PROS Holdings, Inc.
Form 10-Q
November 04, 2010

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington D.C. 20549
FORM 10-Q

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

For the quarterly period ended September 30, 2010

OR

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

For the Transition Period from __________ to __________

Commission File Number: 001-33554

PROS HOLDINGS, INC.

(Exact name of registrant as specified in its charter)

Delaware	**76-0168604**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*

3100 Main Street, Suite 900, Houston, TX 77002
(713) 335-5151
(Address and telephone number of principal executive offices)

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

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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes o No þ

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

Large Accelerated Filer o	Accelerated Filer þ	Non-Accelerated Filer o (Do not check if a smaller reporting company)	Smaller Reporting Company o

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

The number of shares outstanding of the Registrant s Common Stock, $0.001 par value, was 26,185,447 as of November 1, 2010.

PROS Holdings, Inc.
Form 10-Q for the Three Months Ended September 30, 2010
Table of Contents

Cautionary Statement

Except for the historical financial information contained herein, the matters discussed in this report on Form 10-Q (as well as documents incorporated herein by reference) may be considered forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Such forward-looking statements include declarations regarding the intent, belief or current expectations of PROS Holdings, Inc. and its management and may be signified by the words expects, anticipates, target, project, goals, estimates, potential, predicts, may, might, could, intends, believes or sin cautioned that any such forward-looking statements are not guarantees of future performance and involve a number of risks and uncertainties. Actual results could differ materially from those indicated by such forward-looking statements. Factors that could cause or contribute to such differences include those discussed under Risk Factors and elsewhere in this report. PROS Holdings, Inc. disclaims any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

PART I. Financial Information
Item 1. Unaudited Condensed Consolidated Financial Statements

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

	September 30, 2010	December 31, 2009
Assets:		
Current assets:		
Cash and cash equivalents	$ 53,063	$ 62,449
Restricted cash	73	
Accounts and unbilled receivables, net of allowance of $950 and $1,300, respectively	19,591	12,035
Prepaid and other current assets	7,717	4,143
Total current assets	80,444	78,627
Restricted cash	293	
Property and equipment, net	3,173	2,959
Other long term assets, net	2,567	3,743
Total assets	$ 86,477	$ 85,329
Liabilities and Stockholders Equity:		
Current liabilities:		
Accounts payable	$ 1,476	$ 1,198
Accrued liabilities	1,306	3,199
Accrued payroll and other employee benefits	4,551	4,510
Deferred revenue	21,739	14,099
Other current liabilities		4,866
Total current liabilities	29,072	27,872
Long-term deferred revenue	1,208	2,418
Total liabilities	30,280	30,290
Commitments and contingencies (Note 4)		
Stockholders equity:		
Preferred stock, $0.001 par value, 5,000,000 shares authorized none issued		
Common stock, $0.001 par value, 75,000,000 shares authorized, 30,565,369 and 30,163,508 shares issued, respectively, 26,147,784 and 25,745,923 shares outstanding, respectively	31	30
Additional paid-in capital	67,184	63,439
Treasury stock, 4,417,585 common shares, at cost	(13,938)	(13,938)

Accumulated other comprehensive (loss) income		(26)		
Retained earnings		2,946		5,508
Total stockholders equity		56,197		55,039
Total liabilities and stockholders equity	$	86,477	$	85,329

