DemandTec, Inc.
Form 10-K
April 25, 2008

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-K

þ   **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended February 29, 2008

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

Commission file number 001-33634
DemandTec, Inc.
(Exact Name of Registrant as Specified in Its Charter)

Delaware	**7372**	**94-3344761**
(State or Other Jurisdiction of Incorporation or Organization)	*(Primary Standard Industrial Classification Code Number)*	*(I.R.S. Employer Identification Number)*

One Circle Star Way, Suite 200
San Carlos, California 94070
(Address of Principal Executive Offices)

(650) 226-4600
(Registrant s Telephone Number)

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

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, par value $0.001 per share	The NASDAQ Stock Market LLC (NASDAQ Global Market)

Securities registered pursuant to Section 12(g) of the Exchange Act:
None

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the preceding 12 months (or for such shorter period that the registrant was required to file such

reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ   No o

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

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 o   Accelerated filer o   Non-accelerated filer þ   Smaller reporting company o

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

As of August 31, 2007, the last business day of the registrant s most recently completed second fiscal quarter, the aggregate market value of shares of the registrant s common stock held by non-affiliates of the registrant (based upon the closing sale price of $9.59 per share on the NASDAQ Global Market on such date) was approximately $118.6 million.

As of March 31, 2008, there were 26,488,941 shares of the registrant s common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant s definitive proxy statement for its fiscal 2008 Annual Meeting of Stockholders (the   Proxy Statement) are incorporated by reference in Part III of this Report on Form 10-K. 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.

DemandTec, Inc.

Table of Contents

PART I

This Annual Report on Form 10-K contains forward-looking statements that involve risks and uncertainties. Please see the section entitled   Forward-Looking Statements   in Item 7 of this Annual Report on Form 10-K for important information to consider when evaluating these statements.

Item 1.   *Business*

Overview

We are a leading provider of Consumer Demand Management, or CDM, solutions. CDM is a software category based on quantifying consumer demand and using that understanding to make better merchandising and marketing decisions. Our software services enable retailers and consumer products, or CP, companies to define merchandising and marketing strategies based on a scientific understanding of consumer behavior and make actionable pricing, promotion and other merchandising and marketing recommendations to achieve their revenue, profitability and sales volume objectives. We deliver our applications by means of a software-as-a-service, or SaaS, model, which allows us to capture and analyze the most recent retailer and market-level data and enhance our software services rapidly to address our customers   ever-changing merchandising and marketing needs.

Our CDM solutions consist of software services and complementary analytical services. We offer our solutions individually or as a suite of integrated software services.

Our solutions for the retail industry include:

DemandTec Lifecycle Price Optimization^{tm}, which enables retailers to strategically manage pricing for items throughout their stores, including regular items, promoted items, and markdown items.

DemandTec Collaborative Promotion Management^{tm} for Retailers, which supports retailers   end-to-end promotion planning processes, including suppliers, internal workflow, and downstream execution.

Our solutions for the CP industry include:

DemandTec Trade Planning & Optimization^{tm}, which enables CP companies to improve their return on investment on spending for both trade promotions and everyday price reductions.

DemandTec Collaborative Promotion Management^{tm} for CP Companies, which includes services connecting CP companies with their customers (the retailers) in an end-to-end promotion management process.

Underlying our solutions for both the retail and the CP industries is the DemandTec TradePoint Network^{tm}, an Internet-based platform of software services used by retailers and their suppliers to transact, interact, and collaborate. Using our solutions via the DemandTec TradePoint Network^{tm}, retailers and CP companies can streamline business processes, access advanced analytics, and enhance collaboration based on retailer-driven rules of engagement.

Industry Background

Retail trade is one of the world s most widespread activities. There are more than 1,500 retailers worldwide that have annual sales in excess of $500 million. Retailing is highly competitive and generally characterized by low profit

margins. Furthermore, there are thousands of CP companies that sell to retailers. The CP industry is becoming increasingly competitive due to factors such as retailer consolidation, more discerning and less loyal consumers and the growing impact of private label products. To counter these trends, CP companies are making substantial investments in product innovation, market research, branding, and consumer and brand marketing.

