SMITH MICRO SOFTWARE INC
Form DEF 14A
July 16, 2008

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SCHEDULE 14A INFORMATION

PROXY STATEMENT PURSUANT TO SECTION 14(a) OF THE SECURITIES EXCHANGE ACT OF 1934

(AMENDMENT NO.___)

Filed by the Registrant þ

Filed by a Party other than the Registrant o

Check the appropriate box:

o Preliminary Proxy Statement
þ Definitive Proxy Statement
o Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))
o Definitive Additional Materials
o Soliciting Material Pursuant to §240.14a-12

Smith Micro Software, Inc.

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

þ Fee not required.
o Fee computed on table below per Exchange Act Rules 14a-6(i)(4) and 0-11.
(1) Title of each class of securities to which transaction

applies:

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(2) Aggregate number of securities to which transaction applies:

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(3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):

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(4) Proposed maximum aggregate value of transaction:

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o Fee paid previously with preliminary materials.o Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.
(1) Amount Previously Paid:

(2) Form, Schedule or Registration Statement No.:

(3) Filing Party:

(4) Date Filed:

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July 11, 2008

Dear Smith Micro Stockholders:

We are pleased to invite you to the Smith Micro Software, Inc. 2008 Annual Meeting of Stockholders that will be held at the offices of Reed Smith LLP, located at 355 South Grand Avenue, 28th Floor, Los Angeles, California 90071, on Thursday, August 14, 2008, at 10:00 a.m., Pacific Time.

The expected actions to be taken at the Annual Meeting, which include the election of directors, are described in the attached Proxy Statement and Notice of Annual Meeting of Stockholders. Included with this Proxy Statement is a copy of our Annual Report on Form 10-K for the year ended December 31, 2007, which we encourage you to read. It includes our audited financial statements and information about our operations, markets and products.

Your vote is important. Whether or not you plan to attend the Annual Meeting, you can be sure your shares are represented at the meeting by promptly completing, signing, dating and returning the enclosed proxy card in the pre-paid envelope provided for your convenience or, if eligible, voting by Internet. If you later decide to attend the Annual Meeting and wish to change your vote, you may do so simply by voting in person at the meeting.

We look forward to seeing you at the Annual Meeting.

Sincerely,

William W. Smith, Jr.

Chairman of the Board,

President & Chief Executive Officer

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SMITH MICRO SOFTWARE, INC.
51 Columbia
Aliso Viejo, CA 92656
NOTICE OF ANNUAL MEETING OF STOCKHOLDERS
TO BE HELD ON AUGUST 14, 2008

Notice is hereby given that the 2008 Annual Meeting of Stockholders (the Annual Meeting) of Smith Micro Software, Inc. (the Company) will be held at the offices of Reed Smith LLP, located at 355 South Grand Avenue, 28th Floor, Los Angeles, California 90071, on Thursday, August 14, 2008, at 10:00 a.m., Pacific Time, for the following purposes as more fully described in the Proxy Statement accompanying this notice:

1. To elect two (2) directors each to serve on our Board of Directors until the 2011 Annual Meeting of Stockholders or until their successors are duly elected and qualified;

2. To ratify the selection of Singer Lewak Greenbaum & Goldstein LLP as our independent auditors for the fiscal year ending December 31, 2008; and

3. To transact such other business as may properly come before the Annual Meeting or any adjournment or postponement thereof.

The close of business on July 10, 2008 has been fixed as the record date for the determination of stockholders entitled to notice of and to vote at the Annual Meeting and any adjournment or postponement thereof. Only stockholders of record at such time will be so entitled to vote. A list of stockholders entitled to vote at the Annual Meeting will be available for inspection at our executive offices located at 51 Columbia, Aliso Viejo, California 92656, and at the Annual Meeting.

You are cordially invited to attend the Annual Meeting. Whether or not you plan to attend the Annual Meeting, you can be sure your shares are represented at the meeting by promptly voting and submitting your proxy by Internet (if your shares are registered in the name of a bank or brokerage firm and you are eligible to vote your shares in such a manner) or by completing, signing, dating and returning the enclosed proxy card in the pre-paid envelope provided for your convenience. Should you receive more than one proxy because your shares are registered in different names and addresses, each proxy should be signed and returned to assure that all your shares will be voted. You may revoke your proxy at any time prior to the Annual Meeting. If you submit your proxy and then decide to attend the Annual Meeting and vote by ballot, your proxy will be revoked and only your vote at the Annual Meeting will be counted.

A majority of the outstanding shares of Common Stock entitled to vote must be represented at the Annual Meeting in order to constitute a quorum. Please return your proxy card in order to ensure that a quorum is obtained.

