we have incurred annual operating losses and, accordingly, have not recorded a provision for income taxes for any of the periods presented other than provisions for state and foreign income taxes.

Critical Accounting Policies and Judgments

Our condensed consolidated financial statements are prepared in accordance with GAAP. The preparation of these condensed consolidated financial statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, costs and expenses and related disclosures. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances. In many instances, we could have reasonably used different accounting estimates, and in other instances changes in the accounting estimates are reasonably likely to occur from period-to-period. Accordingly, actual results could differ significantly from the estimates made by our management. To the extent that there are material differences between these estimates and actual results, our future financial statement presentation, financial condition, results of operations and cash flows will be affected.

In many cases, the accounting treatment of a particular transaction is specifically dictated by GAAP and does not require management's judgment in its application, while in other cases, significant judgment is required in selecting among available alternative accounting standards that allow different accounting treatment for similar transactions. We consider these policies requiring significant management judgment to be critical accounting policies. These critical accounting policies are:

Revenue recognition;

Internal use software and website development costs;
Deferred commissions;
Accounting for stock-based compensation; and
Goodwill and other intangible assets

There have been no significant changes in our critical accounting policies and estimates during the nine months ended September 30, 2012 as compared to the critical accounting policies and estimates disclosed in “Management’s Discussion and Analysis of Financial Condition and Results of Operations – Critical Accounting Policies and Judgments” included in our

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Annual Report on Form 10-K for the year ended December 31, 2011 filed on February 28, 2012. In addition, please see Note 2 of Notes to the Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q and Note 2 of the Notes to Consolidated Financial Statements included in our 2011 Annual Report on Form 10-K filed on February 28, 2012 for a description of our accounting policies.

Results of Operations

Revenue, Cost of Revenue, Gross Profit and Gross Margin

Information about revenue, cost of revenue, gross profit and gross margin was as follows for the periods presented:

| | Nine Months Ended September 30, 2012 | | Three Months Ended September 30, 2011 | |
|---------------------------------|--|------------|---|-----------|
| | 2012 | 2011 | 2012 | 2011 |
| | (dollars in thousands) | | | |
| Revenue: | | | | |
| Subscription and support | \$ 184,368 | \$ 145,388 | \$ 65,329 | \$ 51,334 |
| Professional services and other | 39,451 | 26,845 | 14,462 | 9,625 |
| Total revenue | 223,819 | 172,233 | 79,791 | 60,959 |
| Cost of revenue (1): | | | | |
| Subscription and support | 30,722 | 24,342 | 10,880 | 8,627 |
| Professional services and other | 38,218 | 27,450 | 14,211 | 9,658 |
| Total cost of revenue | 68,940 | 51,792 | 25,091 | 18,285 |
| Gross profit | \$ 154,879 | \$ 120,441 | \$ 54,700 | \$ 42,674 |
| Gross margin | 69 | % 70 | % 69 | % 70 |

(1) Includes stock-based compensation expense and amortization of intangible assets of:

| | | | | |
|---------------------------------|----------|----------|----------|----------|
| Cost of revenue: | | | | |
| Subscription and support | \$ 3,557 | \$ 2,698 | \$ 1,169 | \$ 807 |
| Professional services and other | 4,365 | 3,055 | 1,688 | 1,067 |
| | \$ 7,922 | \$ 5,753 | \$ 2,857 | \$ 1,874 |

Nine Months Ended September 30, 2012 as Compared to the Nine Months Ended September 30, 2011

Revenue for the nine months ended September 30, 2012 increased \$51.6 million, or 30%, compared to the same period in 2011.

Subscription and support revenue: Subscription and support revenue for the nine months ended September 30, 2012 increased \$39.0 million, or 27%, compared to the same period in 2011. The increase was primarily the result of a \$32.2 million increase in revenue resulting from the acquisition of new customers, the continued adoption of OneWorld and a \$6.8 million increase in revenue from existing customers.

Professional services and other revenue: Professional services and other revenue for the nine months ended September 30, 2012 increased \$12.6 million, or 47%, compared to the same period in 2011. The increase was primarily the result of a \$25.6 million increase in revenue resulting from the acquisition of new customers and an increase in productivity. As we move up market to larger customers, the scope of our professional services engagements have increased resulting in an increase in demand for our professional services. The increase in professional services and other revenue was partially offset by a \$13.0 million decrease in revenue from existing customers related to services purchased in connection with the initial implementation of our product in 2011 that did not recur for those customers in 2012.

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Revenue generated outside of the United States was \$59.2 million, or 26%, of our total revenue for the nine months ended September 30, 2012 as compared to \$46.2 million, or 27%, for the same period in 2011. Revenue generated outside of the United States increased primarily due to an increase in our sales efforts internationally, particularly in Australia.

Cost of revenue for the nine months ended September 30, 2012 increased \$17.1 million, or 33%, compared to the same period in 2011.

Subscription and support cost of revenue: Subscription and support cost of revenue for the nine months ended September 30, 2012 increased \$6.4 million, or 26%, compared to the same period in 2011. The increase was primarily due to a \$3.3 million increase in personnel costs resulting from an increase in headcount and annual salary increases. Additionally, data center and other costs increased by \$2.7 million due to an increase in vendor prices, support costs, depreciation and other operational costs associated with an increase in our data center capacity and activity. In the second quarter of 2012, we also recorded a \$401,000 impairment charge related to the acquired QA developed technology intangible asset because the legacy customers migrated to another NetSuite product or terminated their service completely.

Professional services and other cost of revenue: Professional services and other cost of revenue for the nine months ended September 30, 2012 increased \$10.8 million, or 39%, compared to the same period in 2011. The increase was primarily the result of a \$6.6 million increase in personnel costs, a \$2.2 million increase in overhead expense allocations and a \$1.9 million increase in fees related to outsourced consulting services. Personnel costs increased due to an increase in headcount, annual merit increases and incentive bonuses. Overhead expense allocations increased due to an increase in overhead costs, which are primarily facility costs, and an increase in headcount which is the basis for the allocation. Outsourced consulting fees increased due to an increase in demand for our professional services and an increase in training expenses for professional services consultants.

Our gross margin decreased slightly to 69% during the nine months ended September 30, 2012 from 70% during the same period in 2011. Our professional services, which has a lower gross margin than subscription and support services, represented a larger portion of total revenue during the first nine months of 2012 when compared to the same period in 2011, so our increase in total revenue did not increase the gross margin percentage. Additionally, during the second quarter of 2012, our gross margin was negatively affected by higher subscription revenue costs, particularly a \$401,000 impairment charge related to the acquired QA developed technology intangible asset because the legacy customers migrated to another NetSuite product or terminated their service completely.

Three Months Ended September 30, 2012 as Compared to the Three Months Ended September 30, 2011

Revenue for the three months ended September 30, 2012 increased \$18.8 million, or 31%, compared to the same period in 2011.

Subscription and support revenue: Subscription and support revenue for the three months ended September 30, 2012 increased \$14.0 million, or 27%, compared to the same period in 2011. The increase was primarily the result of a \$11.7 million increase in revenue resulting from the acquisition of new customers, the continued adoption of OneWorld and a \$2.3 million increase in revenue from existing customers.

Professional services and other revenue: Professional services and other revenue for the three months ended September 30, 2012 increased \$4.8 million, or 50%, compared to the same period in 2011. The increase was primarily the result of a \$9.5 million increase in revenue resulting from the acquisition of new customers and an increase in productivity. As we move up market to larger customers, the scope of our professional services engagements have

increased resulting in an increase in demand for our professional services. The increase in professional services and other revenue was partially offset by a \$4.7 million decrease in revenue from existing customers related to services purchased in connection with the initial implementation of our product in 2011 that did not recur for those customers in 2012.