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

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

	For the Three Months Ended September 30, 2010	For the Three Months Ended September 30, 2009	For the Nine Months Ended September 30, 2010	For the Nine Months Ended September 30, 2009
Revenue:				
License and implementation	$ 8,580	$ 10,276	$ 29,382	$ 33,404
Maintenance and support	7,106	6,234	21,470	18,458
Total revenue	15,686	16,510	50,852	51,862
Cost of revenue:				
License and implementation	3,798	3,065	10,432	10,422
Maintenance and support	1,486	1,226	4,382	3,606
Total cost of revenue	5,284	4,291	14,814	14,028
Gross profit	10,402	12,219	36,038	37,834
Operating expenses:				
Selling, general and administrative	9,334	5,954	24,484	17,019
Research and development	4,856	5,177	15,542	14,999
(Loss) income from operations	(3,788)	1,088	(3,988)	5,816
Other income:				
Interest income	24	30	53	177
(Loss) income before income tax provision	(3,764)	1,118	(3,935)	5,993
Income tax (benefit) provision	(1,359)	320	(1,373)	1,669
Net (loss) income	$ (2,405)	$ 798	$ (2,562)	$ 4,324
Net (loss) earnings attributable to common stockholders per share:				
Basic	$ (0.09)	$ 0.03	$ (0.10)	$ 0.17
Diluted	$ (0.09)	$ 0.03	$ (0.10)	$ 0.16
Weighted average number of shares:				
Basic	26,088,971	25,718,342	26,011,473	25,702,736
Diluted	26,088,971	26,397,958	26,011,473	26,395,131

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

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

	For the Nine Months Ended September 30, 2010	2009
Operating activities:		
Net (loss) income	$ (2,562)	$ 4,324
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	1,020	952
Stock-based compensation	4,461	4,022
Excess tax benefits on vesting of restricted stock units	(623)	
Deferred income taxes	(114)	89
Provision for doubtful accounts	(157)	36
Changes in operating assets and liabilities:		
Accounts receivable	(7,597)	(1,398)
Unbilled receivables	(1,383)	(1,789)
Prepaid expenses and other	(2,094)	(1,416)
Accounts payable, accrued liabilities and accrued payroll	7	(1,042)
Other current liabilities	(4,867)	
Deferred revenue	6,430	892
Net cash (used in) provided by operating activities	(7,479)	4,670
Investing activities:		
Purchases of property and equipment	(1,261)	(782)
Increase in restricted cash	(366)	
Net cash used in investing activities	(1,627)	(782)
Financing activities:		
Exercise of stock options	291	70
Excess tax benefits on vesting of restricted stock units	623	
Tax withholding related to net share settlement of restricted stock units	(1,194)	
Net cash (used in) provided by financing activities	(280)	70
Net (decrease) increase in cash and cash equivalents	(9,386)	3,958
Cash and cash equivalents:		
Beginning of period	62,449	51,979
End of period	$ 53,063	$ 55,937

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

PROS Holdings, Inc.
Notes to Unaudited Condensed Consolidated Financial Statements
(unaudited)

1. Summary of business and basis of presentation

Nature of operations

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

Basis of presentation

The accompanying unaudited condensed consolidated financial statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial reporting and applicable quarterly reporting regulations of the Securities and Exchange Commission (SEC). In management s opinion, the accompanying interim unaudited condensed consolidated financial statements include all adjustments necessary for a fair presentation of the financial position of the Company as of September 30, 2010, the results of operations for the three and nine months ended September 30, 2010 and cash flows for the nine months ended September 30, 2010. Certain information and disclosures normally included in the notes to the annual financial statements prepared in accordance with GAAP have been omitted from these interim condensed consolidated financial statements pursuant to the rules and regulations of the SEC. Accordingly, these unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements for the fiscal year ended December 31, 2009, which are included in the Company s 2009 Annual Report on Form 10-K filed with the SEC. The condensed consolidated balance sheet as of December 31, 2009 was derived from the Company s audited consolidated financial statements and does not include all disclosures required by GAAP.

Basis of consolidation

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

Dollar amounts

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

Use of estimates

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

6

also used for, but not limited to, receivables, allowance for doubtful accounts, useful lives of assets, depreciation, income taxes and deferred tax asset valuation, valuation of stock options, other current liabilities and accrued liabilities.

Fair value measurements

At September 30, 2010, the Company s financial assets that are measured at fair value on a recurring basis consisted of $38.0 million invested in diversified money market funds and $14.5 million invested in treasury money market funds. At December 31, 2009, the Company had $45.4 million invested in diversified money market funds and $14.5 million invested in treasury money market funds. The fair value of these accounts is determined based on quoted market prices, which represents level 1 in the fair value hierarchy as defined by Accounting Standard Codification (ASC) 820, *Fair Value Measurement and Disclosure*. Our diversified money market funds and treasury money market funds have a fair value that is not materially different from its carrying amount.