Consumer Demand and Pricing Challenges

Retailers compete for consumers who are becoming more knowledgeable, more selective and, in many instances, more price sensitive. Consumers today devote considerable time to researching products and comparing prices prior to shopping and have a greater array of choices in price, size, brand, color and features. The growth of discount stores, warehouse clubs and dollar stores and the emergence of the Internet as a viable retail destination

3

offer consumers further alternatives when purchasing goods. Recent increases in the costs of fuel and other commodities have further increased the average consumer s price sensitivity. For retailers to compete effectively, they need to better understand and respond to these changes in consumer demand and behavior through targeted pricing, marketing and merchandising strategies.

A basic principle of economics is that a change in the price of an item will affect demand for that item. Every item in a store has a unique price elasticity, or sensitivity between sales volume and price. Small decreases or increases in the prices of some items may lead to significant changes in the demand for those items, whereas larger decreases or increases in the prices of other items may have little effect on demand. In addition, changes in the prices of items in a store often have an impact on the sales volumes of other items in that store. This interdependence is referred to as the cross elasticity of demand. Demand is influenced by a wide variety of additional factors, including store location, customer demographics, advertising, in-store displays, the availability of complementary or substitute products, seasonality, competitive activity and loyalty and marketing programs. These variables make calculating price elasticity for even a single item an extremely data-intensive and complex process. Calculating the cross-elasticity of demand for thousands of items is exponentially more difficult.

Applying these economic concepts to make day-to-day pricing decisions presents enormous challenges to retailers of all sizes, particularly large retailers that sell tens of thousands of items and have hundreds, if not thousands, of stores. These retailers must determine how to price each particular item and whether to vary the price among different regions or individual locations. They also must determine the price of each item relative to competing products and the likely impact on their aggregate profitability if the prices of that item or competing items are increased or decreased. In addition, retailers may want to consider whether promoting an item would result in increased sales volume and, if so, whether that increase would represent incremental revenue or merely cannibalize sales of other items. These pricing and marketing decisions must also strike a balance between the retailer s financial goals and its desired price and brand image in order to enhance consumer loyalty and maximize sustainable, lifetime value from its targeted consumer segments.

CP companies make similar, complex decisions when pricing and promoting their products. Like retailers, CP companies are faced with rising costs, intense competition, less loyal consumers and an operating environment in which it is difficult to raise prices. CP companies must understand how consumers will respond to promotions, how price changes will affect sales volumes, and how often to promote their brands. CP companies also must decide when and how to use trade funds in the form of discounts, offsets or direct cash payments to compensate retailers for offering temporary price reductions on their products. According to Capgemini, most CP companies trade promotion budgets represent 15% or more of their net sales, which percentage is second only to their cost of goods sold. In 2003, CP companies in the grocery channel alone spent over $25 billion on trade promotions according to Accenture, and we believe trade promotion budgets continue to rise across the CP industry. Despite the pervasive use of trade funds, studies suggest that over 90% of trade promotions have negative returns on investment after taking into consideration execution costs and unintended cannibalization.

The trade promotion process is not only generally unprofitable, but also highly inefficient. Submitting and negotiating trade promotions historically have been handled through a combination of fax, voicemail and manual, paper-based processes. This has led to frequent inaccuracies and increasing costs for both CP companies and retailers. CP companies and retailers have lacked an accurate, integrated technology platform for improving the efficiency of their trading relationships.

In order to attain higher revenue growth, improve profit margins and increase market share, while maintaining proper price and brand image, retailers and CP companies must better understand and predict consumer behavior across geographic, demographic, gender, age, income and other segments. However, achieving these objectives through day-to-day pricing and other merchandising and marketing decisions is extremely complex.

Existing Approaches to Understanding Consumer Demand

Retailers and CP companies have made significant investments in information technology, or IT. Most of these IT investments have focused on achieving cost reductions through increased operational efficiencies and transaction automation, including supply chain management, point of sale, or POS, systems, and marketing automation software.