Revenue generated outside of the United States was \$21.1 million, or 26%, of our total revenue for the three months ended September 30, 2012 as compared to \$15.7 million, or 26%, for the same period in 2011. Revenue generated outside of the United States increased primarily due to an increase in our sales efforts internationally, particularly in Australia.

Cost of revenue for the three months ended September 30, 2012 increased \$6.8 million, or 37%, compared to the same period in 2011.

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Subscription and support cost of revenue: Subscription and support cost of revenue for the three months ended September 30, 2012 increased \$2.3 million, or 26%, compared to the same period in 2011. The increase was primarily due to a \$1.2 million increase in personnel costs resulting from an increase in headcount and annual salary increases. Additionally, data center and other costs increased by \$1.1 million due to an increase in vendor prices, support costs, depreciation and other operational costs associated with an increase in our data center capacity and activity.

Professional services and other cost of revenue: Professional services and other cost of revenue for the three months ended September 30, 2012 increased \$4.6 million, or 47%, compared to the same period in 2011. The increase was primarily the result of a \$3.1 million increase in personnel costs, an \$812,000 increase in overhead expense allocations and a \$567,000 increase in fees related to outsourced consulting services. Personnel costs increased due to an increase in headcount, annual merit increases and incentive bonuses. Overhead expense allocations increased due to an increase in higher overhead costs, which are primarily facility costs, and an increase in headcount which is the basis for the allocation. Outsourced consulting fees increased due to an increase in demand for our professional services and an increase in training expenses for professional services consultants.

Our gross margin decreased slightly to 69% during the three months ended September 30, 2012 from 70% during the same period in 2011. Our professional services, which has a lower gross margin than subscription and support services, represented a larger portion of total revenue during the three months ended September 30, 2012 when compared to the same period in 2011, so our increase in total revenue did not increase the gross margin percentage.

Operating Expenses

Operating expenses were as follows for the periods presented:

| | Nine Months Ended September 30, 2012 | | 2011 | | |
|----------------------------|--|-----------------|--------------|-----------------|---|
| | Amount | % of revenue | Amount | % of revenue | |
| | (dollars in thousands) | | | | |
| Operating expenses (1): | | | | | |
| Product development | \$ 38,311 | 17 | % \$ 31,615 | 18 | % |
| Sales and marketing | 111,731 | 50 | % 88,209 | 51 | % |
| General and administrative | 28,334 | 13 | % 23,839 | 14 | % |
| Total operating expenses | \$ 178,376 | 80 | % \$ 143,663 | 83 | % |
| | | | | | |
| | Three Months Ended September 30, 2012 | | 2011 | | |
| | Amount | % of revenue | Amount | % of revenue | |
| | (dollars in thousands) | | | | |
| Operating expenses (1): | | | | | |
| Product development | \$ 13,943 | 17 | % \$ 11,257 | 18 | % |
| Sales and marketing | 38,591 | 48 | % 30,279 | 50 | % |
| General and administrative | 9,458 | 12 | % 7,622 | 13 | % |
| Total operating expenses | \$ 61,992 | 78 | % \$ 49,158 | 81 | % |

(1) Includes stock-based compensation expense, amortization of acquisition-related intangible assets and transaction costs for business combinations as follows:

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| | Nine Months Ended September 30, | | Three Months Ended September 30, | |
|----------------------------|---------------------------------|-----------|----------------------------------|----------|
| | 2012 | 2011 | 2012 | 2011 |
| | (dollars in thousands) | | | |
| Product development | \$ 11,302 | \$ 8,699 | \$ 4,035 | \$ 3,422 |
| Sales and marketing | 12,304 | 9,909 | 4,142 | 3,402 |
| General and administrative | 8,655 | 7,408 | 2,686 | 2,089 |
| Total | \$ 32,261 | \$ 26,016 | \$ 10,863 | \$ 8,913 |

Nine Months Ended September 30, 2012 as Compared to the Nine Months Ended September 30, 2011

Product development expenses for the nine months ended September 30, 2012 increased \$6.7 million, or 21%, as compared to the same period in 2011. The increase was primarily the result of a \$7.4 million increase in personnel costs resulting from an increase in headcount, annual salary increases, payroll tax increases and an increase in stock-based compensation. The increase in personnel costs includes a \$2.6 million increase in stock-based compensation resulting primarily from the issuance of annual equity awards to employees. Additionally, overhead expense allocations and other costs increased by \$1.3 million due to higher overhead costs, which are primarily facility costs, and an increase in product development headcount. These cost increases were partially offset by expense reductions related to a \$1.4 million employment development subsidy from the Czech Republic government for the period from November 2010 to September 30, 2012 and a \$763,000 increase in capitalized product development costs associated with new product functionality.

Sales and marketing expenses for the nine months ended September 30, 2012 increased \$23.5 million, or 27%, as compared to the same period in 2011. The increase was primarily the result of a \$17.5 million increase in personnel costs, a \$3.9 million increase in marketing expenses and a \$2.2 million increase in overhead expense allocations and other operating expenses, net. The increase in personnel costs related primarily to increases in commission and payroll expenses resulting from higher sales and an increase in headcount. Additionally, personnel costs include a \$2.3 million increase in stock-based compensation resulting primarily from the issuance of annual equity awards. Marketing expenses increased by \$3.9 million primarily due to a \$2.5 million increase in on-line and corporate marketing expenses and \$1.4 million in costs associated with our annual user conference, trade shows and other promotional events. Overhead allocation and other operating expenses, net increased due to an increase in overhead cost allocations which consist primarily of facility costs.

General and administrative expenses for the nine months ended September 30, 2012 increased \$4.5 million, or 19%, as compared to the same period in 2011. The increase was primarily the result of a \$5.3 million increase in personnel costs, a \$2.1 million increase in other operational costs, a \$1.3 million increase in overhead costs and a \$736,000 increase in acquisition transaction costs. These cost increases were partially offset by a \$4.3 million increase in overhead expense cost allocations to other departments and a \$720,000 decrease in patents expenses. The increase in personnel costs resulted from an increase in headcount, an increase in merit pay and an increase in other payroll costs such as recruiting. Other operational costs increased primarily due to an increase in costs related to general administrative services and \$507,000 in additional sales taxes. Overhead costs increased primarily due to an increase in facility costs at various locations. Additionally, we incurred \$736,000 in transaction costs in connection with our acquisition of SAC during the second quarter of 2012. Our overhead expense allocations to other departments increased due to an increase in allocated costs such as facility costs, information technology costs and recruiting costs. Our patent costs decreased due to a \$720,000 patent settlement expense recorded in 2011, but not incurred in 2012.

Three Months Ended September 30, 2012 as Compared to the Three Months Ended September 30, 2011

Product development expenses for the three months ended September 30, 2012 increased \$2.7 million, or 24%, as compared to the same period in 2011. The increase was primarily the result of a \$2.9 million increase in personnel costs resulting from an increase in headcount, annual salary increases, payroll tax increases and an increase in stock-based compensation. The increase in personnel costs includes a \$613,000 increase in stock-based compensation resulting primarily from the issuance of annual equity awards to employees. Additionally, overhead expense allocations increased by \$396,000 due to higher overhead costs, which are primarily facility costs, and an increase in product development headcount. These cost increases were partially offset by expense reductions related to a \$421,000 employment development subsidy from the Czech Republic government for the third quarter of 2012 and a \$230,000 increase in capitalized product development costs associated with new product functionality.