Deferred revenue and unbilled receivables

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

Foreign currency

The Company has contracts denominated in foreign currencies and therefore a portion of the Company s revenue is subject to foreign currency risks. Gains and losses from foreign currency transactions, such as those resulting from the settlement of receivables, are included in license and implementation cost of revenue in the accompanying unaudited condensed consolidated statements of operations.

The Company translates assets and liabilities of its foreign subsidiaries, whose functional currency is their local currency, at exchange rates in effect at the balance sheet date. The Company translates revenue and expenses at the monthly average exchange rates. The Company includes accumulated net translation adjustments in stockholders equity as a component of accumulated other comprehensive income (loss).

Income taxes

Historically, the Company s federal effective tax rate has been lower than the statutory rate of 34% largely due to the application of general business tax credits, such as the Research and Experimentation (R&E) tax credit. At the end of 2009, Congress recessed without reinstating the R&E tax credit beyond the current expiration date of December 31, 2009. Since its enactment in 1981, Congress has reinstated on a retroactive basis the R&E tax credit several times. However, unless the R&E tax credit is reinstated, the Company will record federal income taxes (benefit) in 2010 at the enacted federal rate of 34%, net of other tax credits that may benefit the Company, if any.

At the end of each interim reporting period, the Company estimates its effective income tax rate expected to be applicable for the full year. The estimated effective income tax rate includes U.S. federal, state and foreign income taxes and is based on the application of a forecasted annual income tax rate applied to the current quarter s year-to-date pre-tax income (loss). This estimated effective income tax rate is used in providing income taxes on a year-to-date basis and may change in subsequent interim periods. Our effective tax rate for the three months ended September 30, 2010 and 2009 was a benefit of 36% and a provision of 29%, respectively, and our effective tax rate for the nine months ended September 30, 2010 and 2009 was a benefit of 35% and a provision of 28%, respectively. The difference between our effective tax rate and the federal statutory rate of 34% for the three and nine months ended September 30, 2010 was primarily attributable to the Company incurring a pre-tax loss during the three and the nine months ending September 30, 2010 which resulted in a federal tax benefit in both periods offset by a tax provision for both state and foreign taxes.

Recent accounting pronouncements

In October 2009, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2009-13, *Multiple-Deliverable Revenue Arrangements*, (amendments to ASC) Topic 605, *Revenue Recognition*) (ASU 2009-13) and ASU 2009-14, *Certain Arrangements That Include Software Elements*, (amendments to FASB ASC Topic 985, *Software*) (ASU 2009-14). ASU 2009-13 amends ASC Topic 605 to (1) provide updated guidance on whether multiple deliverables exist, how the deliverables in an arrangement should be separated, and the consideration allocated; (2) require an entity to allocate revenue in an arrangement using estimated selling prices of deliverables if a vendor does not have VSOE or third-party evidence of selling price; and (3) eliminate the use of the residual method and require an entity to allocate revenue using the relative selling price method. ASU 2009-14 amends ASC Topic 985 to remove tangible products from the scope of software revenue guidance and provides guidance on determining whether software deliverables in an arrangement that includes a tangible product are covered by the scope of the software revenue guidance. The Company is required to adopt ASU 2009-13 and ASU 2009-14 on January 1, 2011. Early adoption is permitted. The Company is currently evaluating the impact of ASU 2009-13 and ASU 2009-14 on its consolidated financial statements.

2. Earnings per share

The Company computes basic (loss) earnings per share by dividing net (loss) income attributable to common stockholders by the weighted average number of common shares outstanding. Diluted (loss) earnings per share is computed by dividing net (loss) income attributable to common stockholders by the weighted average number of common shares and dilutive potential common shares then outstanding. Diluted (loss) earnings per share reflect the assumed conversion of all dilutive securities, using the treasury stock method. Dilutive potential common shares consist of shares issuable upon the exercise of stock options, shares of non-vested restricted stock units, and settlement of stock appreciation rights.

