

SolarWinds, Inc.
Form 10-K
February 27, 2012
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

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

For the fiscal year ended: December 31, 2011

Commission file number: 001-34358

SOLARWINDS, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of incorporation or organization)

73-1559348
(I.R.S. Employer Identification Number)

3711 S. MoPac Expressway

Austin, Texas
(address of principal executive offices)

78746
(zip code)

Registrant's telephone number, including area code: (512) 682-9300

Securities registered pursuant to Section 12(b) of the Act:

| Title of Each Class | Name of Each Exchange on Which Registered |
|---------------------------------|---|
| Common Stock, \$0.001 par value | New York Stock Exchange |

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate 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). Yes No

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Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

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

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

Based on the closing price of the registrant's common stock on the last business day of the registrant's most recently completed second fiscal quarter, which was June 30, 2011, the aggregate market value of its shares held by non-affiliates on that date was approximately \$1,411,700,000.

On February 17, 2012, 72,425,562 shares of common stock were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Part III of this Annual Report on Form 10-K incorporates certain information by reference from the definitive proxy statement for the registrant's 2012 Annual Meeting of Stockholders to be filed within 120 days of the registrant's fiscal year ended December 31, 2011 (the Proxy Statement). Except with respect to information specifically incorporated by reference in this Form 10-K, the Proxy Statement is not deemed to be filed as part of this Form 10-K.

Table of Contents

| | Page No. |
|---|-----------------|
| PART I | |
| Item 1. <u>Business</u> | 1 |
| Item 1A. <u>Risk Factors</u> | 10 |
| Item 1B. <u>Unresolved Staff Comments</u> | 22 |
| Item 2. <u>Properties</u> | 22 |
| Item 3. <u>Legal Proceedings</u> | 23 |
| Item 4. <u>Mine Safety Disclosures</u> | 23 |
| PART II | |
| Item 5. <u>Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u> | 24 |
| Item 6. <u>Selected Consolidated Financial Data</u> | 26 |
| Item 7. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 28 |
| Item 7A. <u>Quantitative and Qualitative Disclosures About Market Risk</u> | 48 |
| Item 8. <u>Financial Statements and Supplementary Data</u> | 49 |
| Item 9. <u>Changes in and Disagreements With Accountants on Accounting and Financial Disclosure</u> | 49 |
| Item 9A. <u>Controls and Procedures</u> | 49 |
| Item 9B. <u>Other Information</u> | 50 |
| PART III | |
| Item 10. <u>Directors, Executive Officers and Corporate Governance</u> | 51 |
| Item 11. <u>Executive Compensation</u> | 51 |
| Item 12. <u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u> | 51 |
| Item 13. <u>Certain Relationships and Related Transactions, and Director Independence</u> | 51 |
| Item 14. <u>Principal Accountant Fees and Services</u> | 51 |
| PART IV | |
| Item 15. <u>Exhibits and Financial Statement Schedules</u> | 52 |

Table of Contents

Safe Harbor Cautionary Statement

Discussions under the captions *Business*, *Risk Factors*, and *Management's Discussion and Analysis of Financial Condition and Results of Operations* contain or may contain forward-looking statements that are based on our management's beliefs and assumptions and on information currently available to our management. These statements are 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 (the *Exchange Act*). Such statements may be signified by terms such as *anticipates*, *believes*, *could*, *seeks*, *estimates*, *expects*, *intends*, *may*, *plans*, *potential*, *predicts*, *would* or similar expressions and the negatives of those terms. Forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements to be materially and adversely different from any future results, performance or achievements expressed or implied by the forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those discussed under the heading *Risk Factors* in this report and in other documents we file with the Securities and Exchange Commission (*SEC*). Given these risks and uncertainties, you should not place undue reliance on these forward-looking statements. Also, forward-looking statements represent our management's beliefs and assumptions only as of the date of this report. Except as required by law, we assume no obligation to update these forward-looking statements publicly, or to update the reasons actual results could differ materially and adversely from those anticipated in these forward-looking statements, even if new information becomes available in the future.

PART I

ITEM 1. BUSINESS

Overview

SolarWinds, Inc. and its subsidiaries (*SolarWinds*, the *Company*, *we*, *us* or *our*) design, develop, market, sell and support enterprise information technology, or IT, infrastructure management software to IT professionals in organizations of all sizes. Our product offerings range from individual software tools to more comprehensive software products that solve problems encountered every day by IT professionals. Our products are designed to help enable efficient and effective management of their infrastructure, including networks, applications, storage and physical and virtual servers as well as products for log and event management.

As a core part of our strategy, we utilize a differentiated business model for providing enterprise-class software to IT professionals within organizations of all sizes worldwide. Key differentiating elements of our business model include powerful and scalable, yet easy-to-use and affordable IT management software that is produced utilizing a highly efficient product development and engineering process, a scalable marketing model and a high-volume, transaction-oriented inside sales model that have allowed us to drive and support rapid growth in our business at high operating margins while offering our products at prices that are typically significantly lower than competing framework vendors.

We manage our business with a culture and systems that are focused on metrics, helping us to achieve consistency in our execution. We design our products to be easy-to-install and easy-to-evaluate, allowing potential buyers of our software to see the value that the products provide after downloading a free version of the software from our website for evaluation. We design our marketing programs to drive visitors to our websites in order to generate large volumes of highly qualified leads. Our inside sales force uses a disciplined, transaction-oriented process to convert these leads into paying customers at a higher level of productivity at a lower cost than is typically achieved with a traditional direct sales force.

We incorporated in the State of Oklahoma in 1999 and reincorporated in the State of Delaware in 2008 under the name SolarWinds, Inc. Our principal executive offices are located at 3711 South MoPac Expressway, Building Two, Austin, Texas 78735, and our telephone number is (512) 682-9300.

Table of Contents

2011 Highlights and Acquisitions

During 2011, we engaged in a number of activities and completed several initiatives intended to drive and support rapid growth in our business. The following are highlights related to these efforts:

In January 2011, we entered into the system and application performance management market through the launch of SolarWinds Application Performance Monitor.

In January 2011, we also entered the virtualization management market through the acquisition of Hyper9, Inc., or Hyper9, a privately-held virtualization management software provider based in Austin, Texas.

In July 2011, we entered the log and event management market through the acquisition of TriGeo Network Security, Inc., a privately-held log and event management software provider based in Post Falls, Idaho.

In August 2011, we extended our systems and application performance management product portfolio with the release of SolarWinds Synthetic End User Monitor.

In December 2011, we acquired certain assets of DameWare Development, LLC, or DameWare, further broadening the number of systems and application performance problems we can solve with the addition of powerful, yet affordable and easy-to-use tools for systems administrators to remotely manage the computers on their networks.

Throughout 2011, we broadened and deepened our presence in a number of geographic markets including Asia-Pacific, Latin America, Europe, Middle East and Africa through the establishment of distributor and reseller partnerships.

Our Growth Strategy

Our differentiated business model of providing low-cost, easy-to-install and easy-to-use software marketed and sold directly to IT professionals through a highly productive and efficient inside sales force is the core of our strategy. We evaluate all of our strategic opportunities to ensure that they are compatible with our model for providing cost-efficient, downloadable enterprise-class software that can be marketed and sold through a high volume, transaction-oriented model.

We plan to continue to focus on growth opportunities within our existing customer base and IT infrastructure management markets through increased brand awareness and product depth and breadth, through expansion into adjacent areas of IT infrastructure management and by expanding our business globally. Our objective is to extend our market presence by providing IT professionals with enterprise-class software that solves their specific needs. The following are key elements of our growth strategy:

Continue to Add New Customers Globally. We believe that the IT infrastructure management markets throughout North America and the rest of the world remain significantly under-penetrated and represent a significant opportunity to continue our growth. We intend to penetrate these markets further by leveraging our customer base and end-user community and by using our strategic marketing programs to identify and obtain new customers.

Cross-Sell and Up-Sell Existing Products into Our Growing Customer Base. Our customers are generally IT professionals in small- and mid-size businesses, enterprises, and local, state and federal government entities that have purchased one or more of our products. We have an active, loyal end-user community that is built from our customers and end-users who have downloaded our free tools. We seek to expand, and generate loyalty from, our customer base and our end-user community by providing a variety of

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free tools for IT professionals, by hosting our online community website, thwack, and through other marketing programs. We believe our customers are highly satisfied users of our products and that there is a significant opportunity for follow-on sales of both incremental capacity and additional products and modules to these customers.

Table of Contents

Expand Our Business in International Markets. We believe a substantial opportunity exists for sales of our software in the Europe, Middle East and Africa region (EMEA) and the Asian-Pacific region, and we intend to increase our sales, marketing and support operations in these regions. We are in the initial phases of localizing certain of our products with country-specific product documentation, websites and marketing material. We believe our market penetration is low in all geographic and end user markets in which we sell products. We anticipate continuing our international expansion to further market, sell and develop our products. In addition, we plan to continue to scale and develop our existing group of international distributors and resellers. In the new markets we enter, we plan to continue our strategy of delivering powerful, easy-to-use and affordable software while leveraging the web as the primary method to reach potential customers.

Selectively Expand Our Product Portfolio. We plan to continue to develop new software products and modules that enhance and expand our current IT management offerings. We also intend to continue to expand our product offerings into adjacent areas of IT management software in which we can provide differentiated, easy-to-use enterprise-class software products that are marketed and sold directly to IT professionals.

Pursue Strategic Acquisitions of Complementary Products in New and Existing Markets. We expect to continue to pursue acquisitions that will enable us either to bring new product offerings to market more quickly than we can develop them or to enter new markets or segments of markets we currently serve.

Our Products

We offer a broad portfolio of products for IT infrastructure management. Our products fit into one of the following three categories:

Free Tools

Our free tools are desktop, laptop, server-based or internet-based applications designed for use by individual IT professionals, and typically focused on a single network or infrastructure management task or technology. We use free tools primarily to drive awareness of our brand and our paid products within the broader IT management community and to expand and build loyalty among our customers and our end-user community.

Transactional Products

Our transactional products are desktop-based, laptop-based or server-based applications designed for individual IT professionals who need specific solutions for routine, but complicated tasks. Our transactional products include individual tools and toolsets, which combine many powerful tools together into a single package, as well as entry-level IT infrastructure monitoring functionality. We price our transactional products so that an individual IT professional can purchase them with one level of or, in some cases, no management approval. We believe that broad awareness and usage of our tools create positive relationships and loyalty with IT professionals, who in turn influence the purchase of our other products.

Our current transactional products include Standard Toolset, Engineer's Toolset, Kiwi Syslog Server, Kiwi CatTools, and Kiwi Logviewer, or Kiwi products, ipMonitor, LANsurveyor, DameWare SysAdmin Utilities, and DameWare Mini Remote Control, or DameWare products, and various subscription-based tools available at DNSstuff.com.

Core Products

Our core products consist of enterprise-class IT management products that are used by IT professionals and teams in companies of all sizes to configure, monitor and report on network equipment, physical and virtual servers, applications and storage devices to determine the overall health and performance of the IT infrastructure and to automate the processes of change, compliance and inventory. These products provide advanced IT management functionality and are capable of scaling from simple to complex environments.

Table of Contents

Our current core products provide enterprise-class functionality across network management, systems and application management, storage resource management, virtualization management and log and event management:

Network Management. Our enterprise-class network management products share integrated components, databases, web servers and user administration. Our network management products are designed to operate together seamlessly, while still allowing network professionals to purchase and deploy only the products they need.

Network Performance Monitor. Our flagship product, Network Performance Monitor, is a server-based fault and performance management platform designed to minimize network downtime. Network Performance Monitor monitors and analyzes real-time, in-depth network performance metrics for routers, switches, servers and other Simple Network Management Protocol, or SNMP, enabled devices to provide both current and historical views into the availability and performance of a network and all devices attached to it. Network Performance Monitor is modular and has the ability to scale with the growth of a network. It can also be expanded through the use of add-on modules and polling engines. End-users can configure Network Performance Monitor to alert network professionals of network events, including thresholds, correlated events, sustained conditions and complex combinations of device states. Network Performance Monitor drives follow-on sales of our other products and, together with its related modules, currently generates a majority of our revenue.