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Sales and marketing expenses for the three months ended September 30, 2012 increased \$8.3 million, or 27%, as compared to the same period in 2011. The increase was primarily the result of a \$5.7 million increase in personnel costs, a \$1.8 million increase in marketing expenses and an \$841,000 increase in overhead expense allocations and other operating expenses, net. The increase in personnel costs related primarily to increases in commission and payroll expenses resulting from higher sales and an increase in headcount. Additionally, personnel costs include a \$677,000 increase in stock-based compensation resulting primarily from the issuance of annual equity awards. Marketing expenses increased by \$1.8 million primarily due to a \$1.0 million increase in on-line and corporate marketing expenses and \$800,000 in costs associated with a vendor annual user conference, trade shows and other promotional events. Overhead allocation and other operating expenses, net increased due to an increase in overhead cost allocations which consist primarily of facility costs.

General and administrative expenses for the three months ended September 30, 2012 increased \$1.8 million, or 24%, as compared to the same period in 2011. The increase was primarily the result of a \$2.1 million increase in personnel costs, an \$880,000 increase in other operational costs and a \$467,000 increase in overhead costs partially offset by a \$1.5 million increase in overhead expense cost allocations to other departments. The increase in personnel costs resulted from an increase in headcount, an increase in merit pay and an increase in other costs such as recruiting. Other operational costs increased primarily due to an increase in costs related to general administrative services. Overhead costs increased primarily due to an increase in facility costs at various locations. Our overhead expense allocations increased due to an increase in allocated costs such as facility costs, information technology costs and recruiting costs.

Non-operating Items

Non-operating items, including interest income and expense, other expense, net and income taxes were as follows for the periods presented:

| | Nine Months Ended September 30, | | 2011 | | |
|----------------------------|----------------------------------|--------------|----------|--------------|---|
| | 2012 | | 2011 | | |
| | Amount | % of revenue | Amount | % of revenue | |
| | (dollars in thousands) | | | | |
| Interest income | \$ 127 | — | % \$ 127 | — | % |
| Interest expense | (156) |) — | % (104 |) — | % |
| Other expense, net | (185) |) — | % (130 |) — | % |
| Provision for income taxes | 1,896 | 1 | % 1,063 | 1 | % |
| | | | | | |
| | Three Months Ended September 30, | | 2011 | | |
| | 2012 | | 2011 | | |
| | Amount | % of revenue | Amount | % of revenue | |
| | (dollars in thousands) | | | | |
| Interest income | \$ 36 | — | % \$ 36 | — | % |
| Interest expense | (52) |) — | % (39 |) — | % |
| Other expense, net | (73) |) — | % (114 |) — | % |
| Provision for income taxes | 603 | 1 | % 328 | 1 | % |

Liquidity and Capital Resources

As of September 30, 2012, our primary sources of liquidity were our cash and cash equivalents totaling \$178.5 million and our accounts receivable, net of allowance, totaling \$48.2 million.

In the nine months ended September 30, 2012, cash flows from operations were \$40.9 million. Although we have had positive operating cash flows for fourteen consecutive quarters, the possibility remains that we could return to a position of negative operating cash flows in a future period. Despite the possibility of such fluctuations in operating cash outflows,

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management believes its current cash and cash equivalents are sufficient for the next 12 months to meet our operating cash flow needs.

We intend to use our cash for general corporate purposes, including potential future acquisitions or other transactions. Further, we expect to incur additional expenses in connection with our international expansion. We believe that our cash and cash equivalents are adequate to fund those potential or anticipated activities.

While we believe that our uncommitted current working capital and anticipated cash flows from operations will be adequate to meet our cash needs for daily operations and capital expenditures for at least the next 12 months, we may elect to raise additional capital through the sale of additional equity or debt securities, obtain a credit facility or sell certain assets. If additional funds are raised through the issuance of additional debt securities, these securities could have rights, preferences and privileges senior to holders of common stock, and terms of any debt could impose restrictions on our operations. The sale of additional equity or convertible debt securities could result in additional dilution to our stockholders and additional financing may not be available in amounts or on terms acceptable to us. As we believe that our cash and cash equivalents are adequate to fund our operating and investing cash flow needs for at least the next 12 months, we have not found it necessary to reassess our capacity to generate cash from financing cash flows in the current economic climate. If additional financing becomes necessary and we are unable to obtain the additional funds, we may be required to reduce the scope of our planned product development and marketing efforts, potentially harming our business, financial condition and operating results. In the meantime, we intend to continue to manage our cash in a manner designed to ensure that we have adequate cash and cash equivalents to fund our operations as well as future acquisitions, if any.

As of September 30, 2012, restricted cash consists of \$266,000 in current other assets and \$276,000 in long-term other assets. As of December 31, 2011, \$494,000 in total restricted cash was included in long-term other assets.

As of September 30, 2012, we had an accumulated deficit of \$369.1 million. We have funded this deficit primarily through the net proceeds raised from the sale of our capital stock and proceeds from operations.

A summary of our cash flow activities were as follows for the periods presented:

| | Nine Months Ended September 30, | |
|--|---------------------------------|-----------|
| | 2012 | 2011 |
| | (dollars in thousands) | |
| Net cash provided by operating activities | \$ 40,890 | \$ 24,577 |
| Net cash used in investing activities | (13,129) |) (9,337 |
| Net cash provided by financing activities | 8,889 | 7,377 |
| Effect of exchange rate changes on cash and cash equivalents | 354 | (138 |
| Net change in cash and cash equivalents | \$ 37,004 | \$ 22,479 |

Cash provided by operating activities was driven by sales of our application suite offset by costs incurred to deliver that service. The timing of our billings and collections relating to our sales and the timing of the payment of our liabilities have a significant impact on our cash flows. Cash flows from operations increased during the nine months ended September 30, 2012 as compared to the same period in 2011 primarily as a result of an increase in revenue and deferred revenue offset by an increase in accounts receivable and commissions paid.

Cash used in investing activities during the nine months ended September 30, 2012 increased from the same period in 2011 primarily due to a \$3.9 million cash payment, net of cash acquired, for the acquisition of SAC in the second quarter of 2012, a \$766,000 increase in capitalized product development costs and a \$574,000 increase in capital expenditures for property and equipment at our data centers in California and Massachusetts.

The net cash provided by financing activities for the nine months ended September 30, 2012 increased due to proceeds received from employee stock option exercises and the timing of debt payments made to a related party.

Off Balance Sheet Arrangements and Contractual Obligations

During the nine months ended September 30, 2012 and 2011, we did not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would

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have been established for the purpose of facilitating off balance sheet arrangements or other contractually narrow or limited purposes.

During the first quarter of 2012, we amended our Manila, Philippines office lease agreement to extend the termination date from the May 1, 2012 to April 30, 2015. The three year lease extension also includes additional office space so we can expand our operations in the future. According to the amended lease, we will pay a total of \$3.4 million over the extended lease term.

ITEM 3. Quantitative and Qualitative Disclosures about Market Risk

Interest Rate Sensitivity

We had cash and cash equivalents of \$178.5 million as of September 30, 2012. These amounts were held primarily in money market funds.

Cash and cash equivalents are held for working capital purposes, and restricted cash amounts are held as security against various lease obligations. Due to the short term nature of these investments, we believe that we do not have any material exposure to changes in the fair value of our investment portfolio as a result of changes in interest rates.

Foreign Currency Risk

Our results of operations and cash flows are subject to fluctuations due to changes in foreign currency exchange rates, particularly changes in the British Pound Sterling, Canadian Dollar, Australian Dollar, Philippine Peso and the Czech Koruna. Our revenue is generally denominated in the local currency of the contracting party. The majority of our invoicing relates to sales occurring in the United States and therefore is denominated in U.S. dollars. A certain percentage of sales are denominated in foreign currencies including, but not limited to, the local currencies of Australia, the United Kingdom and Canada. Our expenses are incurred primarily in the United States, Canada, the Philippines, Australia and the United Kingdom, with a small portion of expenses incurred in other countries where our international sales and operations offices are located. Our results of operations and cash flows are, therefore, subject to fluctuations due to changes in foreign currency exchange rates. During the nine months ended September 30, 2012, the U.S. dollar weakened against the foreign currencies that our invoicing and operational expenses are denominated in by less than 2% when compared to the same period in the prior year. During the three months ended September 30, 2012, the U.S. dollar strengthened against the foreign currencies that our invoicing and operational expenses are denominated in by 4% when compared to the same period in the prior year. For the nine and three months ended September 30, 2012, the fluctuation in foreign currency rates positively affected our income by approximately \$204,000 and \$148,000.