By Order of the Board of Directors,
ANDREW C. SCHMIDT
Corporate Secretary
Aliso Viejo, California
July 11, 2008

YOUR VOTE IS VERY IMPORTANT, REGARDLESS OF THE NUMBER OF SHARES YOU OWN. PLEASE READ THE ATTACHED PROXY STATEMENT CAREFULLY AND SUBMIT YOUR PROXY BY INTERNET IF ELIGIBLE OR BY COMPLETING, SIGNING AND DATING THE ENCLOSED PROXY CARD AS PROMPTLY AS POSSIBLE AND RETURNING IT IN THE ENCLOSED ENVELOPE.

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SMITH MICRO SOFTWARE, INC.
PROXY STATEMENT
FOR ANNUAL MEETING OF STOCKHOLDERS
To Be Held August 14, 2008

General

This Proxy Statement and the enclosed proxy card are furnished in connection with the 2008 Annual Meeting of Stockholders (the Annual Meeting) of Smith Micro Software, Inc. (Smith Micro, the Company, we, our or us will be held at the offices of Reed Smith LLP, located at 355 South Grand Avenue, 28th Floor, Los Angeles, California 90071, on Thursday, August 14, 2008, at 10:00 a.m., Pacific Time. Stockholders of record at the close of business on July 10, 2008, the record date, are entitled to notice of and to vote at the Annual Meeting and any adjournment thereof. This Proxy Statement, the enclosed proxy card and the Smith Micro Annual Report on Form 10-K for the fiscal year ended December 31, 2007 (the Annual Report) are being first mailed on or about July 20, 2008 to stockholders of record as of the record date.

Purpose of the Meeting

The specific proposals to be considered and acted upon at the Annual Meeting are summarized in the accompanying Notice and are described in more detail in this Proxy Statement. We are not aware of any matter to be presented other than those described in this Proxy Statement.

Voting

Our outstanding common stock, par value $0.001 per share (the Common Stock) is the only class of securities entitled to vote at the Annual Meeting. Common stockholders of record on July 10, 2008, the record date, are entitled to notice of and to vote at the Annual Meeting. As of July 10, 2008, there were 31,267,687 shares of Common Stock outstanding and approximately 183 holders of record, according to information provided by our transfer agent. Each share of Common Stock is entitled to one vote. Stockholders may not cumulate votes in the election of directors. A majority of the outstanding shares of Common Stock entitled to vote at the Annual Meeting will constitute a quorum.

All votes will be tabulated by our inspector of elections for the Annual Meeting who will separately tabulate affirmative and negative votes, abstentions and broker non-votes (*i.e.*, shares held by a broker or other nominee having discretionary power to vote on some matters but not others). Abstentions and broker non-votes are counted as present for purposes of determining the presence or absence of a quorum for the transaction of business. Abstentions will be counted towards the tabulations of votes cast on proposals presented to the stockholders and will have the same effect as negative votes. In the election of directors, the nominee receiving the highest number of affirmative votes shall be elected; broker non-votes and votes marked withhold will not affect the outcome of the election. Proposal 2 requires the affirmative vote of a majority of shares present in person or represented by proxy at the Annual Meeting and entitled to vote. Broker non-votes will not be counted for purposes of determining whether such proposals have been approved.

Proxies

Properly executed proxies will be voted in the manner specified therein. If no direction is made on the proxies, such properly executed proxies will be voted **FOR** the election of the nominees named under the caption Election of Directors as our directors, and **FOR** the ratification of the selection of Singer Lewak Greenberg & Goldstein LLP as our independent registered public accounting firm for the 2008 fiscal year. You may revoke or change your proxy at anytime before the Annual Meeting by filing with the Corporate Secretary at our principal executive offices at 51 Columbia, Aliso Viejo, California 92656 a notice of revocation or another signed Proxy with a later date. You may also revoke your proxy by attending the Annual Meeting and voting in person. Your attendance at the Annual Meeting does not, by itself constitute a revocation of your proxy. Please note that if your shares are held of record by a broker, bank or other nominee, you will not be able to vote in person at the Annual Meeting unless you have obtained and present a proxy issued in your name from the record holder.

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Voting Electronically via the Internet

If your shares are registered in the name of a bank or brokerage firm, you may be eligible to vote your shares electronically over the Internet. A large number of banks and brokerage firms provide eligible stockholders who receive a paper copy of the Annual Report and Proxy Statement the opportunity to vote in this manner. If your bank or brokerage firm allows for this, your voting form will provide instructions for such alternative method of voting. If your voting form does not reference Internet information, please complete and return the paper Proxy in the self-addressed, postage prepaid envelope provided.