Network Performance Monitor Modules. Our Network Performance Monitor modules are a series of add-ons that extend the network management capabilities of our Network Performance Monitor to network traffic analysis and WAN performance monitoring. These modules are purchased separately and are fully integrated with our Network Performance Monitor's web console and database. Based on the nature of the issue they address, these modules are either available for use on a stand-alone basis or must be used in conjunction with our Network Performance Monitor. Our current Network Performance Monitor modules are:

NetFlow Traffic Analyzer. NetFlow Traffic Analyzer utilizes Cisco Systems' NetFlow protocol and other similar protocols to extract data from network devices to provide an in-depth view of which end-users, protocols and applications are consuming network bandwidth.

IP SLA Manager. IP SLA Manager monitors WAN performance from the perspective of multiple remote sites by tracking key edge-to-edge router performance statistics using Cisco IP SLA technology.

IP Address Manager. IP Address Manager tracks, manages and reports on the use of IP addresses through a web interface. IP Address Manager is available as a module of Network Performance Monitor and on a stand-alone basis.

Network Configuration Manager. Network Configuration Manager is a server-based product that automates the processes of network device discovery, network inventory management and network change management. Compliance with internal controls and regulatory standards is growing in importance to companies of all sizes, and network configuration and device configuration changes impact network availability, access and security controls that are critical to ensuring up-time and compliance. Network Configuration Manager automates many device configuration management tasks, including bulk network configuration changes, real-time detection and alerts of network configuration problems and rolling back configuration changes on demand. These capabilities help avoid network downtime and are essential to meeting compliance objectives.

User Device Tracker. User Device Tracker is a server-based switch port management tool for tracking and identifying the devices connected to the network, managing network port capacity and responding to network threats posed by rogue devices.

Table of Contents

Scalability Engines. Scalability engines increase the scale of a number of the products based on their infrastructure increasing their monitoring capabilities to a larger number of devices by distributing the polling load across additional servers.

Enterprise Operations Console. Enterprise Operations Console is a server-based product that provides summarized web-based views of multiple instances of Network Performance Monitor modules and Application Performance Monitor, enabling flexible deployment architectures for large or distributed environments.

Systems and Application Management. Our enterprise-class systems and application performance management products allow system administrators to monitor and manage the performance of systems and applications and end-user application experience as well as perform patch management. In addition, our transactional DameWare products allow system administrators to remotely manage the computers on their networks. Our systems and application management products are designed to operate together seamlessly, as well as with our network management products. Our systems and application management products also integrate with our products for storage resource management.

SolarWinds Application Performance Monitor. Application Performance Monitor is a server-based availability and performance management system for applications and server infrastructure, both virtual and physical. Application Performance Monitor provides a view of critical IT services and allows system administrators to drill down and view application-specific server processes, performance counters, synthetic end-user transactions and custom data collected via scripts. With Application Performance Monitor, end-users can configure customized alerts and reports for tracking and managing application and server performance. These capabilities allow system administrators to monitor, manage and optimize the performance of an increasingly complex and growing number of mission-critical business applications. Application Performance Monitor supports over 200 major applications, with extensibility to support additional applications on both the Windows and Linux operating systems.

SolarWinds Patch Manager. Patch Manager is a server-based product that allows Systems Administrators to automate and improve the process of deploying, managing, and reporting on patches and configuration settings of Microsoft Windows servers and workstations. Patch Manager allows Systems Administrators to automate patching applications across thousands of servers and workstations and receive automatic notifications of new third party patches from vendors of commonly-used commercial software applications. In addition, Patch Manager allows users to leverage the investments they have made in Microsoft Windows Server Update Services (WSUS) and System Center Configuration Manager (SCCM) by extending the capabilities of those products to provide Systems Administrators with an efficient, centralized method of tracking, maintaining, and resolving configuration and health issues on servers and workstations.

SolarWinds Synthetic End User Monitor. Synthetic End User Monitor captures the user steps of any web application through an easy-to-use recorder and continuously monitors the end-user experience of those web applications.

Storage Resource Management. Our enterprise-class storage resource management capabilities are represented by SolarWinds Storage Manager.

SolarWinds Storage Manager, powered by Profiler. Storage Manager is a server-based product that combines reporting, monitoring and notification on the performance of storage resources, including DAS (direct-attached storage), NAS (network-attached storage) and SAN (storage area networks), from a wide range of storage hardware vendors. In addition, Storage Manager provides mapping of storage resources to physical and virtual infrastructure to help optimize storage allocation.

SolarWinds Backup Profiler. Backup Profiler provides storage administrators with a consolidated view of the status of backup operations across all major backup applications.

Table of Contents

Virtualization Management. Our enterprise-class virtualization management capabilities are represented by SolarWinds Virtualization Manager.

SolarWinds Virtualization Manager. Virtualization Manager is a server-based product that provides virtualization administrators with a single solution to manage all the aspects of a virtual server infrastructure, including inventory, sprawl control, performance monitoring, capacity planning, and configuration tracking. Using a multi-dimensional, search-based approach Virtualization Manager combines multiple disparate data points into useable insights, which are presented in management dashboards and reports. Virtualization Manager integrates with other key enterprise applications such as configuration management databases, service desks and enterprise portals.

Log and Event Management. Our enterprise-class log and event management capabilities are represented by SolarWinds Log and Event Manager.

SolarWinds Log and Event Manager. Log and Event Manager is a server-based product that automates the collection and interpretation of logs from a wide variety of sources including network devices, physical and virtual servers, applications and storage infrastructure, providing IT professionals with real-time availability and performance monitoring of the IT infrastructure. Through log analysis and event correlation provided with approximately 700 built-in correlation rules along with customizable rules, Log and Event Manager supports compliance verification with internal policies and regulatory requirements and SOX and also provides IT professionals with real-time and forensic tools for responding to security threats and events.

Maintenance and Support

Our perpetual license customers receive one or more years of software maintenance and support as part of their initial purchase of our products and have the option to renew their maintenance agreements. These maintenance agreements provide customers the right to receive software updates, maintenance releases and patches, when and if they become available, and access to our internal support representatives.

Our typical customers are network professionals, systems administrators, storage administrators or virtual administrators who are sophisticated users of software and related technologies. We devote significant resources to designing software products that are easy-to-install, configure and use, and to developing extensive, easy-to-understand instruction manuals and online tutorials for our products. We also utilize community websites, such as thwack, as forums for our end-users to share information, tips, tools and other valuable resources. Through these online communities, users of our software are able to find answers for many technical problems, discover new uses for our software, and provide suggestions or feedback to our product development teams. As a result of these efforts, our customers are able to resolve most technical issues without having to contact our support representatives, which significantly reduces our total support expenses.

Research and Development

Our research and development organization is responsible for the design, development and testing of our software. Our current research and development efforts are focused on new releases of existing products, as well as new products and modules.

We work closely with our customers in developing our products and have designed a product development process that is responsive to customer feedback throughout the process. Our customers and end-user community provide extensive input regarding a wide variety of use cases that we incorporate into our product definitions and requirements. A subset of customers participates in our product testing, helping us to identify issues prior to product release. Our research and development organization regularly assists customer support personnel with customer inquiries, which provides another mechanism for customer feedback during the development process.

We utilize small development teams. Each of these teams is dedicated to specific products and work according to a structured and repeatable, iterative process. These teams apply a standard architecture to their

Table of Contents

individual products, and are managed centrally to ensure standardization, efficiency and interoperability. We use a hybrid onshore and offshore development model, wherein product requirements definition and technical design are performed in the United States, and our U.S. technical staff work closely with development teams in our international facilities and with two contract development vendors in Eastern Europe that write code and do testing and quality assurance. Since establishing our research and development center in the Czech Republic and as a result of our acquisitions, we have significantly increased our research and development employee headcount. As part of our acquisitions, we increased research and development personnel in New Zealand, India and the United States. We expect to continue to invest in our research and development activities by hiring engineers in the United States and in our international locations. In 2011, we started and completed the expansion of our development center in India which has resulted in and will result in an increase in facilities and personnel costs. We believe that we have developed a differentiated process that allows us to release new software rapidly and cost effectively, a process that we continue to improve upon each year. Using our development model, we made 73 product releases in 2009, 53 product releases in 2010 and 64 product releases in 2011.

Our research and development expenses were \$11.2 million, \$15.7 million and \$21.3 million in 2009, 2010, and 2011, respectively.

Marketing and Sales

We have designed our marketing and sales model to be efficient for very high volumes of low-price transactions. Our marketing efforts focus on driving traffic to our websites and on generating high quality sales leads, primarily consisting of end-users who download a free evaluation of our software. Our sales efforts focus on converting these leads into paying customers through a high volume, short duration, inside sales process that we measure and manage frequently.

Marketing

We use a variety of online marketing programs for lead generation, as well as more traditional direct marketing and indirect channel partner marketing programs to drive traffic to our websites. These efforts leverage the ubiquity of Internet search engines through search engine marketing and optimization programs. In addition, we send a series of targeted emails to end-users who have downloaded free evaluations of one or more of our software products or received our corporate communications or public relations material. Once we drive traffic to our websites, we have a well-defined process that allows us automatically to track visitors' activities, communicate with potential customers, encourage downloads of our software and provide highly qualified leads to our sales organization.

Our historical marketing approach, which continues to be important to us, was based on word of mouth and customer references. It allowed us to build a substantial customer base and community of network engineers and IT professionals who use our products and act as advocates for them. We continue to build our customer base and this community through marketing of relevant web-based content and online communications. Examples of our initiatives include thwack, a community website designed for IT professionals that provides our end-users and the broader IT management community with information, tools and valuable resources; several company sponsored blogs in which we provide perspectives and information relevant to the IT management marketplace, network engineering, systems management, virtualization, security and other technical topics; and quarterly newsletters designed to inform, and keep us connected to, our end-user base and other prospective customers. Other marketing activities include attending IT management related trade shows, social marketing programs, communicating with industry analysts and hosting webinars on IT management issues to create awareness of our brand and software products.

Sales

We license our software directly to our customers. Our direct sales are made exclusively through a low-cost inside sales force that is devoted to turning highly qualified leads into purchasers of our software. The majority

Table of Contents

of our leads come from potential customers who have downloaded our software and are using it during a trial period or from our existing customer base. As a result, our inside sales team typically is calling potential buyers who are already informed on the use and value of our products and do not require a lengthy sales cycle.

We also sell our software through distributors and resellers to supplement our inside sales force and help us to initiate and fulfill sales orders from state, local and federal governments and those commercial customers that prefer to make purchases through a particular reseller. We provide licenses directly to the end user in sales of our software through our distributors and resellers.

Our sales approach focuses on driving a high volume of standard transactions. We implement our approach through a disciplined sales process that provides clear guidelines for our sales force, and we actively measure and manage our sales results. We offer our products at low prices using standard contract terms. We enable our customers to buy our products in a manner convenient to them, whether by purchase order, online with a credit card or through our channel partners.

We have experienced some seasonality in our new license sales and, consequently, our cash collections. We typically achieve the highest levels of new license sales for the year in the third and fourth quarters. We believe that, in general, historical seasonality results primarily from the budgeting cycles of our customers being typically higher in the third and fourth quarters. New license sales for our U.S. federal business tend to peak in the third quarter of each calendar year as September 30 is the fiscal year end for the U.S. federal government. As a result, cash collections have historically been the highest in the fourth quarter of each calendar year. New license sales for our commercial business tend to peak in the fourth quarter of each calendar year as many companies typically have a December 31 fiscal year end.

We believe we have built a sales process and culture that is unique in the software industry, and that our sales force is able to achieve and maintain a higher level of productivity at a lower cost than most other enterprise software companies. Because our sales personnel do not need a professional software sales background, we are able to keep our personnel costs low and can expand our sales force quickly.

Customers

In 2011, 2010 and 2009, we had one distributor that represented 11.9%, 12.4% and 14.4%, respectively, of our revenue from sales to various end-users. In 2010 and 2009, we had one additional distributor that represented 10.0% and 13.8%, respectively, of our revenue from sales to various end-users. We do not believe, however, that our business is substantially dependent on either distributor or that the loss of either relationship, or both relationships, would have a material adverse effect on our business, as we are generally directly involved with the end user in all of our sales regardless of whether we make the sale direct or through the reseller channel. See Note 1 of the notes to our consolidated financial statements for further information regarding concentrations of risks.

Intellectual Property

We rely on a combination of copyright, trademark, trade dress and trade secret laws, as well as confidentiality procedures and contractual restrictions, to establish and protect our proprietary rights. These laws, procedures and restrictions provide only limited protection. We currently have six patents. We have also filed patent applications, but we cannot guarantee that patents will be issued with respect to our current patent applications in a manner that gives us the protection that we seek or at all. Our patent and any future patents issued to us may be challenged, invalidated or circumvented and may not provide sufficiently broad protection or may not prove to be enforceable in actions against alleged infringers.