During the nine and three months ended September 30, 2012, we continued a hedging program to limit the exposure of foreign currency risk resulting from the revaluation of foreign denominated assets and liabilities through the use of forward exchange contracts. See “Balance Sheet Hedging - Hedging of Foreign Currency Assets and Liabilities” in Note 3 (Financial Instruments) under the heading “Notes to Condensed Consolidated Financial Statements” of Part 1, Item 1, “Financial Statements” herein for further disclosures.

Fair Value of Financial Instruments

We do not have material exposure to market risk with respect to investments, as our investments consist primarily of highly liquid investments purchased with a remaining maturity of three months or less. We do not use derivative financial instruments for speculative or trading purposes. However, this does not preclude our adoption of specific hedging strategies in the future.

ITEM 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

An evaluation was performed by management, with the participation of our Chief Executive Officer ("CEO") and our Chief Financial Officer ("CFO"), of the effectiveness of our disclosure controls and procedures as of September 30, 2012 (as defined in Rules 13a-15(e) and 15d - 15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Disclosure controls and procedures are controls and procedures that are designed to ensure that information required to be disclosed in our reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. Based on that evaluation, our CEO and CFO have concluded that as of

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September 30, 2012, our disclosure controls and procedures are effective, to provide reasonable assurance that information required to be disclosed by us in reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified by the SEC's rules and forms and that such information is accumulated and communicated to management including the CEO and CFO, as appropriate, to allow timely decisions regarding required disclosures.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting during our most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Inherent Limitations of Internal Controls

Our management, including our CEO and CFO, does not expect that our disclosure controls and procedures or our internal controls will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of a simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, controls may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and may not be detected.

PART II – OTHER INFORMATION

ITEM 1. Legal Proceedings

We are involved in various legal proceedings and receive claims from time to time, arising from the normal course of business activities. We have accrued for estimated losses in the accompanying condensed consolidated financial statements for matters with respect to which we believe the likelihood of an adverse outcome is probable and the amount of the loss is reasonably estimable.

ITEM 1A. Risk Factors

A description of the risks and uncertainties associated with our business is set forth below. This description includes any material changes to and supersedes the description of the risks and uncertainties associated with our business previously disclosed in Part I, Item 1A of our Annual Report on Form 10-K for the fiscal year ended December 31, 2011 filed on February 28, 2012. You should carefully consider such risks and uncertainties, together with the other information contained in this report, our Annual Report on Form 10-K for the fiscal year ended December 31, 2011 and in our other public filings. If any of such risks and uncertainties actually occurs, our business, financial condition or operating results could differ materially from the plans, projections and other forward-looking statements included in the section titled "Management's Discussion and Analysis of Financial Condition and Results of Operations" and elsewhere in this report and in our other public filings. In addition, if any of the following risks and uncertainties, or if any other risks and uncertainties, actually occurs, our business, financial condition or operating results could be harmed substantially, which could cause the market price of our stock to decline, perhaps significantly.

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Risks Related to Our Business

Continued adverse economic conditions or reduced investments in cloud-based applications and information technology spending may harm our business.

Our business depends on the overall demand for cloud-based applications and information technology spending and on the economic health and general willingness of our current and prospective customers to make capital commitments. If the conditions in the U.S. and global economic environment remain uncertain or continue to be volatile, or if they deteriorate further, our business, operating results, and financial condition may be materially adversely affected. Continued weak or volatile economic conditions, or a reduction in spending for cloud-based applications and information technology even if economic conditions improve, would likely harm our business and operating results in a number of ways, including longer sales cycles, extended payment terms, lower prices for our products and services, reduced sales, and lower customer retention rates.

We have a history of losses, and we may not achieve profitability in the future.

We have not been profitable on a generally accepted accounting principles (“GAAP”) basis during any quarterly or annual period since our formation. We experienced a net loss of \$25.6 million for the nine months ended September 30, 2012. As of that date, our accumulated deficit was \$369.1 million. We expect to make significant future expenditures related to the development and expansion of our business. As a result of these increased expenditures, we will have to generate and sustain increased revenue to achieve and maintain future profitability. While historically our revenue has grown, this growth may not be sustainable and we may not achieve sufficient revenue to achieve or maintain profitability. We may incur significant losses in the future for a number of reasons, including due to the other risks described in this Quarterly Report, and we may encounter unforeseen expenses, difficulties, complications and delays and other unknown factors. Accordingly, we may not be able to achieve or maintain profitability and we may continue to incur significant losses for the foreseeable future.

Our customers are medium sized businesses and divisions of large companies, which may result in increased costs as we attempt to reach, acquire and retain customers.

We market and sell our application suite to medium-sized businesses and divisions of large companies. To grow our revenue quickly, we must add new customers, sell additional services to existing customers and encourage existing customers to renew their subscriptions. However, selling to and retaining medium-sized businesses can be more difficult than selling to and retaining large enterprises because medium-sized business customers:

- are more price sensitive;
- are more difficult to reach with broad marketing campaigns;
- have high churn rates in part because of the nature of their businesses;
- often lack the staffing to benefit fully from our application suite’s rich feature set; and
- often require higher sales, marketing and support expenditures by vendors that sell to them per revenue dollar generated for those vendors.

If we are unable to cost effectively market and sell our service to our target customers, our ability to grow our revenue quickly and become profitable will be harmed.

Our business depends substantially on customers renewing, upgrading and expanding their subscriptions for our services. Any decline in our customer renewals, upgrades and expansions would harm our future operating results. We sell our application suite pursuant to service agreements that are generally one year in length. Our customers have no obligation to renew their subscriptions after their subscription period expires, and they may not renew their subscriptions at the same or higher levels. Moreover, under specific circumstances, our customers have the right to

cancel their service agreements before they expire. In addition, in the first year of a subscription, customers often purchase a higher level of professional services than they do in renewal years. As a result, our ability to grow is dependent in part on customers purchasing additional subscriptions and modules after the first year of their subscriptions. We have limited historical data with respect to rates of customer subscription renewals, upgrades and expansions so we may not accurately predict future trends in customer renewals. Our customers' renewal rates may decline or fluctuate because of several factors, including their satisfaction or dissatisfaction with our services, the prices of our services, the prices of services offered by our competitors or reductions in our customers' spending levels due to the macroeconomic environment or other factors. If our customers do not renew their subscriptions for our services, renew on less favorable terms, or do not purchase additional functionality or subscriptions, our revenue may grow more slowly than expected or decline and our profitability and gross margin may be harmed.

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Any disruption of service at our data centers could interrupt or delay our ability to deliver our service to our customers.

We host our services, serve our customers and support our operations primarily from California-based data centers, which we operate in conjunction with SAVVIS. However, we host our OpenAir applications from a Massachusetts-based data center, which we also operate in conjunction with SAVVIS. In addition, our QuickArrow applications are hosted from a Texas-based data center, which we operate in conjunction with Sungard. We do not have sole control over the operations of these facilities. These facilities are vulnerable to damage or interruption from earthquakes, hurricanes, floods, fires, cybersecurity attacks, terrorist attacks, power losses, telecommunications failures and similar events. The occurrence of a natural disaster or an act of terrorism, a decision to close the facilities without adequate notice or other unanticipated problems could result in lengthy interruptions in our services. As part of our current disaster recovery arrangements, our customer data in our California-based data center production environment is replicated to a data center operated in conjunction with SAVVIS located on the East coast of the United States. In particular, our California-based data facilities are located in an area known for seismic activity, increasing our susceptibility to the risk that an earthquake could significantly harm the operations of these facilities. The facilities also could be subject to break-ins, computer viruses, sabotage, intentional acts of vandalism and other misconduct.