Approximately 3,496,966 and 2,270,725 of potential common shares have not been considered in the diluted (loss) earnings per share calculation for the three and nine months ended September 30, 2010 and 2009, respectively, as the effect would be anti-dilutive.

The following tables set forth the computation of basic and diluted (loss) earnings per share:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2010	2009	2010	2009
Numerator:				
Net (loss) income attributable to common stockholders	$ (2,405)	$ 798	$ (2,562)	$ 4,324
Denominator:				
Weighted average shares (basic)	26,089	25,718	26,011	25,703
Dilutive effect of stock options, restricted stock units and stock appreciation rights		680		692
Weighted average shares (diluted)	26,089	26,398	26,011	26,395
Basic (loss) earnings per share	$ (0.09)	$ 0.03	$ (0.10)	$ 0.17
Diluted (loss) earnings per share	$ (0.09)	$ 0.03	$ (0.10)	$ 0.16

3. Stock-based compensation

The Company maintains incentive stock-based plans to provide long-term incentives to its key employees, officers, directors and consultants. The Company issues or has issued three types of stock-based awards under its incentive stock-based plans: stock options, restricted stock units and stock appreciation rights. The discretionary issuance of stock-based awards generally contains vesting provisions ranging from one to four years.

In March 2010, the Company increased the number of shares available for issuance by 900,000 to 4,568,000 under an evergreen provision in the Company s 2007 equity incentive plan. As of September 30, 2010, 631,303 shares remained available for issuance under this plan. At September 30, 2010, 1,959,873 stock options were outstanding with a weighted average exercise price of $10.58, 1,222,593 restricted stock units were outstanding and 314,500 stock appreciation rights were outstanding. The Company granted 8,000 shares of restricted stock units and 12,000 shares of stock appreciation rights during the three months ended September 30, 2010. For the nine months ended September 30, 2010, the company granted 426,900 restricted stock units and 314,500 stock appreciation rights. The Company did not grant any stock options during the nine months ended September 30, 2010. At September 30, 2010, there was an estimated $10.1 million of total unrecognized compensation costs related to stock-based compensation arrangements. These costs will be recognized over a weighted average period of 1.4 years.

Stock-based compensation expense is allocated to expense categories on the unaudited condensed consolidated statements of operations. The following table summarizes stock-based compensation expense for the three and nine months ended September 30, 2010 and 2009.

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2010	2009	2010	2009
Stock-based compensation:				
Cost of license and implementation revenue	$ 96	$ 229	$ 614	$ 640
Total included in cost of revenue	96	229	614	640
Selling, general and administrative	903	804	2,957	2,127
Research and development	51	438	890	1,254
Total included in operating expenses	954	1,242	3,847	3,381
Total stock-based compensation expense	$ 1,050	$ 1,471	$ 4,461	$ 4,021

Included in the stock-based compensation expense for the nine months ended September 30, 2010 is $0.3 million of accelerated share-based compensation expense related to a severance agreement. In addition, the three and nine months ended September 30, 2010 includes a $0.2 million out of period adjustment and $0.2 million current period adjustment both of which reduced share-based compensation expense resulting from changes in forfeiture rate and other charges.

4. Commitments and contingencies

Litigation

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

In April 2008, Harrah s Entertainment, Inc. (Harrah s) brought suit in the District Court for Clark County, Nevada. The Company in turn brought counterclaims against Harrah s. On September 2, 2010, the parties settled the dispute and neither party admitted liability. As part of the settlement, the Company agreed to pay $9.0 million, which approximates the cash received by the Company under the original contract with Harrah s. The settlement resulted in a pre-tax charge to operating income of $5.1 million, of which $3.1 million was a reduction of revenue and $2.0 million was an expense, and the release of $4.9 million classified as other current liabilities. The $4.9 million of other current liabilities consisted of $1.1 million of capitalized implementation costs included in other assets, $0.2 million in accounts receivable and $6.1 million of long-term deferred revenue related to the Harrah s contract. Included in the $5.1 million third quarter charge are legal fees of $1.0 million.