4

As a result of these IT investments, retailers have accumulated vast amounts of sales data. While a number of academic techniques exist to analyze this data, incorporating advanced statistical analytics into a commercially-useful solution that yields meaningful and actionable insights for retailers and CP companies presents significant scientific, engineering, processing and cost challenges due to the vast amounts of data and the complexities of mathematical computing. Consequently, existing approaches that incorporate an understanding of consumer demand into retail and CP pricing decisions generally have been limited to modeling sample data sets to provide limited insights. As a result, retailers and CP companies historically have made merchandising decisions based on simpler approaches such as:

cost-plus or competitor-matching pricing;

national pricing of items, regardless of local consumer demand and competitive dynamics;

one-size-fits-all assortments of goods, regardless of the unique preferences of consumers who shopped in each location;

habitual promotions, advertisements, mailers and other marketing programs; and

engaging business consultants to provide isolated category-based analyses.

In today s environment, retailers and CP companies need scalable enterprise software that is capable of modeling the numerous variables that affect consumer demand and processing massive data sets in a cost-effective manner and that delivers actionable merchandising and marketing recommendations to achieve their revenue, profitability and sales volume objectives.

DemandTec Solution

We are a leading provider of CDM solutions. Our software services enable retailers and CP companies to define merchandising and marketing strategies based on a scientific understanding of consumer behavior and make actionable pricing, promotion and other merchandising and marketing recommendations to achieve their revenue, profitability and sales volume objectives. We deliver our applications by means of a SaaS model, which allows us to capture and analyze the most recent retailer and market-level data and enhance our software services rapidly to address our customers ever-changing merchandising and marketing needs.

Understand and predict consumer behavior to make merchandising and marketing recommendations that achieve revenue, profitability and sales volume objectives

Our software services enable retailers and CP companies to incorporate a scientific understanding of consumer demand into their day-to-day merchandising and marketing decision-making processes. By using our software, our customers can achieve their revenue, profitability and sales volume objectives, while striking a balance with their desired price and brand images in order to enhance consumer loyalty and maximize the lifetime value of the consumer. Specifically, our software services allow retailers and CP companies to:

make daily pricing, promotion and other merchandising and marketing decisions based on consumer demand;

balance financial goals with price and brand image in order to maximize the lifetime value of their targeted consumer segments;

enforce pricing rules consistently;

forecast sales more accurately;

devise more targeted promotions based on consumer segmentation insights; and

allocate trade funds more effectively and efficiently.

5

Incorporate scalable science into merchandising and marketing decision-making processes

We incorporate advanced econometric modeling techniques and optimization theory into scalable software services that our customers use to make day-to-day merchandising and marketing decisions. Our software automates the process of predicting consumer response to various merchandising and marketing activities, such as pricing, promotion, assortment, loyalty programs and media. Our proprietary demand models quantify consumer response at the individual store and item levels based on a number of factors, including store location, consumer demographics, advertising, in-store displays, the availability of complementary and substitute products, seasonality, competitive activity and loyalty and marketing programs. Our software incorporates optimization science that uses a combination of complex algorithms to help our customers determine in real-time the prices, promotions and markdowns that best accomplish their merchandising and marketing objectives, while complying with their business rules.

Leverage technological advancements through a SaaS delivery model that enables us to adapt to our customers changing business needs rapidly and to deliver results quickly

Our SaaS model leverages a set of pervasive technology trends that includes the availability of greater amounts of computing power at commercially affordable and decreasing prices, dramatic reductions in the cost of data storage and inexpensive and secure access to broadband communication networks. This model represents a dramatic shift from developing and delivering static, highly-customized software code that is installed at the customer s site. Due to the dynamic nature of consumer demand and the changing merchandising and marketing objectives of retailers and CP companies, we believe a CDM solution is delivered most effectively through a SaaS model. By delivering our software as a service, we are able to:

> capture and analyze the most current POS data, transaction log data and loyalty program data from retailers, as well as up-to-date market-level data, syndicated data and other third-party demographic content, in order to better understand the dynamic nature of consumer behavior;

> intimately understand how our customers use our software to make their day-to-day merchandising and marketing decisions so we can continuously enhance our offering to address our customers business needs;

> deliver technical enhancements to our software on a frequent and predictable schedule and with little or no disruption to our customers operations;

> utilize grid computing and service-oriented-architecture, or SOA, techniques to maximize scalability and processing capacity; and

> enable interoperability across our customers diverse legacy systems.