Our data center facilities providers have no obligations to renew their agreements with us on commercially reasonable terms, or at all. If we are unable to renew our agreements with the facilities providers on commercially reasonable terms or if in the future we add additional data center facility providers, we may experience costs or downtime in connection with the transfer to, or the addition of, new data center facilities.

Any errors, defects, disruptions or other performance problems with our services could harm our reputation and may damage our customers' businesses. Interruptions in our services might reduce our revenue, cause us to issue credits to customers, subject us to potential liability, cause customers to terminate their subscriptions and harm our renewal rates.

We may become liable to our customers and lose customers if we have defects or disruptions in our service or if we provide poor service.

Because we deliver our application suite as a service, errors or defects in the software applications underlying our service, or a failure of our hosting infrastructure, may make our service unavailable to our customers. Since our customers use our suite to manage critical aspects of their business, any errors, defects, disruptions in service or other performance problems with our suite, whether in connection with the day to day operation of our suite, upgrades or otherwise, could damage our customers' businesses. If we have any errors, defects, disruptions in service or other performance problems with our suite, customers could elect not to renew, or delay or withhold payment to us, we could lose future sales or customers may make warranty claims against us, which could result in an increase in our provision for doubtful accounts, an increase in collection cycles for accounts receivable or costly litigation.

The market for cloud-based applications may develop more slowly than we expect.

Our success will depend, to a large extent, on the willingness of medium-sized businesses to accept cloud-based services for applications that they view as critical to the success of their business. Many companies have invested substantial effort and financial resources to integrate traditional enterprise software into their businesses and may be reluctant or unwilling to switch to a different application or to migrate these applications to cloud-based services. Other factors that may affect market acceptance of our application include:

- the security capabilities, reliability and availability of cloud-based services;
- customer concerns with entrusting a third party to store and manage their data, especially confidential or sensitive data;
- our ability to minimize the time and resources required to implement our suite;

- our ability to maintain high levels of customer satisfaction;
- our ability to implement upgrades and other changes to our software without disrupting our service;
- the level of customization or configuration we offer;
- our ability to provide rapid response time during periods of intense activity on customer websites;
- and
- the price, performance and availability of competing products and services.

The market for these services may not develop further, or may develop more slowly than we expect, either of which would harm our business.

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If our security measures are breached and unauthorized access is obtained to a customer's data, we may incur significant liabilities, our service may be perceived as not being secure and customers may curtail or stop using our suite.

The services we offer involve the storage of large amounts of our customers' sensitive and proprietary information. If our security measures are breached as a result of third party action, employee error, malfeasance or otherwise, and someone obtains unauthorized access to our customers' data, we could incur significant liability to our customers and to individuals or businesses whose information was being stored by our customers, our business may suffer and our reputation will be damaged. Because techniques used to obtain unauthorized access to, or to sabotage, systems change frequently and generally are not recognized until launched against a target, we may be unable to anticipate these techniques or to implement adequate preventive measures. If an actual or perceived breach of our security occurs, the market perception of the effectiveness of our security measures could be harmed and we could lose sales and customers. Such an actual or perceived breach could also cause a significant and rapid decline in our stock price. We provide service level commitments to our customers, which could cause us to issue credits for future services if the stated service levels are not met for a given period and could significantly harm our revenue.

Our customer agreements provide service level commitments. If we are unable to meet the stated service level commitments or suffer extended periods of unavailability for our service, we may be contractually obligated to provide these customers with credits for future services. Our revenue could be significantly impacted if we suffer unscheduled downtime that exceeds the allowed downtimes under our agreements with our customers. In light of our historical experience with meeting our service level commitments, we do not currently have any reserves on our balance sheet for these commitments. Our service level commitment to all customers is 99.5% uptime per period, excluding scheduled maintenance. The failure to meet this level of service availability may require us to credit qualifying customers for the value of an entire month of their subscription fees, not just the value of the subscription fee for the period of the downtime. As a result, a failure to deliver services for a relatively short duration could cause us to issue these credits to all qualifying customers. Any extended service outages could harm our reputation, revenue and operating results.

Assertions by a third party that we infringe its intellectual property, whether successful or not, could subject us to costly and time consuming litigation or expensive licenses.

The software and technology industries are characterized by the existence of a large number of patents, copyrights, trademarks and trade secrets and by frequent and an increasing amount of litigation based on allegations of infringement or other violations of intellectual property rights. As we continue to grow, the possibility of intellectual property rights claims against us may increase. Our technologies may not be able to withstand any third party claims or rights against their use. Additionally, although we have licensed from other parties proprietary technology covered by patents, we cannot be certain that any such patents will not be challenged, invalidated or circumvented. Furthermore, many of our service agreements require us to indemnify our customers for certain third party intellectual property infringement claims, which could increase our costs as a result of defending such claims and may require that we pay damages if there were an adverse ruling related to any such claims. These types of claims could harm our relationships with our customers, may deter future customers from subscribing to our services or could expose us to litigation for these claims. Even if we are not a party to any litigation between a customer and a third party, an adverse outcome in any such litigation could make it more difficult for us to defend our intellectual property in any subsequent litigation in which we are a named party.

Any intellectual property rights claim against us or our customers, with or without merit, could be time consuming, expensive to litigate or settle and could divert management attention and financial resources. An adverse determination also could prevent us from offering our suite to our customers and may require that we procure or develop substitute services that do not infringe.

For any intellectual property rights claim against us or our customers, we may have to pay damages, license fees and/or stop using technology found to be in violation of a third party's rights. We may have to seek a license for the technology. Such license may not be available on reasonable terms, if at all, and may significantly increase our operating expenses or may require us to restrict our business activities and limit our ability to deliver certain products and services. As a result, we may also be required to develop alternative non-infringing technology, which could require significant effort and expense and/or cause us to alter our product and service offerings which could negatively affect our business.

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Our success depends in large part on our ability to protect and enforce our intellectual property rights.

We rely on a combination of patent, copyright, service mark, trademark and trade secret laws, as well as confidentiality procedures and contractual restrictions, to establish and protect our proprietary rights, all of which provide only limited protection. We cannot assure you that any patents will issue from our currently pending patent applications in a manner that gives us the protection that we seek, if at all, or that any future patents issued to us will not be challenged, invalidated or circumvented. We do not have any issued patents and currently have eight patent applications pending. Any patents that may issue in the future from pending or future patent applications may not provide sufficiently broad protection or they may not prove to be enforceable in actions against alleged infringers. Also, we cannot assure you that any future service mark or trademark registrations will be issued for pending or future applications or that any registered service marks or trademarks will be enforceable or provide adequate protection of our proprietary rights.

We endeavor to enter into agreements with our employees and contractors and agreements with parties with whom we do business to limit access to and disclosure of our proprietary information. The steps we have taken, however, may not prevent unauthorized use or the reverse engineering of our technology. Moreover, others may independently develop technologies that are competitive to ours or infringe our intellectual property. Enforcement of our intellectual property rights also depends on our successful legal actions against these infringers, but these actions may not be successful, even when our rights have been infringed.

Furthermore, effective patent, trademark, service mark, copyright and trade secret protection may not be available in every country in which our services are available. In addition, the legal standards relating to the validity, enforceability and scope of protection of intellectual property rights in Internet related industries are uncertain and still evolving.

We have experienced rapid growth in recent periods. If we fail to manage our growth effectively, we may be unable to execute our business plan, maintain high levels of service or address competitive challenges adequately.