5. Subsequent events

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

Item 2. Management s discussion and analysis of financial condition and results of operations

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

Cautionary statement

The following discussion should be read along with the unaudited condensed consolidated financial statements and unaudited notes to condensed consolidated financial statements included in Item 1 of this Quarterly Report on Form 10-Q, as well as the audited consolidated financial statements and notes to consolidated financial statements and management s discussion and analysis of financial condition and results of operations for the year ended December 31, 2009 set forth in our Annual Report on Form 10-K and filed with the Securities and Exchange Commission (SEC). This management s discussion and analysis of financial condition and results of operations contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These forward-looking statements regarding future events and our future results are based on current expectations, estimates, forecasts and projections, and the beliefs and assumptions of our management including, without limitation, our expectations regarding the following: the sales of our software products and services; the impact of our revenue recognition policies; our belief that our current assets, including cash, cash equivalents, and expected cash flows from operating activities, will be sufficient to fund our operations; our anticipated additions to property, plant and equipment; our belief that our facilities are suitable and adequate to meet our current operating needs; our belief that that we do not have any material exposure to changes in the fair value of our investment portfolio as a result of changes in interest rates**.** Words such as we expect, anticipate, target, project, believe, goals, estimate, po predict, may, might, could, intend, and variations of these types of words and similar expressions are intended to identify these forward-looking statements. Readers are cautioned that these forward-looking statements are predictions and are subject to risks, uncertainties and assumptions that are difficult to predict. Therefore, actual results may differ materially and adversely from those expressed in any forward-looking statements.

Overview

We are a leading provider of pricing and margin optimization software, an emerging category of enterprise applications designed to allow companies to improve financial performance by implementing pricing excellence best practices through the use of our software products. By using our software products, our customers gain insight into their pricing strategies, identify detrimental pricing practices, optimize their pricing decision-making and improve their business processes and financial performance. Our software products incorporate advanced pricing science, which includes operations research, forecasting and statistics. Our innovative science-based software products analyze, execute and optimize pricing strategies using data from traditional enterprise applications, often augmenting it with real-time and historical data. Our software also uses data elements that are determined using advanced pricing science and are stored in our database. Our high performance software architecture supports real-time high-volume transaction processing and allows us to handle the processing and database requirements of the most sophisticated and largest customers, including customers with hundreds of simultaneous users and sub second electronic transactions. We provide professional services including configuring our software products to meet the specific pricing needs of each customer and other implementation services. We provide our software products to enterprises across a range of industries, including manufacturing, distribution, services, hotel and cruise, and airline.

Many of our customers process large volumes of individually priced business-to-consumer and business-to-business transactions every day. Our high-performance, real-time transaction pricing products differ from fixed-list retail pricing products by delivering the relevant pricing information at the time the price is quoted, the deal is negotiated and the sales transaction is made. Our software products are also used to provide optimized price lists and goal-driven price guidance. While companies in our target industries differ in the wide range of business-to-business and business-to-customer products and services that they provide, many are similar in their need to optimally and dynamically price each individual transaction. We have installed over 300 solutions for over 100 customers across a range of industries in more than 40 countries.

Trends and uncertainties

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

Difficult Economic Conditions. We believe the market for pricing and margin optimization software is underpenetrated and in the early innovator stage of adoption. Market interest for our software has increased over the past several years. While there appears to be some improvement in the economy, the current economic conditions continue to be challenging and have had and may continue to have a negative impact on the adoption of pricing and margin optimization software and may increase the volatility in our business. Due to the difficult economic conditions, we have experienced longer sales times, increased scrutiny on purchasing decisions and overall cautiousness taken by customers. In response to the challenging economic environment, some customer prospects have changed their purchasing strategies, including, requesting changes to our contract terms that, in some instances, have affected the timing of revenue recognition or have resulted in an increase in the number of limited term license agreements. We believe our solutions provide value to our customers during periods of growth as well as in recessions, but it is uncertain the extent to which the difficult economic conditions will further affect our business.