By delivering our software as a service, we quickly enable our customers to make better pricing, promotion, trade funds management and other day-to-day merchandising and marketing decisions. With our SaaS model, our customers are able to begin to achieve measurable financial results within a matter of months.

Strategy

Our objective is to extend our position as a leading provider of CDM solutions. Key elements of our strategy to achieve this objective include:

Extending our market position with major retailers worldwide. The retail industry is an international business, with a significant portion of the world s retailers based outside of the United States. We intend to use our market position and distribution investments to pursue additional retail opportunities around the world, leveraging our partnerships and multi-language product capabilities. We believe that our existing retail customers have the ability to influence other retailers worldwide by changing the competitive dynamics in their respective markets.

Expanding our relationships with our existing retail customers. We plan to continue to deliver measurable business results to our existing retail customers in order to encourage their renewals of their existing solutions as well as their adoption of incremental solutions. A key element of our strategy is to leverage our

6

domain expertise, proprietary software platform and advanced analytical capabilities to expand our CDM solutions.

Using our presence with retailers to create and expand our relationships with their CP trading partners. By leveraging our ability to deliver existing and new software services through our DemandTec TradePoint Network, we intend to use our existing retail customer relationships to create and expand our relationships with their CP trading partners. Our retail customers are able to mandate that their CP trading partners submit and negotiate their future trade promotion offers electronically through the DemandTec TradePoint Network. We believe there is a significant opportunity to expand our market presence by way of a network effect driven by cost efficiencies and a common business language.

Products

Overview

Our CDM solutions consist of one or more software services and complementary analytical services. We offer our solutions individually or as a suite of integrated software services. Our software services are configurable to accommodate individual customer needs.

Our solutions for the retail industry include:

DemandTec Lifecycle Price Optimization^{tm}, which enables retailers to strategically manage pricing for items throughout their stores, including regular items, promoted items, and markdown items.

DemandTec Collaborative Promotion Management^{tm} for Retailers, which supports retailers end-to-end promotion planning processes including suppliers, internal workflow, and downstream execution.

Our solutions for the CP industry include:

DemandTec Trade Planning & Optimization^{tm}, which enables CP companies to improve their return on investment on spending for both trade promotions and everyday price reductions.

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Underlying our solutions for both the retail and the CP industries is the DemandTec TradePoint Network^{tm}, an Internet-based platform of software services used by retailers and their suppliers to transact, interact, and collaborate. Using our solutions via the DemandTec TradePoint Network^{tm}, retailers and CP companies can streamline business processes, access advanced analytics, and enhance collaboration based on retailer-driven rules of engagement.

Our proprietary software platform is the foundation for our software services and analytical services. We have developed this platform to transform vast amounts of raw and underutilized business data into actionable insights in an efficient and cost-effective manner. Our platform provides scalability, advanced analytics and an integrated view of demand for each of the DemandTec services.

MyDemandTec is the common, configurable dashboard for all of our applications. Based on industry-standard portal technology, MyDemandTec consolidates web-based content and information through a common portal, providing users with context to make pricing, promotion and other merchandising and marketing decisions and to organize tasks. MyDemandTec can incorporate third-party content within its windows or can exist within a customer s broader

corporate intranet or other portal system.

7

Each of our solutions for the retail industry and the CP industry consists of one or more of the following software services, along with complementary analytical services:

Everyday Price Optimization and Everyday Price Management (together previously referred to as DemandTec Price)

Everyday Price Optimization and Everyday Price Management enable retailers and CP companies to establish everyday prices for their products, using both optimization techniques based on a scientific understanding of consumer behavior as well as rules-based pricing methods.