We have increased our annual revenue from \$17.7 million during the year ended December 31, 2004 to \$236.3 million during the year ended December 31, 2011. We have increased our number of full time employees from 296 as of December 31, 2004 to 1,630 as of September 30, 2012.

Our expansion has placed, and our anticipated growth may continue to place, a significant strain on our managerial, administrative, operational, financial and other resources. We intend to further expand our overall business, customer base, headcount and operations. We also intend to continue expanding our operations internationally. Creating a global organization and managing a geographically dispersed workforce will require substantial management effort and significant additional investment in our infrastructure. We will be required to continue to improve our operational, financial and management controls and our reporting procedures and we may not be able to do so effectively. As such, we may be unable to manage our expenses effectively in the future, which may negatively impact our gross margin or operating expenses in any particular quarter.

Our quarterly and annual operating results may fluctuate in the future. As a result, we may fail to meet or exceed the expectations of research analysts or investors, which could cause our stock price to decline.

Our quarterly and annual operating results may fluctuate as a result of a variety of factors, many of which are outside of our control. A decline in general macroeconomic conditions could adversely affect our customers' ability or willingness to purchase our application suite, which could adversely affect our operating results or financial outlook. Fluctuations in our quarterly operating annual results or financial outlook may also be due to a number of additional factors, including the risks and uncertainties discussed elsewhere in this report.

Fluctuations in our operating results could cause our stock price to decline rapidly, may lead analysts to change their long term model for valuing our common stock, may impact our ability to retain or attract key personnel, or may cause other unanticipated issues. If our operating results or financial outlook fall below the expectations of research analysts or investors, the price of our common stock could decline substantially.

We believe that our revenue and operating results may vary significantly in the future and that period to period comparisons of our operating results may not be meaningful. You should not rely on the results of one quarter as an indication of future performance.

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Our limited operating history makes it difficult to evaluate our current business and future prospects, and may increase the risk of your investment.

Our company has been in existence since 1998, and much of our growth has occurred since 2004, with our revenue increasing from \$17.7 million during the year ended December 31, 2004 to \$236.3 million during the year ended December 31, 2011. Our limited operating history may make it difficult to evaluate our current business and our future prospects. We have encountered and will continue to encounter risks and difficulties frequently experienced by growing companies in rapidly changing industries. If we do not address these risks successfully, our business may be harmed.

The markets in which we compete are intensely competitive, and if we do not compete effectively, our operating results may be harmed.

The markets for financials/ERP, CRM, PSA and Ecommerce applications are intensely competitive and rapidly changing with relatively low barriers to entry. With the introduction of new technologies and market entrants, we expect competition to intensify in the future. In addition, pricing pressures and increased competition generally could result in reduced sales, reduced margin or the failure of our service to achieve or maintain more widespread market acceptance. Often we compete to sell our application suite against existing systems that our potential customers have already made significant expenditures to install. Competition in our market is based principally upon service breadth and functionality; service performance, security and reliability; ability to tailor and customize services for a specific company, vertical or industry; ease of use of the service; speed and ease of deployment, integration and configuration; total cost of ownership, including price and implementation and support costs; professional services implementation; and financial resources of the vendor.

We face competition from both traditional software vendors and SaaS providers. Our principal competitors include Epicor Software Corporation, Intuit Inc., Microsoft Corporation, SAP, The Sage Group plc and salesforce.com, inc. Many of our actual and potential competitors enjoy substantial competitive advantages over us, such as greater name recognition, longer operating histories, more varied products and services and larger marketing budgets, as well as substantially greater financial, technical and other resources. In addition, many of our competitors have established marketing relationships and access to larger customer bases, and have major distribution agreements with consultants, system integrators and resellers. If we are not able to compete effectively, our operating results will be harmed.

Our brand name and our business may be harmed by aggressive marketing strategies of our competitors.

Because of the early stage of development of our markets, we believe that building and maintaining brand recognition and customer goodwill is critical to our success. Our efforts in this area have, on occasion, been complicated by the marketing efforts of our competitors, which may include incomplete, inaccurate and false statements about our company and our services that could harm our business. Our ability to respond to our competitors' misleading marketing efforts may be limited under certain circumstances by legal prohibitions on permissible public communications by us as a public company.

Many of our customers are price sensitive, and if the prices we charge for our services are unacceptable to our customers, our operating results will be harmed.

Many of our customers are price sensitive, and we have limited experience with respect to determining the appropriate prices for our services. As the market for our services matures, or as new competitors introduce new products or services that compete with ours, we may be unable to renew our agreements with existing customers or attract new customers at the same price or based on the same pricing model as previously used. As a result, it is possible that competitive dynamics in our market may require us to change our pricing model or reduce our prices, which could harm our revenue, gross margin and operating results.

If we are unable to develop new services or sell our services into new markets, our revenue growth will be harmed and we may not be able to achieve profitability.

Our ability to attract new customers and increase revenue from existing customers will depend in large part on our ability to enhance and improve our existing application suite and to introduce new services and sell into new markets. The success of any enhancement or new service depends on several factors, including the timely completion,

introduction and market acceptance of the enhancement or service. Any new service we develop or acquire may not be introduced in a timely or cost effective manner and may not achieve the broad market acceptance necessary to generate significant revenue. Any new markets into which we attempt to sell our application, including new vertical markets and new countries or regions, may not be receptive. If we are unable to successfully develop or acquire new services, enhance our existing services to meet customer requirements or sell our services into new markets, our revenue will not grow as expected and we may not be able to achieve profitability.

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Because we are a global organization and our long term success depends, in part, on our ability to expand the sales of our services to customers located outside of the United States, our business is susceptible to risks associated with international sales and operations.

We currently maintain offices outside of the United States and have sales personnel or independent consultants in several countries. Approximately one quarter of our employees are located in an office in the Philippines. We have limited experience operating in foreign jurisdictions and are rapidly building our international operations. Managing a global organization is difficult, time consuming and expensive. Our inexperience in operating our business outside of the United States increases the risk that any international expansion efforts that we may undertake will not be successful. In addition, conducting international operations subjects us to new risks that we have not generally faced in the United States. These risks include:

- localization of our services, including translation into foreign languages and adaptation for local practices and regulatory requirements;
- lack of familiarity with and unexpected changes in foreign regulatory requirements;
- longer accounts receivable payment cycles and difficulties in collecting accounts receivable;
- difficulties in managing and staffing international operations;
- fluctuations in currency exchange rates;
- potentially adverse tax consequences, including the complexities of foreign value added tax systems and restrictions on the repatriation of earnings;
- dependence on certain third parties, including channel partners with whom we do not have extensive experience;
- the burdens of complying with a wide variety of foreign laws and legal standards;
- increased financial accounting and reporting burdens and complexities;
- political, social and economic instability abroad, terrorist attacks and security concerns in general; and
- reduced or varied protection for intellectual property rights in some countries.

Operating in international markets also requires significant management attention and financial resources. The investment and additional resources required to establish operations and manage growth in other countries may not produce desired levels of revenue or profitability.

We rely on third party software, including Oracle database software, that may be difficult to replace or could cause errors or failures of our service that could lead to lost customers or harm to our reputation.

We rely on software licensed from third parties to offer our service, including database software from Oracle. This software may not continue to be available to us on commercially reasonable terms, or at all. Any loss of the right to use any of this software could result in delays in the provisioning of our service until equivalent technology is either developed by us, or, if available, is identified, obtained and integrated, which could harm our business. Any errors or defects in third party software could result in errors or a failure of our service which could harm our business. If we fail to maintain proper and effective internal controls, our ability to produce accurate and timely financial statements could be impaired and investors' views of us could be harmed.