We endeavor to enter into agreements with our employees and contractors and with parties with which we do business in order to limit access to and disclosure of our proprietary information. We cannot be certain that

Table of Contents

the steps we have taken will prevent unauthorized use or reverse engineering of our technology. Moreover, others may independently develop technologies that are competitive with ours or that infringe our intellectual property. The enforcement of our intellectual property rights also depends on any legal actions against these infringers being successful, but these actions may not be successful, even when our rights have been infringed.

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

Competition

We face competition from both traditional, larger software vendors offering enterprise-wide software frameworks and services and smaller companies offering point solutions for application, log and event, network, storage resource or virtualization management. We also compete with network equipment vendors and systems management product providers whose products and services also address network and IT management requirements. Our principal competitors vary depending on the product we offer and include Hewlett Packard, IBM, CA Technologies, Cisco Systems, Inc., VMware, Inc., EMC Corporation, NetApp, Inc., BMC Software, Inc., Quest Software, Inc. and several smaller vendors.

Competition in our market is based on the level of difficulty in using, maintaining and installing solutions; total cost of ownership, including product price and implementation and support costs; professional services implementation; product performance, functionality, flexibility, scalability and interoperability; brand and reputation; distribution channels; vertical markets or industries; and financial resources of the vendor. We generally compete favorably with respect to these factors; however, many of our actual and potential competitors enjoy substantial competitive advantages over us, such as greater name recognition, more comprehensive and varied products and services and substantially greater financial, technical and other resources. We expect competition to continue to increase both from existing competitors and new market entrants.

Employees

As of December 31, 2011, we had 628 full-time employees, of which 367 were employed in the United States and 261 were employed outside of the United States. We consider our current relationship with our employees to be good. None of our employees is represented by a labor union or is a party to a collective bargaining agreement.

Additional Information

Our website address is www.solarwinds.com. Our website and the contents therein or connected thereto are not intended to be incorporated into this Annual Report on Form 10-K. Through a link on the Investor Relations section of our Website, we make available the following filings as soon as reasonably practicable after they are electronically filed with or furnished to the SEC: our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and any amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act. All such filings are available free of charge. The public may read and copy any materials we file with SEC at the SEC's Public Reference Room at 100 F Street, NE, Washington, DC 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. In addition, the SEC maintains an Internet site (<http://www.sec.gov>) that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC.

Table of Contents

ITEM 1A. RISK FACTORS

Risks Related to Our Business and Industry

Our quarterly revenue and operating results have fluctuated in the past and may fluctuate in the future due to a number of factors. As a result, we may fail to meet or exceed the expectations of securities analysts or investors, which could cause our stock price to decline.

We believe our quarterly revenue and operating results may vary significantly in the future. As a result, you should not rely on the results of any one quarter as an indication of future performance and period-to-period comparisons of our revenue and operating results may not be meaningful.

Our quarterly results of operations may fluctuate as a result of a variety of factors, including, but not limited to, those listed below, many of which are outside of our control:

our inability to increase sales to existing customers and to attract new customers;

general economic, industry and market conditions that impact expenditures for enterprise IT management software in the United States and other countries where we sell our software;

the mix of our direct and indirect sales;

the timing and success of new product introductions by us or our competitors;

changes in our pricing policies or those of our competitors;

higher marketing expenditures in an attempt to generate growing numbers of sales leads;

potential foreign exchange gains and losses related to expenses and sales denominated in currencies other than the functional currency of an associated entity;

the timing of revenue and expenses related to the development or acquisition of technologies, products or businesses;

potential goodwill and intangible asset impairment charges and amortization associated with acquired businesses;

the amount and timing of operating expenses and capital expenditures related to the expansion of our operations and infrastructure;

occasional large customer orders, including in particular those placed by the U.S. federal government; and

unpredictability and timing of buying decisions by the U.S. federal government.

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Fluctuations in our quarterly operating results might lead analysts to change their models for valuing our common stock. As a result, our stock price could decline rapidly and we could face costly securities class action suits or other unanticipated issues.

Our actual operating results may differ significantly from our operating results guidance.

From time to time, we may release operating results guidance in our quarterly earnings releases, quarterly earnings conference calls, or otherwise, regarding our future performance that represents our management's estimates as of the date of release. This guidance, which includes forward-looking statements, will be based on projections, including those related to certain of the factors listed above, prepared by our management. Neither our independent registered public accounting firm nor any other independent expert or outside party will compile or examine the projections nor, accordingly, will any such person express any opinion or any other form of assurance with respect thereto.

Table of Contents

These projections will be based upon a number of assumptions and estimates that, while presented with numerical specificity, will be inherently subject to significant business, economic and competitive uncertainties and contingencies, many of which will be beyond our control, and will also be based upon specific assumptions with respect to future business decisions, some of which will change. For example, our management has excluded and currently intends to continue to exclude in their projections the potential revenue associated with certain transactions with U.S. federal government entities that are associated with projects involving larger end user technology implementations that typically involve multiple companies, resellers and/or service providers, or what we refer to as project-based transactions. To the extent we recognize revenue from these project-based transactions during a specific quarter, actual results may differ significantly from our operating results guidance. We intend to state possible outcomes as high and low ranges, which will be intended to provide a sensitivity analysis as variables are changed but will not be intended to represent that actual results could not fall outside of the suggested ranges. The principal reason that we release guidance is to provide a basis for our management to discuss our business outlook with analysts and investors. We do not accept any responsibility for any projections or reports published by analysts.

Guidance is necessarily speculative in nature, and it can be expected that some or all of the assumptions underlying the guidance furnished by us will not materialize or will vary significantly from actual results. Accordingly, our guidance will only be an estimate of what management believes is realizable as of the date of release. Actual results will vary from our guidance, and the variations may be material and adverse. In light of the foregoing, investors are urged to consider these factors, not to rely exclusively upon our guidance in making an investment decision regarding our common stock, and to take such guidance into consideration only in connection with other information included in our filings filed with or furnished to the SEC, including Risk Factors such as this one.

Any failure to implement our operating strategy successfully or the occurrence of any of the events or circumstances set forth under Risk Factors in this report could result in our actual operating results being different from our guidance, and those differences might be adverse and material.

If we are unable to generate significant volumes of sales leads from Internet search engines, marketing campaigns and traffic to our websites, then our revenue may not grow as expected or may decline.

We generate many of our sales leads through visits to our websites by potential end-users interested in purchasing or downloading evaluations of our products. Many of these potential end-users find our websites by searching for enterprise IT management and monitoring products through Internet search engines, such as Google. A critical factor in attracting potential customers to our websites is how prominently our websites are displayed in response to search inquiries. If we are listed less prominently or fail to appear in search result listings for any reason, visits to our websites by customers and potential customers could decline significantly. We may not be able to replace this traffic and, if we attempt to replace this traffic, we may be required to increase our sales and marketing expenses, which may not be offset by additional revenue and could adversely affect our operating results.

We also generate leads through various marketing activities such as targeted email campaigns, attending networking-based trade shows and hosting webinars on enterprise IT management issues. Our marketing efforts may be unsuccessful in generating evaluation downloads, resulting in fewer sales leads. If we fail to generate a sufficient volume of leads from these activities and/or such sales leads do not result in actual sales, our revenue may not grow as expected or could decrease and our operating results could suffer.

If we are unable to sell products to new customers or to sell additional products to our existing customers, our revenue growth will be adversely affected and our operating income could decrease.

To increase our revenue, we must regularly add new customers and/or sell additional products to existing customers. Even if we generate a significant volume of leads from our marketing activities, we must be able to sell products to a sufficient number of these new sales leads in order to achieve our expected revenue growth. We

Table of Contents

expect to incur significant additional expenses in expanding our sales personnel and our international operations in order to convert leads into sales of our products. If we are unable to sell products to new customers and additional products to our existing customers as a result of these expenditures, we may be unable to grow our revenue and/or our operating results may be adversely affected.

Challenging or uncertain economic conditions could adversely affect our operating results.

Economies in many countries are experiencing uncertain and challenging conditions as a result of a multitude of factors, including, but not limited to, declines in gross domestic product, increases in unemployment, sovereign debt levels and volatility in commodity prices and worldwide stock markets. During these challenging and uncertain economic periods, customers may reduce or delay technology purchases, including purchases of our software products. Our typically short sales cycle may lengthen if purchasing decisions are delayed as a result of uncertain information technology budgets, contract negotiations become more protracted or customers institute additional internal approvals for software purchases. Uncertain and challenging economic conditions could result in reductions in sales of our products, longer sales cycles, difficulties in collecting accounts receivable or delayed payments, slower adoption of new technologies and increased price competition. Any of these events would likely harm our business, financial condition, operating results and cash flows.

The ability to recruit, retain and develop key employees is critical to our success and growth, and our inability to attract and retain qualified personnel could harm our business.

Our business requires certain expertise and intellectual capital, particularly within our management team. For us to compete successfully and grow, we must retain, recruit and develop key personnel who can provide the needed expertise for our industry and products. However, the market for qualified personnel is competitive and we may not succeed in recruiting additional key personnel or may fail to replace current key personnel effectively who depart with qualified or effective successors. We believe that replacing our key personnel with qualified successors is particularly challenging as we feel that our business model and approach to marketing and selling our products are unique. Any successors that we hire from outside of the Company would likely be unfamiliar with our business model and may therefore require significant time to understand and appreciate the important aspects of our business or fail to do so altogether. Our effort to retain and develop personnel may also result in significant additional expenses, which could adversely affect our profitability. We have made significant changes, and may make additional changes in the future, to our senior management team and other key personnel. We cannot provide assurances that key personnel, including our executive officers, will continue to be employed or that we will be able to attract and retain qualified personnel in the future. Failure to retain or attract key personnel could have a material adverse effect on the Company.

If we are not able to integrate future acquisitions successfully, our operating results and prospects could be harmed.

In order to expand our business, we made several acquisitions in 2011 and expect to continue making similar acquisitions and possibly larger acquisitions as part of our growth strategy. The success of our future acquisition strategy will depend on our ability to identify, negotiate, complete and integrate acquisitions and, if necessary, to obtain satisfactory debt or equity financing to fund those acquisitions. Mergers and acquisitions are inherently risky, and any mergers and acquisitions we complete may not be successful. Any mergers and acquisitions that we do in the future would involve, numerous risks, including, but not limited to, the following:

difficulties in integrating and managing the operations, systems, technologies and products of the companies we acquire;

diversion of our management's attention from normal daily operations of our business;

our inability to maintain the key business relationships and the reputations of the businesses we acquire;

Table of Contents

uncertainty of entry into markets in which we have limited or no prior experience and in which competitors have stronger market positions;

our dependence on unfamiliar affiliates and partners of the companies we acquire;

insufficient revenue to offset our increased expenses associated with acquisitions;

our responsibility for the liabilities of the businesses we acquire;

our inability to maintain internal standards, controls, procedures and policies; and

potential loss of key employees of the companies we acquire.

Acquisitions or asset purchases made entirely or partially for cash may reduce our cash reserves. We may seek to obtain additional cash to fund an acquisition by selling equity or debt securities. We may be unable to secure the equity or debt funding necessary to finance future acquisitions on terms that are acceptable to us. If we finance acquisitions by issuing equity or convertible debt securities, our existing stockholders will likely experience ownership dilution, and if we finance future acquisitions with debt funding, we will incur interest expense and may have to comply with financing covenants or secure the debt obligation with our assets.

Businesses that we acquire may have greater than expected liabilities for which we become responsible.

Businesses that we acquire may have liabilities or adverse operating issues, or both, that we fail to discover through due diligence or the extent of which we underestimate prior to the acquisition. For example, to the extent that any business that we acquire or any prior owners, employees or agents of any acquired businesses or properties: (i) failed to comply with or otherwise violated applicable laws, rules or regulations; (ii) failed to fulfill or disclose their obligations, contractual or otherwise, to applicable government authorities, their customers, suppliers or others; or (iii) incurred tax or other liabilities, we, as the successor owner, may be financially responsible for these violations and failures and may suffer harm to our reputation and otherwise be adversely affected. An acquired business may have problems with internal control over financial reporting, which could be difficult for us to discover during our due diligence process and could in turn lead us to have significant deficiencies or material weaknesses in our own internal control over financial reporting. These and any other costs, liabilities and disruptions associated with any of our past acquisitions and any future acquisitions could harm our operating results.

Our operating income could fluctuate and may decline as a percentage of revenue as we make further expenditures to expand our operations in order to support additional growth in our business.