Everyday Price Optimization: Using Everyday Price Optimization, customers create scenarios in which they define strategic objectives such as increased revenues, profitability and/or sales volume and optimize prices to best achieve these objectives. A typical strategic objective might be to maximize net margins, while not sacrificing more than a certain defined percentage of sales volume.

Retailers use Everyday Price Optimization to optimize and set retail prices in their stores based on their unique cost structure and strategic goals. Everyday Price Optimization would likely generate different optimized prices for the same item carried by competing retailers in stores located in the same geographic location, since consumer behavior varies between competitors and each retailer has its own vendor costs and strategic pricing objectives.

Key features of Everyday Price Optimization include:

> *Optimization and forecasting* full category price optimization, with store/item level forecasting of revenue, profitability and sales volume at various price points;

> *Image item analysis* determines effective price image items for key consumer segments;

> *Rules management and rules-based pricing* a set of retail pricing rules with a rules editor and rules relaxation capabilities to handle conflicts; and

> *Benefits reporting* the ability to validate the effects of price optimization on actual sales of a particular category and to understand the degree to which factors such as promotions, seasonality and macroeconomic shifts contributed to sales.

Everyday Price Management: Using Everyday Price Management, customers define pricing rules and apply those rules-based prices to merchandise categories that are not modeled and optimized using Everyday Price Optimization. In addition, customers maintain both optimized and rules-based prices using Everyday Price Management as vendor costs and competitor prices change.

Key features of Everyday Price Management include:

> *Rules management and rules-based pricing* a set of retail pricing rules with a rules editor and rules relaxation capabilities to handle conflicts;

> *Advanced price maintenance* operational price management features to handle frequent vendor cost changes and competitive price changes; and

> *Price delivery* regularly scheduled delivery of recommended base prices to customers.

Both Everyday Price Optimization and Everyday Price Management utilize a library of configurable business rules that act as constraints on the optimization by limiting the set of possible outcomes. For example, a customer can ensure that larger size items always cost more than smaller size items but are a better value, or that an optimized price is within a given percentage of a competitor s price.

8

Promotion Planning & Optimization (previously referred to as DemandTec Promotion)

Promotion Planning & Optimization enables retailers and CP companies to create and simulate multiple scenarios based on mathematical forecasts of results in order to evaluate tradeoffs among various promotions such as discounts, advertisements and displays. Key features of Promotion Planning & Optimization include:

Category plan and master calendar management the ability to generate, view and forecast promotion calendars, taking into account factors such as cannibalization of regular priced items, concurrent promotions and the pantry-loading effect of successive promotions;

Promotion offer support the ability to enter key promotion performance details that drive promotion response, as well as CP company allowances that drive financial performance for individualized promotions;

Event and tactic management the ability to plan and manage different promotional events and capture individual performance details such as holidays, features and in-store displays;

Deal Management integration the ability for all vendor offers entered into DemandTec s Deal Management software service (previously referred to as DemandTec TradePoint) to flow directly into Promotion Planning & Optimization for analysis, optimization and forecasting; and

Pre-configured outbound interfaces the ability to export promotional forecast information to supply chain systems, promotional details to advertisement execution systems, and other details to other customer systems.

Retailers use Promotion Planning & Optimization to evaluate and forecast the likely results from incoming vendor offers, as well as to plan private label and other promotions. CP companies use Promotion Planning & Optimization to maximize the effectiveness and efficiency of the trade funds investments they make with retailers by developing plans that are effective for both their brands and the retailers product categories.

Markdown Optimization (previously referred to as DemandTec Markdown)

Markdown Optimization enables retailers to optimize plans and prices for items they intend to remove from their assortments, such as end-of-season items, discontinued product lines or overstocked merchandise. Key features of Markdown Optimization include:

Scenario management the ability to create and forecast multiple scenarios in order to evaluate tradeoffs between timing and depth of markdown prices, as well as other factors such as the number of markdowns taken within a time period;

Rules management the ability to configure markdown-specific rules; and

Re-optimization the ability to re-optimize plans and prices on a weekly basis to adjust for changes in demand and inventory position.