Solicitation

The enclosed proxy is being solicited by our Board of Directors, and Smith Micro will bear the entire cost of solicitation, including the preparation, assembly, printing and mailing of this Proxy Statement, the proxy card and any additional solicitation materials furnished to the stockholders. Copies of solicitation materials will be furnished to brokerage houses, fiduciaries and custodians holding shares in their names that are beneficially owned by others so that they may forward solicitation material to such beneficial owners. We may reimburse such persons for their costs in forwarding the solicitation materials to such beneficial owners. In addition, the original solicitation of proxies by mail may be supplemented by a solicitation by Internet or other means by our directors, officers or employees. No additional compensation will be paid to these individuals for any such services, although we may reimburse reasonable out-of-pocket expenses. Except as described above, we do not presently intend to solicit proxies other than by mail.

Deadline for Receipt of Stockholder Proposals

Stockholders may present proposals for action at a future meeting only if they comply with the requirements of the proxy rules established by the Securities and Exchange Commission (SEC) and our Bylaws. Stockholder proposals that are intended to be presented at our 2009 Annual Meeting of Stockholders (the 2009 Annual Meeting) and included in the proxy solicitation materials related to that meeting must be received by us no later than March 22, 2009, which is 120 calendar days prior to the anniversary date of the mailing of this Proxy Statement. Stockholders are also advised to review our Bylaws which contain additional advance notice requirements, including requirements with respect to advance notice of stockholder proposals and director nominations. Under our current Bylaws, the deadline for submitting a stockholder proposal is not less than 30 days and no more than 90 days prior to the date of the Annual Meeting and the deadline for submitting a nomination for a director is not less than 60 days prior to the date of the Annual Meeting. Stockholder proposals must be in writing and should be addressed to the Corporate Secretary at our principal executive offices located at 51 Columbia, Aliso Viejo, California 92656.

In addition, the proxy solicited by the Board of Directors for the 2009 Annual Meeting will confer discretionary authority to vote on any stockholder proposal presented at that meeting, unless we receive notice of such proposal not later than June 5, 2009, which is 45 calendar days prior to the anniversary date of the mailing of this Proxy Statement. It is recommended that stockholders submitting proposals direct them to our Corporate Secretary and utilize certified mail, return receipt requested in order to provide proof of timely receipt. The Chairman of the Annual Meeting reserves the right to reject, rule out of order, or take other appropriate action with respect to any proposal that does not comply with these and other applicable requirements, including conditions set forth in our Bylaws and conditions established by the Securities and Exchange Commission.

We have not been notified by any stockholder of his or her intent to present a stockholder proposal from the floor at this year s Annual Meeting. The enclosed proxy grants the proxy holders discretionary authority to vote on any matter properly brought before the Annual Meeting.

MATTERS TO BE CONSIDERED AT ANNUAL MEETING
PROPOSAL 1:
ELECTION OF DIRECTORS

Our Amended and Restated Certificate of Incorporation and Bylaws provide for our Board of Directors to be divided into three classes, as nearly equal in number as is reasonably possible, serving staggered terms that expire in different years. At each annual meeting of stockholders, the successors to the class of directors whose term expires are elected to hold office for a term of three years. The term of one class of directors expires at each annual meeting. The preceding notwithstanding, directors serve until their successors have been duly elected and qualified or until they earlier resign, become disqualified or disabled, or are otherwise removed.

Our Board currently has six directors: Thomas G. Campbell, Samuel Gulko, Ted Hoffman, William C. Keiper, William W. Smith, Jr. and Gregory J. Szabo. The class whose term expires at this Annual Meeting contains two directors. The Nominating Committee of the Board of Directors selected, and the Board of Directors approved, Mr. Smith and Mr. Keiper as nominees for election at the Annual Meeting to the class being elected at this meeting. The enclosed proxy will be voted, unless authority is withheld or the proxy is revoked, **FOR** the election of each nominee for election named below to hold office until the date of our 2011 Annual Meeting or until his successor has been duly elected and qualified or until he earlier resigns, becomes disqualified or disabled, or is otherwise removed. Each returned proxy cannot be voted for a greater number of persons than the nominees named on the proxy. In the unanticipated event that a nominee becomes unable or declines to serve at the time of the Annual Meeting, the proxies will be voted for a substitute person selected by the Nominating Committee of the Board of Directors and approved by the Board of Directors. Each nominee for election has agreed to serve if elected, and management has no reason to believe that such nominee will be unavailable to serve.

Stockholders may communicate with members of the Board of Directors by mail addressed to the full Board, a specific member of the Board or to a particular committee of the Board at our principal executive offices located at 51 Columbia, Aliso Viejo, California 92656.

Directors and Nominees

Nominees for Directors for Term Ending at the 2011 Annual Meeting of Stockholders:

Name	Age	Present Position with the Company
William W. Smith, Jr.	60	Chairman of the Board, President and Chief Executive Officer
William C. Keiper (1)(2)	57	Director

(1) Member of Compensation Committee.