We have continued to make significant investments in our operations to support additional growth, such as hiring substantial numbers of new personnel, investing in new facilities, acquiring other companies or their assets and establishing and broadening our international operations in order to expand our business. We intend to make additional investments in systems and personnel and to continue to expand our operations to support anticipated future growth in our business. We also expect to make acquisitions, many or all of which may increase our operating costs more than our revenue. As a result of these investments, our operating income could fluctuate and may decline as a percentage of revenue.

Our business depends on customers renewing their maintenance contracts. Any decline in maintenance renewals could harm our future operating results.

We sell most of our products pursuant to a perpetual license, which ordinarily includes one year of maintenance as part of the initial price. Our customers have no obligation to renew their maintenance agreements after the expiration of this initial period. We may be unable to predict future customer renewal rates accurately. Our customers' renewal rates may decline or fluctuate as a result of a number of factors, including their level of satisfaction with our products, the prices of our products, the prices of products and services offered by our

Table of Contents

competitors or reductions in our customers' spending levels. If our customers do not renew their maintenance arrangements or if they renew them on less favorable terms, our revenue may decline and our business will suffer. A substantial portion of our quarterly maintenance revenue is attributable to maintenance agreements entered into during previous quarters. As a result, if there is a decline in renewed maintenance agreements in any one quarter, only a small portion of the decline will be reflected in our maintenance revenue recognized in that quarter and the rest will be reflected in our maintenance revenue recognized in the following four quarters or more.

Failure to expand our sales operations effectively could harm our ability to increase our customer base and achieve broader market acceptance of our products.

Increasing our customer base and achieving broader market acceptance of our products will depend on our ability to expand our sales operations effectively. We are substantially dependent on our direct inside sales force, and to a significantly lesser extent certain resellers and distributors, to obtain new customers. We plan to continue to expand our direct inside sales force both domestically and internationally. Our ability to achieve significant growth in revenue in the future will depend on our success in recruiting, training and retaining sufficient numbers of direct inside sales personnel, and on the productivity of those personnel. Our recent and planned personnel additions may not become as productive as we would like, and we may be unable to hire or retain sufficient numbers of qualified individuals in the future in the markets where we do or plan to do business. Our operating results will be seriously harmed if these expansion efforts do not generate a corresponding significant increase in revenue.

If we are unable to enhance existing products, particularly our core products, or to develop or acquire new products that respond to rapidly changing customer requirements, technological developments or evolving industry standards, our long-term revenue growth will be harmed.

The market for our products is characterized by rapid technological advances, changes in customer requirements, changes in protocols and evolving industry standards. Our long-term growth depends on our ability to enhance and improve our existing products and to introduce or acquire new products that respond to these demands. The success of any enhancement or new product depends on a number of factors, including its timely completion, introduction and market acceptance. New products that 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. Additionally, our existing and prospective customers may develop their own competing technologies, purchase competitive products or services or engage third party providers. If we are unable to develop or acquire enhancements to, and new features for, our existing products or acceptable new products that keep pace with rapid technological developments, our products may become obsolete, less marketable and less competitive, and our business will be harmed.

We operate much of our research and development activities internationally and outsource a portion of the coding and testing of our products and product enhancements to contract development vendors. We believe that performing research and development in our international facilities and supplementing these activities with our contract development vendors enhances the efficiency and cost-effectiveness of our product development. If we experience problems with our workforce or facilities internationally, we may not be able to develop new products or enhance existing products in an alternate manner that may be equally or less efficient and cost-effective.

We depend significantly on our core products, which represent a majority of our revenue in 2011, 2010 and 2009. If we are unable to add products and develop enhancements to our core products that are satisfactory to our customers, or if our customers purchase or develop their own competing products and technologies causing a reduction in demand for our core products, our operating results will be harmed.

Table of Contents

We depend on the U.S. federal government for a meaningful portion of our sales, including maintenance renewals, and orders from the U.S. federal government are unpredictable. The delay or loss of these sales may harm our operating results.

A meaningful portion of our sales, including maintenance renewals, are to a number of different departments of the U.S. federal government. Any factors that cause a decline in government expenditures generally or government IT expenditures in particular could cause our revenue to grow less rapidly or even to decline. Furthermore, sales orders from the U.S. federal government tend to be dependent on many factors and therefore unpredictable in timing. Any sales we expect to make in a fiscal quarter may not be made in that quarter or at all, and our operating results for that quarter may therefore be adversely affected.

Because our long-term success depends on our ability to operate our business internationally and increase sales of our products to customers located outside of the United States, our business will be susceptible to risks associated with international operations.

We have international operations in the Republic of Ireland, the Czech Republic, Australia, India, Singapore and New Zealand, all of which we established or acquired within the past five years. We also expect to continue to expand our international operations for the foreseeable future. Our limited experience in operating our business outside the United States increases the risk that our current and future international expansion efforts may not be successful. In particular, our business model may not be successful in particular countries or regions outside the United States for reasons that we currently are unable to anticipate. In addition, conducting international operations subjects us to risks that we have not generally faced in the United States. These include, but are not limited to:

fluctuations in currency exchange rates (which we only hedge to a limited extent at this time);

unexpected changes in foreign regulatory requirements;

difficulties in managing the staffing of international operations;

potentially adverse tax consequences, including the complexities of foreign value added tax systems, restrictions on the repatriation of earnings and changes in tax rates;

dependence on resellers and distributors to increase customer acquisition;

the burdens of complying with a wide variety of foreign laws and different 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.

The occurrence of any one of these risks could negatively affect our international business and, consequently, our operating results. Additionally, operating in international markets requires significant management attention and financial resources. We cannot be certain that the investment and additional resources required to establish, acquire or integrate operations in other countries will produce desired levels of

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revenue or profitability.

If we fail to develop our brands cost-effectively, our financial condition and operating results might suffer.

We believe that developing and maintaining awareness and integrity of our brands in a cost-effective manner are important to achieving widespread acceptance of our existing and future products and are important elements in attracting new customers. We believe that the importance of brand recognition will increase as we enter new markets and as competition in our existing markets further intensifies. Successful promotion of our

Table of Contents

brands will depend on the effectiveness of our marketing efforts and on our ability to provide reliable and useful products at competitive prices. We intend to increase our expenditures on brand promotion. Brand promotion activities may not yield increased revenue, and even if they do, the increased revenue may not offset the expenses we incur in building our brands. We also rely on our customer base and community of end-users in a variety of ways, including to give us feedback on our products and to provide user-based support to our other customers. If we fail to promote and maintain our brands successfully, maintain loyalty among our customers and our end-user community, or incur substantial expenses in an unsuccessful attempt to promote and maintain our brands, we may fail to attract new customers or retain our existing customers and our financial condition and results of operations could be harmed.

We operate in a highly competitive market, which could make it difficult for us to acquire and retain customers.

The market for enterprise IT management solutions is intensely competitive. Competition in our market is based primarily on the level of difficulty in using, maintaining and installing solutions; total cost of ownership, including product price and implementation and support costs; professional services implementation; product performance, functionality, flexibility, scalability and interoperability; brand and reputation; distribution channels; vertical markets or industries; and financial resources of the vendor. We often compete to sell our products against existing products or systems that our potential customers have already made significant expenditures to install. Many of our actual and potential competitors enjoy substantial competitive advantages over us, such as greater name recognition, more comprehensive and varied products and services, and 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. Given their larger size, greater resources and existing customer relationships, our competitors may be able to compete and respond more effectively than we can to new or changing opportunities, technologies, standards or customer requirements.

We face competition from both traditional, larger software vendors offering enterprise-wide software frameworks and services and smaller companies offering point solutions for IT infrastructure management. We also compete with network equipment vendors and systems management product providers whose products and services also address network and IT management requirements. Our principal competitors vary depending on the product we offer and include Hewlett Packard, IBM, CA Technologies, Cisco Systems, Inc., VMware, Inc., EMC Corporation, NetApp, Inc., BMC Software, Inc., Quest Software, Inc. and several smaller vendors.

Some of our competitors have made acquisitions or entered into strategic relationships with one another to offer a more comprehensive product than they individually had offered. We expect this trend to continue as companies attempt to strengthen or maintain their market positions in an evolving industry and as companies enter into partnerships or are acquired. Companies and alliances resulting from these possible consolidations and partnerships may create more compelling product offerings and be able to offer more attractive pricing, making it more difficult for us to compete effectively.

We have experienced rapid growth in recent periods. If we fail to manage our growth effectively, our financial performance may suffer.

We have substantially expanded our overall business, customer base, headcount and operations since 2006 both domestically and internationally. We have made substantial investments in our information systems, significantly expanded our operations outside the United States, made several acquisitions and significantly increased the number of our customers, including resellers and distributors. Our expansion has placed, and our expected future growth will continue to place, a significant strain on our managerial, administrative, operational, financial and other resources. If we are unable to manage our growth successfully, our operating results will suffer.

Table of Contents

We rely on third parties for financial and operational services essential to our ability to manage our business. A failure or disruption in these services would materially and adversely affect our ability to manage our business effectively.

Currently, we use NetSuite to manage our order management and financial processes, salesforce.com to track our sales and marketing efforts and Eloqua to manage our online marketing efforts. We believe the availability of these services is particularly essential to the management of our high-volume, transaction-oriented business model. As we expand our operations and sales efforts, we expect to utilize additional systems and service providers that may also be essential to managing our business. Although the systems and services that we require are typically available from a number of providers, it is time consuming and costly to qualify and implement these relationships. Therefore, if one or more of our providers suffer an interruption in their business, or experience delays, disruptions or quality control problems in their operations, or we have to change or add additional systems and services, our ability to manage our business would suffer.

Material defects or errors in our products could harm our reputation, result in significant costs to us and impair our ability to sell our products.

Software products are inherently complex and often contain defects and errors when first introduced. Any defects in our products could result in:

lost or delayed market acceptance and sales of our products;

a reduction in maintenance renewals;

diversion of development resources; and

injury to our reputation and our brand.

The costs incurred in correcting or remediating the impact of defects or errors in our products may be substantial and could adversely affect our operating results.

Litigation exposure related to our pending and any future litigation could exceed our expectations and adversely affect our results of operations, profitability and cash flows.

We have been and may be involved, from time-to-time, in disputes incidental to our business. We are currently the subject of allegations of patent infringement further described under the caption "Legal Proceedings" in Part I, Item 3 of this Annual Report on Form 10-K. We cannot predict when these lawsuits will be completed and are unable to accurately assess the financial outcome that could result from these matters at this time. These lawsuits may result in a diversion of management's attention and resources, including the significant costs of document production and legal fees, and may contribute to current and future stock price volatility. No assurance can be made that these matters will not have material financial exposure, which together with the potential for similar suits and reputational harm, could have a material adverse effect upon our results of operations, profitability and cash flows.

In particular, the software and technology industries are characterized by the existence of a large number of patents, copyrights, trademarks and trade secrets and by frequent litigation based on allegations of infringement or other violations of intellectual property rights. We have received, and from time to time may receive, letters claiming that our products infringe or may infringe the patents or other intellectual property rights of others. As we face increasing competition, the possibility of additional intellectual property rights claims against us grows. Our technologies may not be able to withstand any third party claims or rights against their use. Additionally, we have licensed from other parties proprietary technology covered by patents, and these patents may be challenged, invalidated or circumvented. These types of claims could harm our relationships with our customers, might deter future customers from acquiring our products or could expose us to litigation with respect to these claims. Even if we are not a party to any litigation between a customer and a third party, an adverse outcome in that litigation

Table of Contents

could make it more difficult for us to defend our intellectual property in any subsequent litigation in which we are named as a party. Any of these results could harm our brand and operating results.

Any additional intellectual property rights claim against us or our customers, with or without merit, could be time-consuming, expensive to litigate or settle, and divert management resources and attention. As a result of any successful intellectual property rights claim against us or our customers, we might have to pay damages or stop using technology found to be in violation of a third party's rights, which could prevent us from offering our products to our customers. We could also have to seek a license for the technology, which might not be available on reasonable terms, might significantly increase our cost of revenue or might require us to restrict our business activities in one or more respects. The technology also might not be available for license to us at all. As a result, we could also be required to develop alternative non-infringing technology, which could require significant effort and expense.

Our exposure to risks associated with the use of intellectual property may be increased as a result of our past and any future acquisitions as we have a lower level of visibility into the development process with respect to acquired technology or the care taken to safeguard against infringement risks. Third parties may make infringement and similar or related claims after we have acquired technology that had not been asserted prior to our acquisition.