Variability in revenue among industries and geography. We sell our products to customers in the manufacturing, distribution, services, hotel and cruise and airline industries. From a geographical standpoint, approximately 69% and 61% of our consolidated revenues were derived from customers outside the United States for the three months ended September 30, 2010 and 2009, respectively, and approximately 61% and 59% of our consolidated revenues were derived from customers outside the United States for the nine months ended September 30, 2010 and 2009, respectively. The current economic environment could change our trends of revenue within industries and across geographies if certain industries or geographies are more impacted than others.

Research and experimentation tax credit. At the end of 2009, Congress recessed without reinstating the Research & Experimentation (R&E) tax credit beyond the current expiration date of December 31, 2009. Since its enactment in 1981, Congress has reinstated on a retroactive basis the R&E tax credit several times. However, unless the R&E tax credit is reinstated, we will record the federal income tax provision (benefit) in 2010 at the enacted federal rate of 34%, net of other tax credits that may benefit us, if any.

Critical accounting policies and estimates

We prepare our unaudited condensed consolidated financial statements in accordance with accounting principles generally accepted in the United States of America (GAAP). We make estimates and assumptions in the preparation of our unaudited condensed consolidated financial statements, and our estimates and assumptions may affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the unaudited condensed consolidated financial statements, and the reported amounts of revenue and expenses during the reporting periods. Actual results could differ from those estimates. The complexity and judgment of our estimation process and issues related to the assumptions, risks and uncertainties inherent in the application of the percentage-of-completion method of accounting affect the amounts of revenue, expenses, unbilled receivables and deferred revenue. Estimates are also used for, but not limited to, receivables, allowance for doubtful accounts, useful lives of assets, depreciation, income taxes and deferred tax asset valuation, valuation of stock options, other current liabilities and accrued liabilities. Numerous internal and external factors can affect estimates. The critical accounting policies related to the estimates and judgments are discussed in our Annual Report on Form 10-K for the year ended December 31, 2009 under management s discussion and analysis of financial condition and results of operations. There have been no changes to our critical accounting policies during 2010.

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

We also license software products under term licenses agreements that typically include maintenance during the license term. The term license agreements range from two to five years. Revenue and the associated costs are deferred until the delivery of the product and recognized ratably over the remaining license term. Revenue from term licenses, which is included in license and implementation revenue in the unaudited condensed consolidated statements of operations, represented approximately 6.2% and 5.6% of total revenue for the three months ended September 30, 2010 and 2009, respectively, and approximately 5.0% and 5.5% of total revenue for the nine months ended September 30, 2010 and 2009, respectively.

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

On September 2, 2010, we settled our sole legal dispute with a customer and neither party admitted liability. As part of the settlement, the Company agreed to pay $9.0 million, which approximates the cash received by us under the original contract. The settlement resulted in a pre-tax charge to operating income of $5.1 million of which $3.1 million was a reduction of revenue and $2.0 million was an expense. In accordance with the Accounting Standard Codification (ASC) 605-50, we reduced total revenue by $3.1 million, consisting of a reduction of $2.8 million in license and implementation revenue and a reduction of $0.3 million in maintenance and support revenue. In addition, we released the $4.9 million classified as other current liabilities, which consisted of $1.1 million of capitalized implementation costs included in other assets, $0.2 million in accounts receivable and $6.1 million of long-term deferred revenue related to the Harrah s contract. Included in the $5.1 million third quarter charge are legal fees of $1.0 million in the quarter. We do not anticipate any future payment obligations related to the litigation.

Results of operations

Comparison of three months ended September 30, 2010 with three months ended September 30, 2009

Revenue:

	For the Three Months Ended September 30,					
	2010		2009			
(Dollars in thousands)	**Amount**	**As a percentage of total revenue**	**Amount**	**As a percentage of total revenue**	**Variance $**	**Variance %**
License and implementation	$ 8,580	55%	$ 10,276	62%	$ (1,696)	(17)%
Maintenance and support	7,106	45%	6,234	38%&nb		