(2) Member of the Governance and Nominating Committee.

Mr. Smith co-founded Smith Micro and has served as our Chairman of the Board, President and Chief Executive Officer since inception in 1982. Mr. Smith was employed by Rockwell International Corporation in a variety of technical and management positions from 1975 to 1984. Mr. Smith served with Xerox Data Systems from 1972 to 1975 and RCA Computer Systems Division from 1969 to 1972 in mainframe sales and pre-sale technical roles. Mr. Smith received a B.A. in Business Administration from Grove City College.

Mr. Keiper became a director in May 2002. Mr. Keiper served as Chief Executive Officer of Hypercom Corporation (NYSE: HYC) from March 2005 through August 2007 and continued in a consulting capacity through the end of 2007. He was a member of the Hypercom Board of Directors from April 2000 through August 2007, and also served as its Chairman. Prior to joining Hypercom, Mr. Keiper was Chief Executive Officer of Arrange Technology LLC, a software development services outsourcing company, from April 2003 to March 2005. From January 1998 to March 2003, he served as a principal in mergers and acquisitions firms serving middle market software and information technology services companies. From January 1991 to September 1997, Mr. Keiper was Chief Executive Officer of Artisoft, Inc., a publicly traded networking and communications software company. He also served as Chairman of Artisoft from August 1993 to September 1997. Mr. Keiper holds a B.S. in Business degree (finance major) from Eastern Illinois University, a Juris Doctorate degree from Arizona State University and a Masters degree in International Management from the Thunderbird American Graduate School of International Management. In addition, Mr. Keiper is currently a director of Radyne Corporation, a publicly traded manufacturer of data transmission and reception products, systems and software, and Zones, Inc., a publicly traded direct marketing reseller of information technology products.

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Continuing Directors for Term Ending at the 2009 Annual Meeting of Stockholders:

Name	Age	Present Position with the Company
Thomas G. Campbell (1)(2)(3)	57	Director
Ted L. Hoffman (2)(4)	61	Director

(1) Member of Audit Committee.

(2) Member of the Compensation Committee.

(3) Member of the Governance and Nominating Committee.

(4) Member of the Mergers & Acquisitions Committee.

Mr. Campbell became a director in July 1995. From March 1999 to the present, he has served as the Executive Vice President of King Printing, Inc. From July 1996 to March 1999, he was the Vice President of Operations of Complete Concepts, Ltd., a manufacturer and distributor of women s accessories. From November 1995 to July 1996, Mr. Campbell was an independent management consultant specializing in corporate turnarounds. From February 1995 to November 1995, he served as the Chief Operating Officer of Laser Atlanta Optics, Inc. From 1985 to February 1995, he served in several senior management positions at Hayes, Inc., including Vice President of Operations and Business Development and as Chief Operating Officer and a member of the Board of Directors of Practical Peripherals, a Hayes subsidiary. Prior to 1985, Mr. Campbell was employed by Digital Equipment Corporation. Mr. Campbell attended Boston University.

Mr. Hoffman became a director in December 2005. He is the retired Vice President Technology Development of Verizon Wireless, a wireless voice and data carrier, where he was responsible for all technical product and service development. He was with Verizon Wireless, and its predecessor Bell Atlantic Mobile, from July 1993 until his retirement in August 2005. Mr. Hoffman was a member of the Board of Directors of Omnitel Pronto Italia, a Verizon Communications Wireless affiliate operating in Italy. He is a past officer and a member of the Board of Directors of the CDMA Development Group, an organization responsible for promotion, advancement, deployment and future developments of CDMA. He has served on the Wireless Engineering Advisory Board at Auburn University as well as on the Intel Communications Advisory Board. He is currently a member of the Board of Directors of w2bi, Incorporated, a developer of software solutions for wireless network operators and device manufacturers.
Mr. Hoffman began his telecommunications career at Bell Telephone Laboratories, which designs products and services for communications technology and conducts fundamental research in fields important to communications, in June 1969 as a member of the technical staff. He joined Bell Atlantic, a telephone and communications company, in August 1976, holding a variety of engineering, operations, marketing, external affairs, corporate planning and headquarters positions. Mr. Hoffman holds a B.A. from Elizabethtown College, a B.S. in Electrical Engineering from Penn State University, an M.S. in Electrical Engineering from Northwestern University and an M.B.A. from Drexel

University. He holds three patents.

Continuing Directors for Term Ending at the 2010 Annual Meeting of Stockholders:

Name	Age	Present Position with the Company
Samuel Gulko (1) (2)	76	Director
Gregory J. Szabo (1)(2)	60	Director

(1) Member of Audit Committee.

(2) Member of the Mergers & Acquisitions Committee.