The success of our business depends on our ability to protect and enforce our intellectual property rights.

We rely primarily on a combination of patent, copyright, trademark, trade dress, unfair competition and trade secret laws, as well as confidentiality procedures and contractual restrictions, to establish and protect our proprietary rights. These laws, procedures and restrictions provide only limited protection. We have six patents and have also filed patent applications, but patents may not be issued with respect to these applications. Our patents and any future patents issued to us may be challenged, invalidated or circumvented, and may not provide sufficiently broad protection or may not prove to be enforceable in actions against alleged infringers.

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

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

If we fail to maintain proper and effective internal controls, our ability to produce accurate and timely financial statements could be impaired, which could harm our operating results, our ability to operate our business and investor views of us.

Section 404 of the Sarbanes-Oxley Act of 2002 (the "Sarbanes-Oxley Act") and related requirements require an annual management assessment of the effectiveness of our internal control over financial reporting and an audit by our independent auditors of our internal control over financial reporting. 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 generally accepted accounting principles. If we fail to maintain proper and effective internal controls, our ability to produce accurate and timely financial statements could be impaired, which could harm our operating results, harm our ability to operate our business and reduce the trading price of our stock.

Table of Contents

Changes in financial accounting standards or practices may cause adverse, unexpected financial reporting fluctuations and affect our reported results of operations.

A change in accounting standards or practices can have a significant effect on our reported 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 adversely affect our reported financial results or the way in which we conduct our business.

We may be subject to regulation of our advertising and customer solicitation or to other newly adopted laws and regulations, which could harm our business.

As part of our product download process and during our sales process, most of our customers agree to receive emails and other communications from us. However, we may be subject to restrictions on our ability to communicate with these customers through email and phone calls. Several jurisdictions have proposed or adopted privacy-related laws that restrict or prohibit unsolicited email or spam. These laws may impose significant monetary penalties for violations and complex and often burdensome requirements in connection with sending commercial email. Depending on how they are interpreted, these laws may impose burdens on our email marketing practices. If any of those challenges are successful, our business may become subject to state laws and regulations that further restrict our email marketing practices. The scope of those regulations is unpredictable. Compliance with laws and regulations of different jurisdictions imposing different standards and requirements is very burdensome for businesses like ours.

We offer products to customers in multiple states and foreign jurisdictions. Our business efficiencies and economies of scale depend on generally uniform product offerings and uniform treatment of customers across all jurisdictions in which we operate. Compliance requirements that vary significantly from jurisdiction to jurisdiction impose an added cost to our business and increased liability for compliance deficiencies. In addition, laws or regulations that could harm our business could be adopted, or reinterpreted so as to affect our activities, by the U.S. government, state governments, regulatory agencies or by foreign governments or agencies. Violations or new interpretations of these laws or regulations may result in penalties or damage our reputation or could increase our costs or make our products less attractive.

If we fail to protect confidential information against security breaches, or if our customers or potential customers are reluctant to use our websites because of privacy concerns, we might face additional costs and activity in our websites could decline.

Some of our customers pay for our products with credit cards. During the purchasing process and in connection with evaluations of our software, either we or third party providers collect and use personally identifiable information, such as credit card numbers, email addresses and phone numbers. This information could be compromised or accessed as a result of misappropriation or security breaches, and we could be subject to liability as a result. Our policies concerning the collection, use and disclosure of personally identifiable information are described on our websites. We could be subject to legal claims, government action or harm to our reputation if we or our third party service providers fail to comply or are seen as failing to comply with our policies concerning personally identifiable information or if our policies are inadequate. Concern among prospective customers regarding our use of personal information collected on our websites could keep prospective customers from purchasing our products.

Our servers and those of our third party service providers are vulnerable to computer viruses or physical or electronic break-ins. Industry-wide incidents or incidents with respect to our specific websites, including misappropriation of third party information, security breaches, or changes in industry standards, regulations or laws, could deter people from using the Internet or our websites to conduct transactions that involve the transmission of confidential information, which could harm our business.

Table of Contents

The laws of some states and countries require businesses that maintain personal information about their residents in electronic databases to implement reasonable measures to keep that information secure. In addition, under the laws of some states and countries, if there is a breach of our computer systems and we know or suspect that unencrypted personal customer information has been stolen, we are required to inform any customers whose information was stolen, which could harm our reputation and business. Other states and countries have enacted different and often contradictory requirements for protecting personal information collected and maintained electronically. Compliance with numerous and contradictory requirements of the different states and countries is particularly difficult for an online business such as ours that collects personal information from customers in multiple jurisdictions. Failure to comply with these laws could result in legal liability. In addition, we could suffer adverse publicity and loss of consumer confidence were it known that we did not take adequate measures to assure the confidentiality of the personally identifiable information that our customers had given to us. This could result in a loss of customers and revenue that could jeopardize our success. We may not be successful in avoiding potential liability or disruption of business resulting from the failure to comply with these laws. If we were required to pay any significant amount of money in satisfaction of claims under these new laws, or any similar laws enacted by other jurisdictions, or if we were forced to cease our business operations for any length of time as a result of our inability to comply fully with any of these laws, our business, operating results and financial condition could be adversely affected. Further, complying with the applicable notice requirements in the event of a security breach could result in significant costs.

Our business and financial performance could be negatively impacted by changes in tax laws or regulations.

New income, sales, use or other tax laws, statutes, rules, regulations or ordinances could be enacted at any time. Further, existing tax laws, statutes, rules, regulations or ordinances could be interpreted, changed, modified or applied adversely to us. Any changes to these existing tax laws could adversely affect our domestic and international business operations, and our business and financial performance. Additionally, these events could require us or our customers to pay additional tax amounts on a prospective or retroactive basis, as well as require us or our customers to pay fines and/or penalties and interest for past amounts deemed to be due. If we raise our product and maintenance prices to offset the costs of these changes, existing customers may elect not to renew their maintenance arrangements and potential customers may elect not to purchase our products. Additionally, new, changed, modified or newly interpreted or applied tax laws could increase our customers' and our compliance, operating and other costs, as well as the costs of our products. Further, these events could decrease the capital we have available to operate our business. Any or all of these events could adversely impact our business and financial performance.

Our results of operations benefit from the tax credit incentives under the U.S. research and experimentation tax credit extended to taxpayers engaged in qualified research and experimental activities while carrying on a trade or business. The tax credit expired on December 31, 2011, and may not be renewed, or if renewed, it may be renewed on terms significantly less favorable than current tax incentives or on terms resulting in our disqualification from the benefits of the tax credit. The elimination or significant reduction in the tax credit would increase our effective tax rate and would adversely affect our results of operations.

Additional liabilities related to taxes or potential tax adjustments could adversely impact our business and financial performance.

We are subject to tax and related obligations in various federal, state, local and foreign jurisdictions in which we operate or do business. The taxing rules of the various jurisdictions in which we operate or do business are often complex and subject to differing interpretations. Tax authorities could challenge our tax positions we historically have taken, or intend to take in the future, or may audit the tax filings we have made and assess additional taxes. Tax authorities may also assess taxes in jurisdictions where we have not made tax filings. Any assessments incurred could be material, and may also involve the imposition of substantial penalties and interest. Significant judgment is required in evaluating our tax positions and in establishing appropriate reserves, and the resolutions of our tax positions are unpredictable. The payment of additional taxes, penalties or interest resulting from any assessments could adversely impact our business and financial performance.

Table of Contents

We intend either to invest our non-U.S. earnings permanently in foreign operations or to remit these earnings to our U.S. entities in a tax-free manner. If for some reason our need for U.S. cash changes, and we are unable to remit these foreign earnings to our U.S. entities in a tax-free manner, we could incur material U.S. federal tax liabilities which could adversely impact our business and financial performance.

Government regulation of the Internet and e-commerce 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. 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 our products. In addition, taxation of products and 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 exchange over the Internet could result in a decline in the use of the Internet and the viability of Internet-based services and product offerings, which could harm our business and operating results.

Risks Related to Ownership of Our Common Stock

Our stock price may be volatile.

The market price of our common stock has been and could be subject to wide fluctuations in response to, among other things, the factors described in this Risk Factors section or otherwise, and other factors beyond our control, such as fluctuations in the valuations of companies perceived by investors to be comparable to us.

Furthermore, the stock markets have experienced price and volume fluctuations that have affected and continue to affect the market prices of equity securities of many companies. These fluctuations often have been unrelated or disproportionate to the operating performance of those companies. These broad market fluctuations, as well as general economic, political and market conditions, such as sovereign debt issues, interest rate changes and international currency fluctuations, may negatively affect the market price of our common stock.

We and other companies that have experienced volatility in the market price of their stock have become subject to securities class action litigation. We may be the target of additional litigation of this type in the future. Additional securities litigation against us could result in substantial costs and divert our management's attention from other business concerns, which could seriously harm our business.

Your ownership percentage could be diluted and our stock price could decline due to the issuance of additional shares of stock in connection with acquisitions, our equity incentive plans or otherwise.

We have a number of shares of common stock authorized but unissued and not reserved for issuance under our equity incentive plans or otherwise. As of December 31, 2011, we had 73.4 million shares outstanding, 4.2 million shares subject to issuance upon the exercise of stock options and settlement of restricted stock units, and 9.9 million shares available for issuance under our 2008 equity incentive plan, or 2008 Plan. In addition, our 2008 Plan contains an evergreen provision, which increased the number of shares issuable under the plan by 1.7 million shares on January 1, 2012. We may issue all of these shares without any action or approval by our stockholders. We intend to continue to pursue strategic acquisitions and may pay for such acquisitions, in part or in full, through the issuance of additional equity. Any issuance of shares in connection with our acquisitions, the exercise of stock options, the settlement of restricted stock units or otherwise would dilute the percentage ownership held by our then existing stockholders and could cause our stock price to decline.

Table of Contents

We can issue shares of preferred stock without stockholder approval, which could adversely affect the rights of common stockholders.

Our amended and restated certificate of incorporation permits us to establish the rights, privileges, preferences, and restrictions, including voting rights, of future series of our preferred stock and to issue such stock without approval from our stockholders. The rights of holders of our common stock may suffer as a result of the rights granted to holders of preferred stock that we may issue in the future. In addition, we could issue preferred stock to prevent a change in control of us, depriving common stockholders of an opportunity to sell their stock at a price in excess of the prevailing market price.

Our charter documents and Delaware law could prevent a takeover that stockholders consider favorable and could also reduce the market price of our stock.

Our amended and restated certificate of incorporation and our amended and restated bylaws contain provisions that could delay or prevent a change in control of our Company. These provisions could also make it more difficult for stockholders to elect directors and take other corporate actions. These provisions include:

a classified board of directors with three-year staggered terms;

not providing for cumulative voting in the election of directors;

authorizing the board to issue, without stockholder approval, preferred stock with rights senior to those of our common stock;

prohibiting stockholder action by written consent; and

requiring advance notification of stockholder nominations and proposals.

These and other provisions in our amended and restated certificate of incorporation and our amended and restated bylaws and under Delaware law could discourage potential takeover attempts, reduce the price that investors might be willing to pay in the future for shares of our common stock and result in the market price of our common stock being lower than it would be without these provisions.

If securities analysts do not continue to publish research or reports about our business or if they publish negative evaluations of our stock, the price of our stock could decline.

We believe that the trading price for our common stock will be affected by research or reports that industry or financial analysts publish about us or our business. If one or more of the analysts who may elect to cover us downgrade their evaluations of our stock, the price of our stock could decline. If one or more of these analysts cease coverage of our company, we could lose visibility in the market for our stock, which in turn could cause our stock price to decline.

We do not intend to pay dividends on our common stock.

We have neither declared nor paid any cash dividends on our common stock. We currently anticipate that all of our future earnings will be used for the operation and growth of our business and do not expect to pay any dividends in the foreseeable future.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

We lease our offices and do not own any real estate. Our largest leased facilities consist of approximately (i) 102,224 square feet for our corporate headquarters in Austin, Texas under a lease agreement that expires on June 1, 2016; (ii) 16,507 square feet for our international headquarters in Cork, Ireland under a lease agreement

Table of Contents

that expires on April 2, 2029 subject to our right to terminate earlier each five year period; (iii) 18,837 square feet for our research and development facility in Brno, Czech Republic that expires on August 15, 2020 and (iv) 13,722 square feet for our facility in Chennai, India that expires on June 30, 2014. We also lease space domestically and internationally for our operations, including local sales, support and development personnel. We believe our current facilities and planned expansion facilities will be adequate for the foreseeable future.