Ensuring that we have adequate internal financial and accounting controls and procedures in place so that we can produce accurate financial statements on a timely basis is a costly and time consuming effort that needs to be re-evaluated frequently. Our internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with GAAP. Although we have completed the process of documenting, reviewing and improving our internal controls and procedures for compliance with Section 404 of the Sarbanes Oxley Act of 2002 for the fiscal year ended December 31, 2011, there can be no assurances that control deficiencies will not be identified in the future.

Implementing any additional required changes to our internal controls may distract our officers and employees, entail substantial costs to modify our existing processes and add personnel and take significant time to complete. These changes may not, however, be effective in maintaining the adequacy of our internal controls. Any failure to maintain

that adequacy, or a consequent inability to produce accurate financial statements on a timely basis, could increase our operating costs and harm our business. In addition, investors' perceptions that our internal controls are inadequate or that we are unable to produce accurate financial statements on a timely basis may harm our stock price and make it more difficult for us to effectively market and sell our service to new and existing customers.

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Our business is subject to changing regulations regarding corporate governance and public disclosure that will increase both our costs and the risk of noncompliance.

As a public company, we incur significant legal, accounting and other expenses associated with compliance with applicable laws, rules, regulations and listing requirements. In addition, the Sarbanes-Oxley Act, the Dodd-Frank Act, and rules subsequently implemented by the SEC and The New York Stock Exchange, have imposed a variety of compliance requirements on public companies, including requiring changes in corporate governance practices. In addition, the SEC and the U.S. Congress may continue to increase the scope of applicable disclosure and corporate governance-related rules. Our management and other personnel may need to devote a substantial amount of time to the compliance requirements associated with being a public company. Moreover, these laws, rules and regulations have increased and may continue to increase the scope, complexity and cost of our corporate governance, reporting and disclosure practices.

Because we recognize subscription revenue over the term of the applicable agreement, the lack of subscription renewals or new service agreements may not be reflected immediately in our operating results.

The majority of our quarterly revenue is attributable to service agreements entered into during previous quarters. A decline in new or renewed service agreements in any one quarter will not be fully reflected in our revenue in that quarter but will harm our revenue in future quarters. As a result, the effect of significant downturns in sales and market acceptance of our services in a particular quarter may not be fully reflected in our operating results until future periods. Our subscription model also makes it difficult for us to rapidly increase our revenue through additional sales in any period, because revenue from new customers must be recognized over the applicable subscription term.

Material defects or errors in the software we use to deliver our services could harm our reputation, result in significant costs to us and impair our ability to sell our services.

The software applications underlying our services are inherently complex and may contain material defects or errors, particularly when first introduced or when new versions or enhancements are released. We have from time to time found defects in our service, and new errors in our existing service may be detected in the future. Any defects that cause interruptions to the availability of our services could result in:

- a reduction in sales or delay in market acceptance of our services;
- sales credits or refunds to our customers;
- loss of existing customers and difficulty in attracting new customers;
- diversion of development resources;
- harm to our reputation; and
- increased warranty and insurance costs.

After the release of our services, defects or errors may also be identified from time to time by our internal team and by our customers. The costs incurred in correcting any material defects or errors in our services may be substantial and could harm our operating results.

Government regulation of the Internet and Ecommerce is evolving, and unfavorable changes or our failure to comply with regulations could harm our operating results.

As Internet commerce continues to evolve, increasing regulation by federal, state or foreign agencies becomes more likely. For example, we believe increased regulation is likely in the area of data privacy, and laws and regulations applying to the solicitation, collection, processing or use of personal or consumer information could affect our customers' ability to use and share data, potentially reducing demand for financials/ERP, CRM, PSA and Ecommerce solutions and restricting our ability to store, process and share our customers' data. In addition, taxation of services provided over the Internet or other charges imposed by government agencies or by private organizations for accessing

the Internet may also be imposed. Any regulation imposing greater fees for Internet use or restricting information exchanged over the Internet could result in a decline in the use of the Internet and the viability of Internet based services, harming our business and operating results.

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Privacy concerns and laws or other domestic or foreign regulations may reduce the effectiveness of our application suite and harm our business.

Our customers can use our service to store personal or identifying information regarding their customers and contacts. Federal, state and foreign government bodies and agencies, however, have adopted or are considering adopting laws and regulations regarding the collection, use and disclosure of personal information obtained from consumers and other individuals. The costs of compliance with, and other burdens imposed by, such laws and regulations that are applicable to the businesses of our customers may limit the use and adoption of our service and reduce overall demand for it.

In addition to government activity, privacy advocacy groups and the technology and other industries are considering various new, additional or different self regulatory standards that may place additional burdens on us. If the gathering of personal information were to be curtailed, financials/ERP, CRM, PSA and Ecommerce solutions would be less effective, likely reducing demand for our service and harming our business.

If benefits currently available under the Czech Republic government subsidy program are reduced or disallowed, our business could suffer.

At our product development facility in the Czech Republic, we participate in a government subsidy program for employing local residents. Under the program, the Czech government will reimburse us for certain operating expenses we incur. The reimbursements are based upon qualifying product development expenditures which are primarily salaries for persons conducting product development activities. During the nine months ended September 30, 2012, we recorded \$1.4 million in expected expense reimbursements through this program for expenses incurred during the period of November 2010 to September 30, 2012. The expense reimbursement subsidy is treated as a reduction in the qualifying expenses. During the nine months ended September 30, 2012, we received \$652,000 in subsidy reimbursement payments. The Czech Republic government will determine if we met the program requirements and that our expenses are reimbursable. If the Czech Republic government determines that our expense are ineligible for reimbursement, our financial condition and operating results may be adversely affected.

Changes in financial accounting standards or practices may cause adverse, unexpected financial reporting fluctuations and harm our operating results.

A change in accounting standards or practices could harm our operating results and may even affect our reporting of transactions completed before the change is effective. New accounting pronouncements and varying interpretations of accounting pronouncements have occurred and may occur in the future. Changes to existing rules or the questioning of current practices may harm our operating results or the way we conduct our business.

Unanticipated changes in our effective tax rate could harm our future operating results.

We are subject to income taxes in the United States and various foreign jurisdictions, and our domestic and international tax liabilities are subject to the allocation of expenses in differing jurisdictions. Our tax rate is affected by changes in the mix of earnings and losses in countries with differing statutory tax rates, certain non deductible expenses arising from the requirement to expense stock options and the valuation of deferred tax assets and liabilities, including our ability to utilize our net operating losses. Increases in our effective tax rate could harm our operating results.

We may be unable to integrate acquired businesses and technologies successfully or to achieve the expected benefits of such acquisitions. We may acquire or invest in additional companies, which may divert our management's attention, result in additional dilution to our stockholders and consume resources that are necessary to sustain our business.

We have undertaken acquisitions in the past and may continue to evaluate and consider potential strategic transactions, including acquisitions and dispositions of businesses, technologies, services, products and other assets in the future. An acquisition, investment or business relationship may result in unforeseen operating difficulties and expenditures. In particular, we may encounter difficulties assimilating or integrating the businesses, technologies, products, personnel or operations of the acquired companies, particularly if the key personnel of the acquired company chooses not to work for us, the company's software is not easily adapted to work with ours or we have difficulty retaining the customers of any acquired business due to changes in management or otherwise. Acquisitions may also disrupt our business, divert our resources and require significant management attention that would otherwise be available for development of our business. Moreover, the anticipated benefits of any acquisition, investment or business relationship may not be realized or we may be exposed to unknown liabilities.