Mr. Gulko became a director in October 2004. Since October 2006, Mr. Gulko has served as Chief Financial Officer, on a part-time basis, of Royal Standard Minerals Inc., an exploration and development company. In addition, since September 2002, he has provided tax and consulting services on a part-time basis to a limited number of clients. From July 1996 until his retirement in September 2002, Mr. Gulko functioned as the Chief Financial Officer, and as the Vice President of Finance, Secretary and Treasurer of Neotherapeutics, Inc., a publicly traded biotechnology company (now known as Spectrum Pharmaceuticals, Inc.). During this same period he also served as a member of the Board of Directors of Neotherapeutics, Inc. From April 1987 to July 1996, Mr. Gulko was self employed as a Certified Public Accountant and business consultant, as well as the part time Chief Financial Officer of several privately-owned companies. Mr. Gulko was a partner in the audit practice of Ernst & Young LLP, an accounting and business services firm, from September 1968 until March 1987. Mr. Gulko holds a B.S. in Accounting from the University of Southern California.

Mr. Szabo became a director in June 2001. From August 2002 to January 2004 Mr. Szabo served as the Chief Executive Officer of Ertek Solutions, LLC, a provider of antenna technology to the wireless industry focusing on high performance low cost RFID Tag antennas and inlays, which he co-founded. Mr. Szabo currently serves on the Board of Directors, and was formerly the Chairman, of Ertek. From April 1987 to June 2000 Mr. Szabo served in a series of senior management positions with AirTouch Cellular, Vodafone and Verizon Wireless. As Vice President-Network Services, he directed the engineering and operations of AirTouch s cellular systems in the eastern United States. As Executive Director Global Technology for Vodafone AirTouch he was a member of the Advanced Services Council and responsible for the Next Generation Network initiative. Prior to AirTouch, Mr. Szabo held managerial positions with Motorola and Martin Marietta. Mr. Szabo holds both a B.S. and an M.S. in Electrical Engineering from the Ohio University.

Board Independence

The Board of Directors has determined that Messrs. Campbell, Gulko, Hoffman, Keiper and Szabo are independent within the meaning of the listing standards of the Nasdaq Stock Market, as currently in effect.

Board Meetings and Committees

Our Board of Directors held 13 meetings and acted by written consent 1 time during 2007. Each director attended or participated in 75% or more of the aggregate number of meetings of the Board and of meetings of the committees of the Board on which such director served.

Although we do not have a formal policy regarding attendance by members of the Board of Directors at our annual meeting of stockholders, directors are encouraged to attend our annual meetings. One of our current directors attended our annual meeting of stockholders in 2007.

Our board of directors has established four standing committees: an audit committee; a compensation committee; a governance and nominating committee; and a mergers and acquisitions committee. Each of these committees has adopted a written charter. All members of the committees are appointed by the Board of Directors and are non-employee directors and independent within the meaning of the Nasdaq Stock Market listing standards.

Audit Committee. Our Audit Committee is comprised of three members: Messrs. Campbell, Gulko and Szabo. The Board of Directors has determined that all of these members of the Audit Committee are independent within the meaning of the Nasdaq Stock Market listing standards and also within the meaning of Rule 10A-3 of the Securities Exchange Act of 1934, as amended (the Exchange Act), and that each member can read and has an understanding of fundamental financial statements. The Audit Committee reviews our financial statements and accounting practices, makes recommendations to the Board of Directors regarding the selection of our independent registered public accounting firm and reviews the results and scope of our annual audit and other services provided by our independent registered public accounting firm. The Audit Committee also is responsible for establishing, and has established, procedures for the receipt, retention and treatment of complaints regarding accounting, internal accounting controls or auditing matters, and for the confidential, anonymous submission by our employees of concerns regarding questionable accounting or auditing matters. In addition, all related party transactions are reviewed and approved by the Audit Committee. The Board of Directors has adopted and approved an amended and restated written charter for the Audit Committee. A current copy of this charter is posted on our web site at http://www.smithmicro.com under the Investor Relations section. Mr. Gulko is the Audit Committee Chairman and has been designated by the Board of Directors as the Audit Committee s financial expert, as that term is described in the rules of the SEC. The Audit Committee held 6 meetings during 2007.

Compensation Committee. The Compensation Committee is comprised of three members: Messrs. Campbell, Hoffman and Keiper. The Board of Directors has determined that all the members of the Compensation Committee are independent within the meaning of the Nasdaq Stock Market listing standards. The Compensation Committee administers our executive compensation programs and makes recommendations to the Board of Directors concerning officer and director compensation. The Compensation Committee also has the authority to administer the Amended and Restated Smith Micro 2005 Stock Option/Stock Issuance Plan (the 2005 Plan) and to award stock options and direct stock issuances under that plan to our officers and employees. The Board of Directors has adopted and approved a written charter for the Compensation Committee. A current copy of this charter is posted on our web site at http://www.smithmicro.com under the Investor Relations section. The Compensation Committee held 4 meetings during 2007.