Retailers use Markdown Optimization to eliminate excess inventory by a specified date after which an item will no longer be sold and to maximize profitability of items sold before that date.

Deal Management (previously referred to as DemandTec TradePoint)

Deal Management enables retailers and CP companies to automate and streamline the presentation, negotiation and reconciliation of trade promotion offers. The Deal Management and Promotion Planning & Optimization services are integrated such that offers entered by CP companies are available for analysis, optimization and forecasting by retailers, and both parties can manage the status of those trade promotions in an interactive, collaborative environment. Key features of Deal Management for the retailer include:

Proprietary offer sheet mapping   uses each retailer s existing paper-based offer format to ease adoption by retailers;

Online deal center for both parties   provides a common platform for retailers and their trading partners to present and negotiate the terms of trade promotion offers;

9

Retailer item catalog-based entry   provides vendors use of retailer-specific item catalogs in order to eliminate data-entry errors;

Deal history archive   provides version control of offers, final contract terms, user activity and communications in order to facilitate regulatory compliance and dispute resolution; and

Accounting and reconciliation   provides for reconciliation of invoicing and deduction notices with CP trading partners.

When a retailer implements Deal Management, that retailer requires that all of its CP trading partners submit and negotiate their future trade promotion offers electronically through the Deal Management software service. We offer two editions of this service for CP companies: Deal Management,   which is offered at no charge and allows vendors to submit promotion offers by selecting valid items from the retailer s item catalog, and   Advanced Deal Management (previously referred to as VendorPlus), which is a paid upgrade that includes additional features specific to a CP company, such as accounting and reconciliation, transaction and workflow reporting, catalog management, vendor item catalog synchronization and deal history archiving.

Professional Services

Our professional services organization works closely with our customers to implement our software so that our customers can rapidly begin to achieve their merchandising and marketing objectives. The organization consists of field consultants and project managers, technology integration specialists, modeling experts, and training specialists with experience in implementing software in various retail and CP segments. Depending on a specific customer s requirements, we also may engage third parties to assist with implementations. We generally make our software available to a customer within two weeks of signing its agreement, with several of its product categories being fully operational within a matter of months.

The analytical services group within our professional services organization works with prospects and customers to identify actionable insights in order to improve our customers   returns on investment from using our software. Leveraging our software platform, retailer POS and loyalty data, and additional third-party data sources, we offer a number of strategic analytical insights both as part of our software and as customer-specific services. For example, we offer an affinity analysis, which summarizes millions of transaction-level records to identify sets of products frequently purchased together, and recommend subsequent strategies for maximizing consumer purchases.

The education group within our professional services organization provides education and training services to our customers and partners. The education group works closely with each customer or partner to design and deliver a training curriculum to match its needs. We deliver courses through lectures, written materials and e-learning modules. We also offer a   train-the-trainer   program for customers with extensive or ongoing training requirements.

Science and Technology

Science

Our science-based CDM software applies advanced statistical analytics in the following areas:

Demand Modeling. Our CDM software uses complex econometric models designed to predict accurately the sales volume of products under varying merchandising conditions and at various prices, which enables customers to determine the factors that influence consumer demand for a given product and location, and to what extent. Our

proprietary demand models quantify consumer response to different merchandising and marketing activities, environmental factors and elements of consumer behavior across various consumer segments. Since our models are non-linear, they are able to capture the complex underlying relationships between consumer demand and the factors that influence that demand.

Consumer-Centric Merchandising and Marketing. Individual consumers and particular consumer segments respond differently to price changes for different items. By applying various data mining and statistical techniques to analyze sales data and combining the results with additional data such as demographics, buying histories and item

10

affinities, our software enables our customers to understand consumer and product segmentation more fully, to determine more effective product assortments, and to design more individualized promotion offers. These techniques enable our customers to make more granular, and therefore more effective, merchandising and marketing decisions.

Forecasting and Simulation. Our forecasting software enables our customers to determine the likely revenue, profit and sales volumes for specific product categories, brands or promoted groups at the store/item level for a given set of prices and merchandising conditions. Our software does this by incorporating and analyzing factors such as product distribution, assortment and complementarity, cannibalization, stockpiling by consumers, equivalent volumes and discrete events such as holidays and localized merchandising categories. Our software also includes an activity-based costing model to quantify and forecast the store/item level margin impact caused by varying supply chain costs.