ITEM 3. LEGAL PROCEEDINGS

From time to time, we have been and may be involved in various legal proceedings and claims, including the pending litigation discussed below, as well as other legal proceedings and claims that have not been fully resolved and that have arisen in our ordinary course of business. In the opinion of management, there was not at least a reasonable possibility we may have incurred a material loss, or a material loss in excess of a recorded accrual, with respect to any legal proceedings. However, the outcome of legal proceedings and claims brought against us are subject to significant uncertainty. Therefore, although management considers the likelihood of such an outcome to be remote, if one or more of these legal matters were resolved against us in the same reporting period for amounts in excess of management's expectations, our consolidated financial statements of a particular period could be materially adversely affected. See the risk factor *Litigation exposure related to our pending and any future litigation could exceed our expectations and adversely affect our results of operations, profitability and cash flows* in Part I, Item 1A under the heading Risk Factors. We settled certain matters during the 2011 that did not individually or in the aggregate have a material impact on our financial condition or results of operations.

On September 13, 2010, Uniloc USA, Inc. and Uniloc (Singapore) Private Limited (Uniloc) brought a lawsuit against the Company and several other defendants in the United States District Court for the Eastern District of Texas (Eastern District of Texas). The complaint filed by Uniloc alleges that the Company and each of the other fifteen named defendants' software infringe U.S. patent 5,490,216 (216 Patent) allegedly owned by Uniloc. Uniloc alleges that the Company's software, specifically its license key system, infringes upon its patent that utilizes a system for activating software products through a registration process. Uniloc has brought a series of lawsuits against numerous software companies around the world. In September, another company, Sureloc, Inc. (Sureloc) claimed that it owns the 216 Patent. As a result, on November 3, 2011, Uniloc and, its affiliates filed a lawsuit in the Superior Court of the State of California against Sureloc, Inc., Patrick Rooney, and Does 1-100 (the Sureloc case), seeking, among other things, a declaratory judgment that Uniloc and not Sureloc, is the exclusive owner of the 216 Patent. Once the Eastern District of Texas was informed of the Sureloc case, all Uniloc cases that were pending before the Eastern District of Texas were stayed on December 1, 2011. Consequently, the entire basis of Uniloc's claim of ownership of the 216 Patent is pending the outcome of the Sureloc case. Because this lawsuit is stayed and continues to only be in the initial stages, it is not possible to reliably predict the outcome of the litigation. Therefore, we cannot currently estimate the loss, if any, associated with the litigation. We intend to contest the claims associated with this lawsuit vigorously.

On June 22, 2011, Achates Reference Publishing, Inc. (Achates) brought a lawsuit against SolarWinds, Inc. and several other defendants in the United States District Court for the Eastern District of Texas. The complaint filed by Achates alleges that SolarWinds, Inc. and each of the other twelve named defendants' software infringe U.S. Patent No. 5,982,889 (889 Patent) and U.S. Patent No. 6,173,403 (403 Patent) which are allegedly owned by Achates. Achates alleges that SolarWinds, Inc.'s Engineer Suite family of software infringes upon the 889 and 403 Patents by employing activation technology. Achates has brought a series of lawsuits against numerous software companies around the world. Currently, it is not possible to reliably predict the outcome of the litigation. Therefore, we cannot currently estimate the loss, if any, associated with the litigation. We intend to contest the claims associated with this lawsuit vigorously.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

Table of Contents**PART II****ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES****Market Information**

Our common stock is listed on the New York Stock Exchange (NYSE) under the symbol SWI. The following table sets forth for the periods indicated the high and low sales prices per share of our common stock as reported on the NYSE:

| Quarter | Sales Price Per Share in 2011 | |
|----------------|----------------------------------|----------|
| | Low | High |
| Fourth Quarter | \$ 21.05 | \$ 33.28 |
| Third Quarter | \$ 20.05 | \$ 26.30 |
| Second Quarter | \$ 22.79 | \$ 26.16 |
| First Quarter | \$ 18.64 | \$ 24.07 |

| Quarter | Sales Price Per Share in 2010 | |
|----------------|----------------------------------|----------|
| | Low | High |
| Fourth Quarter | \$ 16.20 | \$ 19.59 |
| Third Quarter | \$ 12.10 | \$ 18.18 |
| Second Quarter | \$ 15.98 | \$ 24.95 |
| First Quarter | \$ 18.25 | \$ 23.54 |

On February 17, 2012, the last reported sales price of our common stock on the NYSE was \$37.23 per share and, as of December 31, 2011, there were 32 holders of record of our common stock. Because many of our shares of common stock are held by brokers and other institutions on behalf of stockholders, this number is not representative of the total number of stockholders represented by these stockholders of record.

Dividend Policy

We have neither declared nor paid any cash dividends on our common stock and we do not expect to pay dividends on our common stock for the foreseeable future. We anticipate that all of our earnings will be used for the operation and growth of our business. Any future determination to pay dividends on our common stock would be subject to the discretion of our board of directors and would depend upon various factors, including our results of operations, financial condition and liquidity requirements, restrictions that may be imposed by applicable law and our contracts, and other factors deemed relevant by our board of directors.

Performance Graph

The graph set forth below compares the cumulative total stockholder return on our common stock between May 20, 2009 (the date of our initial public offering (IPO)) and December 31, 2011, with the cumulative total return of the (i) the Russell 2000 Index and (ii) the Nasdaq Computer Index (the Industry Index). This graph assumes the investment of \$100 on May 20, 2009 in our common stock at our IPO offering price of \$12.50 per share, the Russell 2000 Index and the Industry Index, and assumes the reinvestment of dividends, if any. We are currently included in the Russell 2000 Index. The Industry Index consists of NASDAQ-listed computer hardware and software companies that provide products or services. Note that historic stock price performance is not necessarily indicative of future stock price performance.

Table of Contents

The information contained in the Stock Performance Graph shall not be deemed to be soliciting material or to be filed with the SEC nor shall such information be incorporated by reference into any future filing under the Securities Act of 1933 or the Exchange Act, except to the extent we specifically incorporate it by reference into such filing.

Table of Contents**ITEM 6. SELECTED CONSOLIDATED FINANCIAL DATA**

We have derived the following consolidated statement of income data for 2011, 2010 and 2009 and consolidated balance sheet data as of December 31, 2011 and 2010 from our audited consolidated financial statements contained in this Annual Report on Form 10-K. We have derived the following consolidated statement of income data for 2008 and 2007 and consolidated balance sheet data as of December 31, 2009, 2008 and 2007 from our audited consolidated financial statements included in our other SEC filings and not included in this Annual Report. You should read the consolidated financial data set forth below in conjunction with our consolidated financial statements and related notes and the information under Management's Discussion and Analysis of Financial Condition and Results of Operations. Our historical results are not necessarily indicative of our results to be expected in any future period.

| Consolidated Statements of Income Data: | Year Ended December 31, | | | | |
|---|-------------------------|-----------|-----------|-----------|-----------|
| (in thousands, except per share data) | 2011 | 2010 | 2009 | 2008 | 2007 |
| Revenue: | | | | | |
| License | \$ 92,254 | \$ 75,603 | \$ 62,378 | \$ 55,461 | \$ 39,525 |
| Maintenance and other | 106,104 | 76,790 | 54,068 | 37,674 | 22,210 |
| Total revenue | 198,358 | 152,393 | 116,446 | 93,135 | 61,735 |
| Cost of revenue | 11,989 | 7,930 | 4,860 | 3,588 | 2,253 |
| Gross profit | 186,369 | 144,463 | 111,586 | 89,547 | 59,482 |
| Operating expenses: | | | | | |
| Sales and marketing | 53,850 | 43,252 | 30,548 | 22,664 | 12,909 |
| Research and development | 21,332 | 15,731 | 11,199 | 8,452 | 5,899 |
| General and administrative | 28,076 | 23,476 | 26,038 | 16,464 | 9,763 |
| Accrued earnout gain | (664) | | | | |
| Total operating expenses | 102,594 | 82,459 | 67,785 | 47,580 | 28,571 |
| Operating income | 83,775 | 62,004 | 43,801 | 41,967 | 30,911 |
| Other income (expense): | | | | | |
| Interest income | 308 | 177 | 267 | 528 | 528 |
| Interest expense | | (1,146) | (4,253) | (8,539) | (10,235) |
| Other income (expense) | 720 | 115 | 90 | (934) | (73) |
| Total other income (expense) | 1,028 | (854) | (3,896) | (8,945) | (9,780) |
| Income before income taxes | 84,803 | 61,150 | 39,905 | 33,022 | 21,131 |
| Income tax expense | 22,360 | 16,404 | 10,396 | 10,717 | 7,524 |
| Net income | 62,443 | 44,746 | 29,509 | 22,305 | 13,607 |
| Amount allocated to participating preferred stockholders | | | | (10,922) | (6,681) |
| Net income available to common stockholders | \$ 62,443 | \$ 44,746 | \$ 29,509 | \$ 11,383 | \$ 6,926 |
| Basic earnings per share available to common stockholders | \$ 0.86 | \$ 0.65 | \$ 0.58 | \$ 0.40 | \$ 0.25 |
| Diluted earnings per share available to common stockholders | \$ 0.84 | \$ 0.61 | \$ 0.52 | \$ 0.35 | \$ 0.24 |
| Shares used in computation of basic earnings per share available to common stockholders | 72,812 | 68,664 | 51,042 | 28,137 | 27,969 |
| Shares used in computation of diluted earnings per share available to common stockholders | 74,413 | 72,862 | 56,824 | 32,652 | 56,030 |

Table of Contents

| | December 31, | | | | |
|---|--------------|------------|------------|-----------|-----------|
| Consolidated Balance Sheet Data: | | | | | |
| (in thousands) | 2011 | 2010 | 2009 | 2008 | 2007 |
| Cash and cash equivalents | \$ 122,707 | \$ 142,003 | \$ 129,788 | \$ 40,566 | \$ 19,303 |
| Short-term investments | 29,688 | | | | |
| Working capital | 93,187 | 108,203 | 89,699 | 16,393 | 6,130 |
| Deferred revenue | 77,147 | 55,758 | 38,647 | 27,162 | 17,092 |
| Total assets | 362,408 | 247,477 | 181,470 | 86,907 | 49,262 |
| Long-term obligations and convertible preferred stock | 4,367 | 3,992 | 29,377 | 95,379 | 101,897 |
| Total stockholders' equity (deficit) | 264,947 | 175,609 | 89,066 | (48,555) | (78,534) |

Table of Contents

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the Selected Consolidated Financial Data and our consolidated financial statements and related notes included elsewhere in this report. In addition to historical consolidated financial information, the following discussion contains forward-looking statements that reflect our plans, estimates and beliefs. Our actual results could differ materially and adversely from those anticipated in the forward-looking statements. See the Safe Harbor Cautionary Statement above for a discussion of the uncertainties, risks and assumptions associated with these statements.

Overview

We design, develop, market, sell and support powerful yet easy-to-use enterprise IT infrastructure management software to IT professionals in organizations of all sizes. Our offerings range from individual software tools to more comprehensive software products that solve problems faced every day by IT professionals and help to enable efficient and effective management of their infrastructure, including networks, applications, storage and physical and virtual servers. All of our products are ready-to-use, featuring intuitive and easily customized user interfaces and built-in workflows. Our products can be downloaded directly from our websites and installed and configured by our end-users in a matter of hours. Our customers include small- and mid-size businesses, enterprises, and local, state and federal government entities that have purchased our products.

We made a number of strategic investments in our business during 2011 that we believe are important to our long-term growth. Through our product launches and strategic acquisitions we entered into several new markets including the system and application market, virtualization management market and the log and event management market. We continued to focus on increasing our presence in several geographic markets including Asian-Pacific, Latin America, Europe, Middle East and Africa. We increased our presence in the Asian-Pacific market by establishing new relationships with several distributors and reseller partners in Japan and establishing our Asian-Pacific headquarters in Brisbane. We also began the process of localizing certain products with country-specific product documentation, websites and marketing material. Despite these investments and many others, we have continued to grow revenue and increase our cash flow from operations.

In the coming year, we plan to continue to focus on growth opportunities in the IT infrastructure management market while expanding our customer base and brand awareness in the network, application, storage resource, virtualization and log and event management markets. We believe our market penetration is low in all geographic and end user markets in which we sell products; therefore, our focus will continue to be on expanding partner relationships, localized web presence and products in various key international markets. Specifically, we intend to continue to expand in Brazil, Japan, China and Germany. In the new markets we have entered, we will continue our strategy of delivering powerful, easy to use and affordable software along with leveraging the web as the primary method to reach potential customers. We will continue to look for acquisitions similar to those we have completed over the last year to supplement our internal product development efforts.