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Governance and Nominating Committee. The Governance and Nominating Committee (the Nominating Committee) is comprised of two members: Messrs. Keiper and Campbell. The Board of Directors has determined that all the members of the Nominating Committee are independent within the meaning of the Nasdaq Stock Market listing standards. The Nominating Committee receives proposed nominations to the Board of Directors, reviews the eligibility of each proposed nominee, and nominates, with the approval of the Board of Directors, new members of the Board of Directors to be submitted to the stockholders for election at each annual meeting. The Board of Directors has adopted and approved a written charter for the Nominating Committee. A current copy of this charter is posted on our web site at http://www.smithmicro.com under the Investor Relations section. The Nominating Committee held 1 meeting during 2007.

When considering a potential candidate for membership on our Board of Directors, our Nominating Committee considers relevant business and industry experience and demonstrated character and judgment. There are no differences in the manner in which the Nominating Committee evaluates a candidate that is recommended for nomination for membership on our Board of Directors by a stockholder. The Nominating Committee has not received any recommended nominations from any of our stockholders in connection with this Annual Meeting. Each of the current nominees for this Annual Meeting is standing for re-election.

The Nominating Committee will consider stockholder nominations for directors submitted in accordance with the procedure set forth in Article II, Section 12 of our Bylaws. The procedure provides that a notice relating to the nomination must be timely given in writing to our Corporate Secretary prior to the meeting. To be timely, the notice must be delivered within the time permitted for submission of a stockholder proposal as described herein under Deadline for Receipt of Stockholder Proposals. Such notice shall set forth (a) as to each person whom the stockholder proposes to nominate for election or reelection as a director, (i) the name, age, business address and residence address of each such person, (ii) the principal occupation or employment of such person, (iii) the class and number of shares of Smith Micro Common Stock that are beneficially owned by such person and (iv) any other information relating to such person that is required to be disclosed in solicitations of proxies for election of directors, or is otherwise required, in each case pursuant to Regulation 14A under the Exchange Act (including, without limitation, such person s written consent to being named in the proxy statement as a nominee and to serving as a director if elected); and (b) as to the stockholder giving the notice (i) the name and address of such stockholder as they appear on our books and (ii) the class and number of shares of Smith Micro common stock that are beneficially owned by such stockholder.

Mergers and Acquisitions Committee. The Mergers and Acquisitions Committee (the M&A Committee) is comprised of three members: Messrs. Hoffman, Gulko and Szabo. The Board of Directors has determined that all the members of the M&A Committee are independent within the meaning of the Nasdaq Stock Market listing standards. The M&A Committee evaluates and reviews potential acquisition targets, strategic investments and divestitures, and makes recommendations regarding the same to our Board of Directors. The M&A Committee is also charged with overseeing the due diligence process with respect to proposed acquisitions, strategic investments and divestitures. The Board of Directors has adopted and approved a written charter for the M&A Committee. The M&A Committee held 3 meetings during 2007.

Code of Ethics

We have adopted a Code of Ethics for all of our employees, executive officers and directors. We will provide a copy of the Code of Ethics upon request made by email to investor-relations@smithmicro.com or in writing to Smith Micro Software, Inc. at 51 Columbia, Aliso Viejo, California 92656, Attention: Investor Relations. The full text of our Code of Ethics is posted on our web site at http://www.smithmicro.com under the Investor Relations section. We intend to disclose any amendment to the Code of Ethics or waiver of a provision of the Code of Ethics applicable to our executive officers or directors, including the name of the executive officer or director to whom the amendment applies or for whom the waiver was granted, at the same location on our website identified above. The inclusion of our web site address in this proxy does not include or incorporate by reference the information on our web site into this proxy or our Annual Report on Form 10-K.

Vote Required

The affirmative vote of the holders of a plurality of the outstanding shares of Common Stock present or represented at the Annual Meeting and entitled to vote is required for approval of the election of the nominee as a member of our

Board of Directors.

The Board of Directors recommends a vote FOR the nominees named above or their substitutes as set forth herein.

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PROPOSAL 2:
RATIFICATION OF APPOINTMENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

On December 8, 2005, our Audit Committee engaged Singer Lewak Greenbaum & Goldstein LLP (Singer Lewak) as our independent registered public accounting firm to audit our financial statements for the year ending December 31, 2005. The Audit Committee has selected Singer Lewak as the Company s independent auditors for the fiscal year ending December 31, 2008 and has further directed that the selection of the independent auditors be submitted for ratification by the stockholders at the Annual Meeting. Representatives of Singer Lewak are expected to be present at the Annual Meeting, will have an opportunity to make a statement if they so desire and will be available to respond to appropriate questions.