Optimization and Rules Enforcement. While demand modeling is a powerful tool that can provide quantifiable benefits, achieving those benefits would be difficult if our software relied solely upon modeling, because of the large number of possibilities that our models generate. Our optimization science uses a combination of complex algorithms to help customers determine prices, promotions and markdowns that best accomplish their objectives, while complying with their business rules. These algorithms are designed to ensure accurate results and incorporate rule relaxation that automatically resolves conflicts in business rules according to the customer s preferences.

Technology

Data Processing. We receive and process terabytes of customer data. This information is provided by retailers, CP companies and syndicated data providers on a daily or weekly basis and usually includes all of a retailer s POS transactions. We process data through our proprietary software platform, which integrates, validates and cleanses multiple data types and enhances data quality by identifying and correcting common data problems.

Grid Computing. The implementation of our advanced mathematical software requires substantial computing resources. To address this challenge, we distribute our software across a scalable grid of servers. This approach allows us automatically to partition large computational problems into smaller computations and to execute those computations in parallel across the grid. We design our grid architecture to ensure that optimizations are completed reliably and that computing resources are allocated dynamically to our various customers.

Enterprise Application Technology. Since our customers access our software through a web browser, no software is installed on our customers premises. Our portal technology allows us to incorporate content from other sources and allows our content to be shown in other applications and portals. Customers can configure the user interface, customer-specific fields, customer-specific workflow behavior and portal layout and content. Our scalable architecture allows us to add new customers without requiring us to make substantial incremental investments in IT infrastructure.

Enterprise Integration. We provide multiple integration points with our customers IT systems. Large incoming and outgoing data feeds use data-level integration to transfer bulk files on an automated basis. We use industry-standard web services protocols to communicate with customer systems and to process customer system requests. Our MyDemandTec portal technology enables user interface-layer integration between our system and our customers systems, allowing us to display content served by customer systems and to serve content to customer systems using industry-standard protocols.

SaaS Operations

Our operations organization is responsible for delivering our software as a service to our customers, which includes quality assurance, release deployment, database management and application tuning, systems monitoring and proactive problem detection and prevention, application availability and customer support.

Under our SaaS model, we release a new software version approximately every six weeks. Since June 1, 2004, we have released 31 new versions of our software, each one containing significant new functionality. Releases are deployed simultaneously to all of our customers. Prior to deployment, each release undergoes multi-stage testing

11

and substantial quality assurance, including build acceptance tests, regression test cases, customer integration tests and final system verification tests.

Our software is hosted in two data centers, one in San Jose, California and one in Sacramento, California. Each of these facilities includes advanced security, power redundancy, and disaster mediation safeguards and procedures such as biometric access control, onsite power generation and earthquake hardening.

We have implemented a comprehensive information security management program. As part of this program, our processes and procedures include: logical access controls such as certificate authentication, role-based authorization and detailed system logging; vulnerability management assessment and remediation; network security measures including encryption, firewalls and monitoring; strict data and software back-up procedures with regular rotations to a secure, offsite storage location; and network and system redundancy to provide application resiliency.

In March 2008, an independent accounting and auditing firm completed an audit of our controls over information technology and processes in accordance with Statement on Auditing Standards No. 70, or SAS 70. This firm issued a SAS 70 Type II report confirming that suitably-designed controls were in place and operating effectively.

Superior customer support is critical to customer satisfaction and to retaining and expanding our customer base. By leveraging our relationship with Sonata Services Limited in Shanghai, China, discussed below in   Research and Development,   we are able to provide customer support 24 hours a day, seven days a week through our support web portal and by telephone. Since we manage our software for our customers, we often are able to detect and resolve delivery problems or processing capacity needs well in advance of when a customer might actually notice the problem.