Key Financial Highlights

Key financial highlights for 2011 include the following:

Total revenue was \$198.4 million for 2011 compared to \$152.4 million for 2010, or an increase of 30%;

Net income was \$62.4 million compared to \$44.7 million for 2010, or an increase of 40%;

Net income was \$0.84 per share on a fully diluted basis for 2011 compared to \$0.61 per share on a fully diluted basis for 2010; and

Cash flow from operations was \$111.4 million for 2011 compared to \$66.0 million for 2010, or an increase of 69%.

Table of Contents

Acquisitions

We have made multiple acquisitions of businesses as part of our growth strategy. Each of these acquisitions has been accounted for using the acquisition method of accounting. Accordingly, the financial results for these entities have been included in our consolidated financial results since the applicable acquisition dates. The more recent acquisitions are as follows:

In January 2011, we acquired Hyper9, Inc., or Hyper9, for approximately \$23.0 million in cash and contingent consideration ranging from \$0 to \$7.0 million based on sales milestones for the one year period after the closing of the acquisition. Hyper9 increased our product offerings to include virtualization management software and eliminated the normal time to market required to develop a new software product.

In July 2011, we acquired TriGeo Network Security, Inc., or TriGeo, for approximately \$35.5 million in cash. By acquiring TriGeo, we increased our product offerings to include log and event management software.

In October 2011, we acquired DNS Enterprise, Inc., or DNS, a provider of free tools and inexpensive subscription-based tools used by a community of system administrators, application administrators, network engineers and IT professionals. We do not believe this acquisition will have a material impact on our consolidated financial statements.

In December 2011, we acquired certain assets of privately-held DameWare Development LLC, or DameWare, for \$40.0 million in cash. DameWare increased our product offerings to include remote system management and administration software tools. For further information regarding these acquisitions, see Note 2, *Acquisitions*, in the Notes to Consolidated Financial Statements in Item 15 of Part IV of this Annual Report on Form 10-K.

Key Business Metrics

We review a number of key business metrics to help us monitor the performance of our business model and to identify trends affecting our business. The measures that we believe are the primary indicators of our quarterly and annual performance are as follows:

Revenue Growth

We have employed a differentiated business model for marketing and selling high volumes of enterprise-class software, which is focused on rapid revenue growth at high operating margins. We regularly review our total revenue growth to measure our success. We have built a pricing model for our products that aims to maximize our recurring revenue and the value of a customer over time and not upfront license revenue. This is an important component of our financial model. This model is based on the premise that we will be able to deliver ongoing value to our customers and maintain a long-term financial relationship with the users of our core enterprise-class IT management products. Our annual revenue growth percentages were 30.2%, 30.9% and 25.0% for the years ended December 31, 2011, 2010 and 2009, respectively.

Core Product Transaction Growth for New License Sales.

We focus our sales, marketing and research and development efforts on IT professionals in organizations of all sizes, with the goal of driving purchases of our software by these IT professionals in short sales cycles. In addition, many of our customers make small initial purchases of our software to manage specific components of their infrastructures and, then, make additional purchases over time to expand the use of the product that they purchased or to buy additional software products from us. We review the core product transaction growth to ensure the effectiveness of our marketing and sales model.

Table of Contents

We define our core product transactions as the number of new license sales transactions that include at least one of our core products. We define a transaction as each invoice issued for the sale of one or more of our products. If none of our core products is included in a particular transaction, then that transaction is not a core product transaction. While our transactional products are important by creating broad awareness which may influence the purchase of our core products, the new license sales of core products represented more than 90% of our license revenue for 2011. Accordingly, we believe that management can better evaluate changes in our product portfolio, expansion into new markets and the addition of new customers by evaluating the transactional growth of our core products. Our core product transaction growth for new license sales was 30.9%, 24.7% and 6.2% for the years ended December 31, 2011, 2010 and 2009, respectively.

Non-GAAP Operating Income

Our management uses non-GAAP operating income to measure our performance. Because non-GAAP operating income excludes certain non-cash expenses including amortization, stock-based compensation and certain expenses that may not be indicative of our core business, we believe that this measure provides us with additional useful information to measure and understand our performance, particularly with respect to changes in performance from period to period. We use non-GAAP operating income in the preparation of our budgets and to measure and monitor our performance. Non-GAAP operating income is not determined in accordance with GAAP and is not a substitute for, or superior to, financial measures determined in accordance with GAAP.

Free Cash Flow

We believe free cash flow is an important liquidity measure that reflects the cash generated by the business after the purchase of property and equipment that can then be used for, among other things, strategic acquisitions and investments in the business, stock repurchases and funding ongoing operations. We regularly review our free cash flow generation to measure our effectiveness at running our operations efficiently and in a manner that maximizes the value of our customers. We define free cash flow as cash flows from operating activities plus the excess tax benefit from stock-based compensation and less the purchase of property and equipment. Free cash flow does not represent the total increase or decrease in the cash balance for the period, is not determined in accordance with GAAP and is not a substitute for, or superior to, financial measures determined in accordance with GAAP.

For further discussion regarding non-GAAP financial measures including non-GAAP operating income and free cash flow, see *Non-GAAP Financial Measures* below.

Opportunities and Trends

Businesses, governments and other organizations are increasingly relying on data networks and IT infrastructures to execute their operations, facilitate their internal and external communications and transact business with their customers and partners. The size of these networks, the number of applications and servers, and the complexity of physical and virtual server environments are increasing as organizations place more reliance on them. We believe that the increasing challenges of IT infrastructure management and the limitations of existing offerings present a market opportunity for our products. In addition to the network management products that we have offered since 2001, we also offer products that we have developed or acquired and we believe these products allow us to compete effectively in the adjacent markets of systems and application, storage resource, virtualization and log and event management. We expect our revenue to continue to grow as we capitalize on these and other market opportunities. While we feel that we have integrated or begun to integrate our acquired businesses successfully, any revenue growth and operating synergies of our acquired products may be lower than expected if we are unable to do so in the future.

In 2011, we recognized 23.7% of our revenue from sales by our international subsidiaries. We believe there is a substantial opportunity for additional sales of our software in the Europe, Middle East and Africa region

Table of Contents

(EMEA) and the Asian-Pacific region, and we intend to increase our sales, marketing and support operations in these regions. However, we believe there is significant uncertainty regarding the economic conditions in certain of these geographic regions, particularly in parts of Europe. We believe that any difficult economic conditions may adversely affect the sales of our products, but could offer us an opportunity to market and sell our products to mid-size businesses and enterprise customers at compelling prices compared to the prices of many competing products.

We expect the U.S. federal government to continue to be a significant market opportunity, as we believe the ease of deployment, power and scalability of our products gives us an enhanced opportunity to sell to various agencies and departments of the U.S. federal government. The U.S. federal government new license sales were 12.8% of our total new licenses sales in 2011. We have experienced and continue to expect inconsistency in the buying pattern of the U.S. federal government for larger transactions with our products. Our sales, both new licenses and maintenance renewals, to the U.S. federal government are largely dependent on systems integrators, distributors and resellers whose purchases from us have been difficult to predict. In addition, we believe that many of our larger transactions with the U.S. federal government are dependent on specific projects that may or may not be continued at the same scale in the future due to budgetary cuts or other reasons, and the reduction or cancellation of specific projects such as these may change the buying patterns of the U.S. federal government and could result in our sales to the U.S. government being less than expected.

Key Components of Our Results of Operations

Sources of Revenue

Our revenue is primarily comprised of license and maintenance revenue. We license our software under perpetual licenses, which ordinarily includes one year of maintenance as part of the initial purchase price of the product. License revenue reflects the revenue recognized from sales of new licenses and upgrades to our software. We have experienced annual growth in license revenue. Customers can renew, and generally have renewed, their maintenance agreements at our standard list maintenance renewal pricing for their software products. Current customers with maintenance agreements are entitled to receive unspecified upgrades or enhancements when and if they become available. Maintenance revenue is an important source of our future revenue. We have experienced strong and consistent annual and quarterly growth in maintenance and other revenue. Because our maintenance base grew during 2009, 2010 and 2011 due to new license sales and high customer retention and acquisitions, we expect maintenance revenue to continue to increase in future periods.

Cost of Revenue

Cost of revenue primarily consists of personnel costs related to providing technical support services and amortization of acquired developed product technologies and third party software licenses. Personnel costs include salaries, bonuses and stock-based compensation and related employer-paid payroll taxes for technical support personnel, as well as an allocation of our facilities, information technology and other overhead costs and our employee benefit costs. We allocate stock-based compensation expense and related employer-paid payroll taxes to personnel costs based on the expense category in which the option or restricted stock unit holder works. We allocate overhead, such as rent, computer and other technology costs, and employee benefit costs to personnel costs in each expense category based on worldwide headcount in that category. We expect our cost of revenue to increase in absolute dollars and to fluctuate as a percentage of revenue as we acquire additional companies and integrate the businesses.

Operating Expenses

We classify our operating expenses into four categories: sales and marketing, research and development and general and administrative and accrued earnout (gain) loss.

Table of Contents

Our operating expenses primarily consist of personnel costs, contract research and development costs, marketing program costs and legal, accounting, consulting and other professional service fees. Personnel costs for each category of operating expenses primarily include employee compensation costs and facility overhead costs.

Our operating expenses increased in absolute dollars and decreased as a percentage of revenue in 2011 compared to 2010 and 2009, as we have continued to build infrastructure and add employees through acquisitions and internal growth across all departments in order to accelerate and support our growth. The number of full-time employees as of December 31, 2011, was 628, as compared to 458, as of December 31, 2010 and 353 as of December 31, 2009. We will continue to make investments in our business by expanding our direct inside sales force domestically and internationally, increasing our marketing operations and programs and adding research and development personnel worldwide which will increase our operating expenses. We expect our operating expenses in future periods to continue to increase in absolute dollars and to fluctuate as a percentage of revenue as we acquire additional companies and integrate the businesses.

Sales and Marketing. Sales and marketing expenses primarily consist of personnel costs for our sales, marketing and business development employees and executives, commissions earned by our sales personnel, the cost of marketing programs such as paid search, search engine optimization and management, trade shows, webinars and the cost of business development programs. We expect to continue to hire sales personnel in the United States and in our international sales offices. In 2011, we completed the expansion of our sales offices in Singapore and Australia which has resulted in and will result in an increase in facilities and personnel costs. We also expect to continue to invest in our website, online user community site and marketing programs to drive customer downloads and support our new product launches.

Research and Development. Research and development expenses primarily consist of personnel costs for our product development employees and executives. We have devoted our development efforts primarily to expanding our product line and increasing the functionality and enhancing the ease-of-use of our software products. Since establishing our research and development center in the Czech Republic and as a result of our acquisitions, we have significantly increased our research and development employee headcount. As part of our acquisitions, we increased research and development personnel in India and the United States. We expect to continue to invest in our research and development activities by hiring engineers in the United States and in our international locations. In 2011, we completed the expansion of our development center in India which has resulted in and will result in an increase in facilities and personnel costs. This expansion will allow us to continue our research and development growth strategy internationally.

General and Administrative. General and administrative expenses primarily consist of personnel costs for our executive, finance, legal, human resources and administrative personnel, as well as legal, accounting and other professional service fees and other corporate expenses. We expect to incur higher administrative costs in future periods as our business continues to grow both organically and through acquisitions. In addition, we intend to continue to grant equity awards to our current executives and employees and those who join us in the future through acquisitions or otherwise, which will result in additional stock-based compensation expense.

Accrued Earnout (Gain) Loss. Accrued earnout (gain) loss represents the change in the fair value of the contingent consideration obligation recorded on the acquisition date due to subsequent adjustments in the probability assumptions with respect to the likelihood of achieving the earnout criteria.

Other Income (Expense)

Other income (expense) primarily consists of interest income, interest expense, foreign exchange gains (losses), government grant income and acquisition related contingent consideration fair value adjustments due to the passage of time. Interest income represents interest received on our cash, cash equivalents and short-term investments, net of amortization of prepaid interest. Interest expense in 2010 was associated with our outstanding

Table of Contents

long-term debt which was paid in full in May 2010. Foreign exchange gains (losses) relate to expenses and billing transactions denominated in currencies other than the functional currency of the associated subsidiary. Government grant income is primarily related to grants received by our Czech Republic entity for the creation of job positions and related training costs.