Stockholder ratification of the selection of Singer Lewak as the Company s independent auditors is not required by the Company s Bylaws or otherwise. However, the Board of Directors is submitting the selection of Singer Lewak to the stockholders for ratification as a matter of good corporate practice. If the stockholders fail to ratify the selection, the Audit Committee will reconsider whether or not to retain that firm. Even if the selection is ratified, the Audit Committee in its discretion may direct the appointment of different independent auditors at any time during the year if they determine that such a change would be in the best interests of the Company and its stockholders.

Principal Accounting Fees and Services

The following is a summary of the fees billed to Smith Micro by Singer Lewak for professional services rendered for the fiscal year ended December 31, 2006:

Fee Category	**Fiscal 2006 Fees**
Audit Fees	$1,346,000
Audit-Related Fees	30,000
Tax Fees	10,000
All Other Fees	0

The following is a summary of the fees billed to Smith Micro by Singer Lewak for professional services rendered for the fiscal year ended December 31, 2007:

Fee Category	**Fiscal 2007 Fees**
Audit Fees	$1,029,000
Audit-Related Fees	25,000

Audit Fees*:* This category consists of fees billed for professional services rendered for the audit of our consolidated annual financial statements and internal control over financial reporting, review of the interim consolidated financial statements included in quarterly reports, billing for professional services performed in connection with our public offering in December 2006 and services that are normally provided by our independent registered public accounting firm in connection with statutory and regulatory filings or engagements.

Audit-Related Fees*:* This category consists of assurance and related services that are reasonably related to the performance of the audit or review of our financial statements and are not reported above under Audit Fees.

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Tax Fees*:* This category consists of fees billed for professional services rendered for tax compliance, tax advice and tax planning.

The Audit Committee has determined that all non-audit services provided by Singer Lewak were compatible with Singer Lewak s audit independence.

Policy on Audit Committee Pre-Approval of Audit and Permissible Non-Audit Services of Independent Registered Public Accounting Firm.

The Audit Committee pre-approves all audit and permissible non-audit services provided by our independent registered public accounting firm. These services may include audit services, audit-related services, and other services. The Audit Committee has adopted a policy for the pre-approval of services provided by the independent registered public accounting firm. Under the policy, pre-approval is generally provided for up to one year and any pre-approval is detailed as to the particular service or category of services and is subject to a specific budget. In addition, the Audit Committee may also pre-approve particular services on a case-by-case basis. For each proposed service, the independent registered public accounting firm is required to provide detailed back-up documentation at the time of approval. The Audit Committee may delegate pre-approval authority to one or more of its members. Such a member must report any decisions to the Audit Committee at the next scheduled meeting.

Stockholder Approval

The affirmative vote of a majority of the outstanding voting shares of the Company present or represented and entitled to vote at the Annual Meeting is being sought to ratify the selection of Singer Lewak.

The Board of Directors recommends a vote FOR ratification of the appointment of Singer Lewak as our independent registered public accounting firm.

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AUDIT COMMITTEE REPORT

The following is the report of the Audit Committee with respect to our audited financial statements for the fiscal year ended December 31, 2007, which include the consolidated balance sheets of Smith Micro as of December 31, 2007 and 2006, and the related consolidated statements of operations, stockholders equity and cash flows for each of the three years in the period ended December 31, 2007, and the notes thereto. The information contained in this report shall not be deemed to be soliciting material or to be filed with the Securities and Exchange Commission, nor shall such information be incorporated by reference into any future filing under the Securities Act of 1933, as amended, or the 1934 Securities Exchange Act, as amended, except to the extent that we specifically incorporate it by reference in such filing.

Review with Management. The Audit Committee has reviewed and discussed our audited financial statements with management.

Review and Discussions with Independent Accountants. The Audit Committee has discussed with Singer Lewak Greenbaum & Goldstein, LLP, our independent registered public accounting firm for the year ended December 31, 2007, the matters required to be discussed by SAS 61 (Codification of Statements on Accounting Standards) which includes, among other items, matters related to the conduct of the audit of our financial statements.

The Audit Committee has also received written disclosures and the letter from Singer Lewak Greenbaum & Goldstein, LLP required by Independence Standards Board Standard No. 1 (which relates to the accountant s independence from us and our related entities) and has discussed with Singer Lewak Greenbaum & Goldstein, LLP its independence.

Conclusion. Based on the review and discussions referred to above, the Committee recommended to our Board that our audited financial statements be included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2007 for filing with the Commission.