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We may in the future seek to acquire or invest in additional businesses, products, technologies or other assets. We also may enter into relationships with other businesses to expand our service offerings or our ability to provide service in foreign jurisdictions, which could involve preferred or exclusive licenses, additional channels of distribution, discount pricing or investments in other companies. Negotiating these transactions can be time consuming, difficult and expensive, and our ability to close these transactions may often be subject to approvals that are beyond our control. Consequently, these transactions, even if undertaken and announced, may not close. For one or more of those transactions, we may:

- issue additional equity securities that would dilute our stockholders;
- use cash that we may need in the future to operate our business;
- incur debt on terms unfavorable to us or that we are unable to repay;
- incur large charges or substantial liabilities;
- encounter difficulties retaining key employees of the acquired company or integrating diverse software codes or business cultures; and
- become subject to adverse tax consequences, substantial depreciation or deferred compensation charges.

Any of these risks could harm our business and operating results.

We rely on our management team and need additional personnel to grow our business, and the loss of one or more key employees or our inability to attract and retain qualified personnel could harm our business.

Our success and future growth depends to a significant degree on the skills and continued services of our management team, especially Zachary Nelson, our President and Chief Executive Officer, and Evan M. Goldberg, our Chief Technology Officer and Chairman of the Board. We do not maintain key man insurance on any members of our management team, including Messrs. Nelson and Goldberg. Our future success also depends on our ability to attract, retain and motivate highly skilled technical, managerial, sales, marketing and service and support personnel, including members of our management team. Competition for sales, marketing and technology development personnel is particularly intense in the software and technology industries. As a result, we may be unable to successfully attract or retain qualified personnel. Our inability to attract and retain the necessary personnel could harm our business.

Risks Related to Ownership of our Common Stock

Lawrence J. Ellison or members of his family, and related entities, beneficially own a majority of our outstanding shares of common stock, which may limit your ability to influence or control certain of our corporate actions. This concentration of ownership may also reduce the market price of our common stock and impair a takeover attempt of us.

Entities beneficially owned by Lawrence J. Ellison held an aggregate of approximately 44.6% of our common stock as of September 30, 2012. Further, Mr. Ellison, his family members, trusts for their benefit, and related entities together beneficially owned an aggregate of approximately 51.1% of our common stock as of that date. Mr. Ellison is able to exercise control over approval of significant corporate transactions, including a change of control or liquidation. In addition, if the voting restrictions that apply to NetSuite Restricted Holdings LLC, the investment entity to which Mr. Ellison has transferred his shares, lapse or are amended, Mr. Ellison will be able to exercise control over additional corporate matters, including elections of our directors. So long as Mr. Ellison continues to be either an officer or director of Oracle, these voting restrictions cannot be changed without the approval of an independent committee of Oracle's board of directors. Mr. Ellison's interests and investment objectives may differ from our other stockholders. Mr. Ellison is also the Chief Executive Officer, a principal stockholder and a director of Oracle Corporation. Oracle supplies us with database software on which we rely to provide our service and is also a potential

competitor of ours.

Our Board of Directors adopted resolutions which renounce and provide for a waiver of the corporate opportunity doctrine as it relates to Mr. Ellison. As a result, Mr. Ellison will have no fiduciary duty to present corporate opportunities to us. In addition, Mr. Ellison's indirect majority interest in us could discourage potential acquirers or result in a delay or prevention of a change in control of our company or other significant corporate transactions, even if a transaction of that sort would be beneficial to our other stockholders or in our best interest.

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Our failure to raise additional capital or generate the cash flows necessary to expand our operations and invest in our application services could reduce our ability to compete successfully.

We may need to raise additional funds, and we may not be able to obtain additional debt or equity financing on favorable terms, if at all. If we raise additional equity financing, our stockholders may experience significant dilution of their ownership interests and the per share value of our common stock could decline. If we engage in debt financing, we may be required to accept terms that restrict our ability to incur additional indebtedness and force us to maintain specified liquidity or other ratios. If we need additional capital and cannot raise it on acceptable terms, we may not be able to, among other things:

- develop or enhance our application and services;
- continue to expand our product development, sales and marketing organizations;
- acquire complementary technologies, products or businesses;
- expand operations, in the United States or internationally;
- hire, train and retain employees; or
- respond to competitive pressures or unanticipated working capital requirements.

Future sales of shares by existing stockholders could cause our stock price to decline.

If our existing stockholders sell or otherwise dispose of, or indicate an intention to sell or dispose of, substantial amounts of our common stock in the public market, the trading price of our common stock could decline. As of September 30, 2012, we had a total of 71,591,988 shares of our common stock outstanding. Although shares that are held by NetSuite Restricted Holdings LLC are subject to certain restrictions on disposition and a portion of the remaining shares are subject to our Insider Trading Compliance Policy during certain periods of each quarter, substantially all of the shares held by parties other than NetSuite Restricted Holdings LLC, representing 55.4% of our outstanding shares as of September 30, 2012, are freely tradable, subject to our quarterly black-out periods that apply to shares held by our directors, officers, employees and consultants. If a significant number of these shares are sold, or if it is perceived that they will be sold, in the public market, the trading price of our common stock could decline.

Anti takeover provisions contained in our amended and restated certificate of incorporation and amended and restated bylaws, as well as provisions of Delaware law, could impair a takeover attempt.

Our amended and restated certificate of incorporation, amended and restated bylaws and Delaware law contain provisions that could have the effect of rendering more difficult or discouraging an acquisition deemed undesirable by our Board of Directors. Our corporate governance documents include provisions:

- authorizing blank check preferred stock, which could be issued with voting, liquidation, dividend and other rights superior to our common stock;
- limiting the liability of, and providing indemnification to, our directors and officers;
- limiting the ability of our stockholders to call and bring business before special meetings and to take action by written consent in lieu of a meeting;
- requiring advance notice of stockholder proposals for business to be conducted at meetings of our stockholders and for nominations of candidates for election to our Board of Directors;
- controlling the procedures for the conduct and scheduling of board and stockholder meetings;
- providing the Board of Directors with the express power to postpone previously scheduled annual meetings and to cancel previously scheduled special meetings;
- limiting the determination of the number of directors on our board and the filling of vacancies or newly created seats on the board to our board of directors then in office; and
- providing that directors may be removed by stockholders only for cause.

These provisions, alone or together, could delay hostile takeovers and changes in control or changes in our management.

As a Delaware corporation, we are also subject to provisions of Delaware law, including Section 203 of the Delaware General Corporation law, which prevents some stockholders holding more than 15% of our outstanding common stock from engaging in certain business combinations without approval of the holders of substantially all of our outstanding common stock. Under Section 203, our majority stockholder, which is beneficially owned by Lawrence J. Ellison, and our current

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stockholders associated with members of Mr. Ellison's family are not subject to the prohibition from engaging in such business combinations.

Any provision of our amended and restated certificate of incorporation or bylaws or Delaware law that has the effect of delaying or deterring a change in control could limit the opportunity for our stockholders to receive a premium for their shares of our common stock, and could also affect the price that some investors are willing to pay for our common stock.

ITEM 6. Exhibits

The exhibits listed below are filed or incorporated by reference as part of this Report.

| Exhibit No | Description of Exhibits |
|------------|---|
| 31.1 | Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act. |
| 31.2 | Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act. |
| 32.1 | Certification of the Chief Executive Officer and the Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act. |
| 101.INS** | XBRL Instance Document |
| 101.SCH** | XBRL Taxonomy Extension Schema Document |
| 101.CAL** | XBRL Taxonomy Extension Calculation Linkbase Document |
| 101.DEF** | XBRL Taxonomy Extension Definition Linkbase Document |
| 101.LAB** | XBRL Taxonomy Extension Label Linkbase Document |
| 101.PRE** | XBRL Taxonomy Extension Presentation Linkbase Document |

Users of this data are advised that, pursuant to Rule 406T of Regulation S-T, these interactive data files are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933 or Section 18 of the Securities Exchange Act of 1934 and otherwise are not subject to liability under these sections.

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SIGNATURES

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

Date: October 30, 2012

NETSUITE INC.

By:

/S/ RONALD GILL
Ronald Gill
Chief Financial Officer