Income Tax Expense

Income tax expense primarily consists of corporate income taxes related to profits resulting from the sale of our software offerings by our United States and Irish entities. The rate of taxation on income earned by our United States entity is higher than the rate of taxation on income earned by our Irish entity. If our international income, as a percentage of total income, increases as we expect, then our effective income tax rate should correspondingly decline. However, our effective tax rate may be affected by many other factors, such as changes in tax laws, regulations or rates, new interpretations of existing laws or regulations, the impact of accounting for stock-based compensation, the impact of accounting for business combinations, changes in our international structure, shifts in the amount of taxable income earned in the United States, as compared with other regions in the world, and changes in overall levels of income before tax.

We benefit from the tax credit incentives under the U.S. research and experimentation tax credit extended to taxpayers engaged in qualified research and experimental activities while carrying on a trade or business. The tax credit expired on December 31, 2011, and if not renewed under similar terms as in prior years, the result could have a material impact on our financial results. In 2011 and 2010, we received a benefit to our income tax expense from these research and development tax credits of \$2.0 million and \$3.0 million, respectively.

Critical Accounting Policies and Estimates

Our financial statements are prepared in conformity with United States of America generally accepted accounting principles, or GAAP, and require our management to make estimates and assumptions that affect the reported amounts and disclosures. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances; however, actual results could differ from those estimates. We believe certain accounting policies requiring significant management judgment are critical to understanding our historical and future performance, as these policies relate to the more significant areas involving management's judgment and estimates. These critical accounting policies include valuation of goodwill, intangibles, long-lived assets and contingent consideration, revenue recognition, stock-based compensation and income taxes.

Acquisitions, Goodwill and Identifiable Intangible Assets. When we acquire businesses, we allocate the purchase price to tangible assets and liabilities and identifiable intangible assets acquired. Any residual purchase price is recorded as goodwill. We must also estimate the fair value of any contingent consideration. The operating results of acquisitions are included in our consolidated financial statements from the effective date of the acquisition.

The fair value of identifiable intangible assets is based on significant judgments made by management. We typically engage third party valuation appraisal firms to assist us in determining the fair values and useful lives of the assets acquired. Such valuations and useful life determinations require us to make significant estimates and assumptions. These estimates and assumptions are based on historical experience and information obtained from management, and also include, but are not limited to, future expected cash flows earned from the intangible asset and discount rates applied in determining the present value of those cash flows. Unanticipated events and circumstances may occur that could affect the accuracy or validity of such assumptions, estimates or actual results.

The acquired developed product technologies recorded for each acquisition were feasible at the date of acquisition as they were being actively marketed and sold by the acquired company at the acquisition date. In addition to the acquired developed product technologies, we also record intangible assets for the acquired company's customer relationships, trademarks and non-competition covenants.

Table of Contents

An impairment of goodwill or indefinite lived intangible assets is recognized when the carrying amount of the assets exceeds their fair value. The process of evaluating the potential impairment is highly subjective and requires the application of significant judgment. For purposes of the annual impairment test, we consider our market capitalization compared with the carrying amount of our net assets on the date of the test, since we have only one reporting unit. If an event occurs that would cause us to revise our estimates and assumptions used in analyzing the value of our goodwill and other intangible assets with indefinite lives, the revision could result in a non-cash impairment charge that could have a material impact on our financial results. As of December 31, 2011 and 2010, we performed our annual review of goodwill and indefinite lived intangible assets and concluded that no impairment existed for our reporting unit during any of the periods presented. No impairment charges have been required to date.

We evaluate long-lived assets, including identifiable intangible assets and other assets, for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. Events or changes in circumstances that could result in an impairment review include, but are not limited to, significant underperformance relative to historical or projected future operating results, significant changes in the manner of use of the acquired assets or the strategy for our overall business, and significant negative industry or economic trends. If an event occurs that would cause us to revise our estimates and assumptions used in analyzing the value of our property and equipment or our finite-lived intangibles and other assets, that revision could result in a non-cash impairment charge that could have a material impact on our financial results. As of December 31, 2011 and 2010, there were no indicators that our long-lived assets were impaired.

Contingent Consideration. Our acquisitions may include contingent consideration payments based on future sales or product milestones of an acquired entity. We estimate the fair value of contingent consideration liabilities based on certain milestones of the acquired companies and estimated probabilities of achievement and discount the liabilities to present value using a weighted-average cost of capital. We believe our estimates and assumptions are reasonable, however, there is significant judgment involved. Changes in the fair value of contingent consideration liabilities may result from changes in discount periods, changes in the timing and amount of sales and/or other specific milestone estimates and changes in probability assumptions with respect to the likelihood of achieving the various earnout criteria. At each reporting date, the contingent consideration liability is revalued to estimated fair value and changes in fair value subsequent to the acquisitions are reflected in net income in the consolidated statements of income and could cause a material impact to, and volatility in, our operating results.

Revenue Recognition

We derive substantially all of our revenue from the licensing of our software products and from the sale of maintenance agreements. We typically include one year of maintenance as part of the initial purchase price of each software offering and then sell renewals of this maintenance agreement. In accordance with current guidance, we recognize revenue for software, maintenance and other services when persuasive evidence of an arrangement exists, delivery has occurred, the sales price is fixed or determinable and collectability is probable. Our return policy generally does not allow our customers to return software offerings.

License Revenue. We consider delivery of our software to have occurred and recognize revenue from the sale of perpetual licenses to our software when risk of loss transfers to the customer or reseller, which is generally upon electronic transfer of the license key that provides immediate availability of the product to the purchaser.

We sell licenses to our software products through our direct inside sales force and through our distributors and other resellers. Our distributors and resellers do not carry inventory of our software and we generally require them to specify the end-user of the software at the time of the order. If the distributor or reseller does not provide end-user information, then we will generally not fulfill the order. Our distributors and resellers have no rights of return or exchange for software that they purchase from us and payment for these purchases is due to us without regard to whether the distributors or resellers collect payment from their customers.

Table of Contents

Because our software is generally sold with maintenance, we calculate the amount of revenue allocated to the software license by determining the fair value of the maintenance and subtracting it from the total invoice or contract amount. We establish vendor-specific objective evidence, or VSOE, of the fair value of maintenance services by the standard published list pricing for our maintenance renewals since we generally charge list prices for our maintenance renewals. If in the future we were unable to establish VSOE of fair value of the maintenance or other services we would defer all revenue over the term of the agreement and until all elements of the agreement had been delivered which could significantly impact the timing of our revenue recognition.

Maintenance and Other Revenue. We derive maintenance revenue from fees for software maintenance services which includes the maintenance portion allocated from the initial license transaction and any subsequent maintenance renewal transactions. We generally bill maintenance renewal agreements annually in advance for services to be performed over a 12-month period. Customers have the option to purchase maintenance renewals for periods longer than 12 months. We initially record the amounts to be paid under maintenance agreements as deferred revenue and recognize these amounts ratably on a daily basis over the term of the maintenance agreement. Customers with maintenance agreements are entitled to receive unspecified upgrades or enhancements to new versions of their software products on a when-and-if-available basis.

Other revenue consists primarily of training, consulting, subscription and product development services, which is recognized upon delivery of the training or consulting services to the end customer or when the development work is performed. We establish VSOE of fair value for training through the standard rates we charge for training when sold separately. Other revenue is not currently significant nor do we expect it to be significant in future periods.

Stock-Based Compensation

We have granted and expect to continue to grant our employees and directors stock-based incentive awards. These awards are in the form of stock options, restricted stock and restricted stock units. We measure stock-based compensation expense for all share-based awards granted based on the estimated fair value of those awards on the date of grant. The fair values of stock option awards are estimated using a Black-Scholes valuation model.

We use various assumptions in estimating the fair value of options at the date of grant using the Black-Scholes option model including expected dividend yield, volatility, risk-free rate of return and expected life. We have not paid and do not anticipate paying cash dividends on our common stock; therefore, we assume the expected dividend yield to be zero. Since we were a private entity prior to our IPO in May 2009 with no historical data regarding the volatility of our own common stock price, we based the expected volatility on the historical and implied volatility of comparable companies from a representative industry peer group. We determined expected volatility of options granted using an average of the historical volatility measures of this peer group of companies. We based the risk-free rate of return on the average U.S. treasury yield curve for five- and seven-year terms. As allowed under current guidance, we have elected to apply the simplified method in developing our estimate of expected life for plain vanilla stock options by using the midpoint between the vesting date and contractual termination date since we do not have sufficient historical exercise data to provide a reasonable basis upon which to estimate expected term due to the limited period of time our common stock has been publicly traded. For all dates, we granted employees options at exercise prices equal to the fair value of the underlying common stock at the time of grant, which is the closing price of our common stock as reported by the NYSE.

Income Taxes

We use the liability method of accounting for income taxes as set forth in the authoritative guidance for accounting for income taxes. Under this method, we recognize deferred tax liabilities and assets for the expected future tax consequences of temporary differences between the respective carrying amounts and tax basis of our assets and liabilities.

Table of Contents

The guidance on accounting for uncertainty in income taxes prescribes a recognition threshold and measurement attribute for financial statement disclosure of tax positions taken or expected to be taken on a tax return. At December 31, 2011 and 2010, we had \$4.0 million and \$1.4 million of gross unrecognized tax benefits, respectively, all of which, if recognized, would affect our effective tax rate.

We accrue interest and penalties related to unrecognized tax benefits as a component of income tax expense. As of December 31, 2011 and 2010, there was an insignificant amount accrued for interest and penalties related to unrecognized tax benefits.

In calculating our effective tax rate, we make judgments regarding certain tax positions, including the timing and amount of deductions and allocations of income among various tax jurisdictions.

The guidance requires us to identify, evaluate and measure all uncertain tax positions taken or to be taken on tax returns and to record liabilities for the amount of these positions that may not be sustained, or may only partially be sustained, upon examination by the relevant taxing authorities. Although we believe that our estimates and judgments are reasonable, actual results may differ from these estimates. Some or all of these judgments are subject to review by the taxing authorities.

We establish valuation allowances when necessary to reduce deferred tax assets to the amounts expected to be realized. On a quarterly basis, we evaluate the need for, and the adequacy of, valuation allowances based on the expected realization of our deferred tax assets. The factors used to assess the likelihood of realization include our latest forecast of future taxable income and available tax planning strategies that could be implemented to realize the net deferred tax assets.

We intend either to invest our non-U.S. earnings permanently in foreign operations or to remit these earnings to our U.S. entities in a tax-free manner. For this reason, we do not record federal income taxes on the undistributed earnings of our foreign subsidiaries.

Table of Contents*Comparison of the Years Ended December 31, 2011 and 2010*

| | 2011 (in thousands) | % of Revenue | Year Ended December 31, 2010 (in thousands) | % of Revenue | Change (in thousands) |
|-----------------------------------|------------------------|-----------------|---|-----------------|--------------------------|
| Revenue: | | | | | |
| License | \$ 92,254 | 46.5% | \$ 75,603 | 49.6% | \$ 16,651 |
| Maintenance and other | 106,104 | 53.5 | 76,790 | 50.4 | 29,314 |
| Total revenue | 198,358 | 100.0 | 152,393 | 100.0 | 45,965 |
| Cost of revenue | 11,989 | 6.0 | 7,930 | 5.2 | 4,059 |
| Gross profit | 186,369 | 94.0 | 144,463 | 94.8 | 41,906 |
| Operating expenses: | | | | | |
| Sales and marketing | 53,850 | 27.1 | 43,252 | 28.4 | 10,598 |
| Research and development | 21,332 | 10.8 | 15,731 | 10.3 | 5,601 |
| General and administrative | 28,076 | 14.2 | 23,476 | 15.4 | 4,600 |
| Accrued earnout gain | (664) | (0.3) | | | (664) |
| Total operating expenses | 102,594 | 51.7 | 82,459 | 54.1 | 20,135 |
| Operating income | 83,775 | 42.2 | 62,004 | 40.7 | 21,771 |
| Other income (expense): | | | | | |
| Interest income | 308 | 0.2 | 177 | 0.1 | 131 |
| Interest expense | | | (1,146) | (0.8) | 1,146 |
| Other income | 720 | 0.4 | 115 | 0.1 | 605 |
| Total other income (expense) | 1,028 | 0.5 | (854) | (0.6) | 1,882 |
| Income before income taxes | 84,803 | 42.8 | | | |