Our Customers

Today, our software as a service is used by over 165 customers worldwide. The following table sets forth our twenty largest retail customers based on annual contract value. Retailers together accounted for approximately 90% of our revenue in fiscal 2008, and Wal-Mart Stores, Inc., our largest customer in fiscal 2008, accounted for approximately 12% of our revenue in fiscal 2008.

Advance Auto Parts	Hannaford Bros. Co.
Best Buy Stores, L.P.	HEB Grocery Company, LP
Big C Supercenter Public Company Limited	Monoprix S.A.
Big Y Foods, Inc.	Office Depot, Inc.
BI-LO LLC	The Penn Traffic Company
Casino Supermarkets/Hypermarkets	RadioShack Corporation
Companhia Brasileira de Distribuição	Safeway Inc.
Food Lion, LLC	Target Corporation
Giant Food Stores, LLC	Toys R Us
Giant Eagle, Inc.	Wal-Mart Stores, Inc.

The following table sets forth our ten largest CP customers based on annual contract value:

Acosta Sales and Marketing*	General Mills Sales, Inc.
Advantage Sales & Marketing LLC*	Kraft Foods Global, Inc.
Cadbury Schweppes	Nestlé USA, Inc.

ConAgra Foods, Inc.   The Procter & Gamble Company
Crossmark, Inc.*   Tyson Foods, Inc.

*   Sales agency that brokers items on behalf of CP companies.

12

Sales and Marketing

We sell our CDM solutions through our direct sales organization, often in cooperation with entities such as systems integration firms, strategy consultants and syndicated data providers. Our sales organization is comprised of two distinct teams, one for retailers and one for the CP industry. We assign our sales directors to specific named target accounts. Solution consultants assist our sales directors in providing detailed technical and business expertise. After the first year of a customer s agreement term, we assign a strategic account executive who is responsible for managing the customer s satisfaction, agreement renewals and sales of additional software and services. Outside the United States, we have employee sales directors located in the United Kingdom, France and Japan.

Our marketing group assists our direct sales, partner and professional services organizations by providing sales tools, programs and training. Our outbound marketing programs are designed to develop awareness of DemandTec and to build our brand through participation in a variety of industry events, public relations, web-based seminar campaigns and other activities targeted at key executives and decision-makers in the industries we serve.

Every year, we host DemandBetter, a two-day conference for our customers that brings together executives from retailers and CP companies to share strategies and best practices. The conference features in-depth product, science and customer case study sessions.

Strategic Relationships

We continually seek to develop and foster alliances with third parties whose products, technologies and services complement our offerings. We work with industry leaders that assist in joint sales activities and software implementation. These relationships vary in complexity and scope and range from formal global alliances to informal regional relationships. Three firms with which we collaborate globally are ACNielsen, Inc., International Business Machines Corporation, or IBM, and Accenture LLP. We have had success working with these companies, and we believe that we can continue to work together to provide complementary solutions.

ACNielsen is a leading marketing information provider. In 2005, we entered into an exclusive agreement with ACNielsen to deliver consumer-centric merchandising solutions to fast moving consumer goods (FMCG) retailers around the globe. Retailers utilizing both our and ACNielsen s offerings can access a combination of consumer and market information, demand-modeling science and optimization software to generate merchandising plans.

The Global Business Services division of IBM provides business process outsourcing, systems integration and general consulting services. IBM has pre-existing relationships with many of our retail customers and prospects. We have worked with IBM to jointly sell and implement our solutions in multiple geographies.

Accenture has a strong retail industry practice that includes expertise and solutions focused on precision pricing. We have successfully collaborated with Accenture on joint sales and implementation efforts for a number of retail customers around the globe.

Research and Development

Under our SaaS model, we maintain and support only one version of our software. This enables us to focus our research and development expenditures on researching new methodologies for understanding and predicting consumer demand and developing new features and functionality. We concentrate our research and development efforts on:

improving our statistical modeling capabilities and advanced optimization techniques to enhance our understanding of consumer demand and consumer segmentation;

enhancing existing applications and developing new applications that leverage our software platform to address a broader set of CDM business requirements; and

enhancing our existing analytical services and developing new analytics and tools.