AUDIT COMMITTEE
Thomas G. Campbell
Samuel Gulko
Gregory J. Szabo

SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The following table sets forth certain information known to us as of May 30, 2008, with respect to beneficial ownership of our Common Stock by (i) each person (or group of affiliated persons) who is known by us to own beneficially more than five percent (5%) of our outstanding Common Stock, (ii) each director and nominee for director, (iii) our Chief Executive Officer and each other Named Executive Officer (as such term is defined below under the caption Executive Compensation and Related Information) and (iv) all current directors and executive officers as a group, together with the approximate percentages of outstanding Common Stock owned by each of them. The following table is based upon information supplied by directors, executive officers, and principal stockholders. Beneficial ownership has been determined in accordance with Rule 13d-3 under the Exchange Act. Unless otherwise indicated the address of each beneficial owner is c/o Smith Micro Software, Inc., 51 Columbia, Aliso Viejo, CA 92656. The percentage of beneficial ownership is based on 30,414,511 shares of our common stock outstanding as of May 30, 2008.

	Shares Beneficially Owned	
Name or Group of Beneficial Owners	**Number**	**Percent**
Named Executive Officers and Directors:		
William W. Smith, Jr. (1)	2,979,698	9.44%
Thomas G. Campbell	10,000	*
Samuel Gulko (2)	42,000	*
Ted L. Hoffman (3)	57,500	*
William C. Keiper(4)	40,000	*
Gregory J. Szabo(5)	51,000	*
Robert Elliott (6)	168,854	*
Jonathan Kahn (7)	204,667	*
Andrew C. Schmidt (8)	180,417	*
David P. Sperling (9)	193,334	*
All executive officers and directors as a group (10 persons)(10)	3,927,470	12.29%
5% Stockholders		
FMR LLC (11) 82 Devonshire Street Boston, MA 02109	2,649,857	8.60%
NorthPointe Capital, LLC(12) 101 W. Big Beaver, Suite 745 Troy, MI 48084	1,606,209	5.14%

* Represents less than 1%.

(1) Includes 2,336,115 shares held in the name of The William W. Smith, Jr. Revocable Trust, of which

Mr. Smith is the trustee, and 289,583 shares issuable upon the exercise of options that are currently exercisable or will become exercisable within 60 days after May 30, 2008.

(2) Includes 10,000 shares issuable upon the exercise of options that are currently exercisable or will become exercisable within 60 days after May 30, 2008.

(3) Includes 20,000 shares issuable upon the exercise of options that are currently exercisable or will become exercisable within 60 days after May 30, 2008.

(4) Includes 15,000 shares issuable upon the exercise of options that are currently exercisable or will become exercisable within 60 days after May 30,

2008.

(5) Includes 20,000 shares issuable upon the exercise of options that are currently exercisable or will become exercisable within 60 days after May 30, 2008.

(6) Includes 77,604 shares issuable upon the exercise of options that are currently exercisable or will become exercisable within 60 days after May 30, 2008.

(7) Includes 104,667 shares issuable upon the exercise of options that are currently exercisable or will become exercisable within 60 days after May 30, 2008.

(8) Includes 35,417 shares issuable upon the exercise of options that are currently exercisable or will become exercisable within 60 days after May 30, 2008.

(9) Includes 108,334 shares issuable upon the exercise of options that are currently exercisable or will become exercisable within 60 days after May 30, 2008.

(10) Includes 680,605 shares issuable upon the exercise

of options that are currently exercisable or will become exercisable within 60 days after May 30, 2008.

(11) Based upon information reported on the following website: www.mffais.com.

(12) Based upon information reported on the following website: www.mffais.com.

EXECUTIVES

Executive Officers of the Company

The following table sets forth certain information regarding our executive officers as of May 30, 2008:

Name	Age	Position(s)
William W. Smith, Jr.	60	Chairman of the Board of Directors, President and Chief Executive Officer
Andrew C. Schmidt	46	Vice President and Chief Financial Officer
David P. Sperling	39	Vice President and Chief Technical Officer
Jonathan Kahn	50	Executive Vice President Business Operations
Robert Elliott	56	Vice President and Chief Marketing Officer

For background information regarding Mr. Smith, see Proposal 1 Election of Directors.

Mr. Schmidt joined the Company in June 2005 and serves as the Company s Chief Financial Officer. Prior to joining Smith Micro, Mr. Schmidt was the Chief Financial Officer of Genius Products, Inc., a publicly traded entertainment company from August 2004 to June 2005. From April 2003 to June 2004, he was Vice President (Finance) and acting Chief Accounting Officer of Peregrine Systems, Inc., a publicly held provider of enterprise level software then in Chapter 11 reorganization. From July 2000 to January 2003, he was Executive Vice President and Chief Financial Officer of Mad Catz Interactive, Inc., a publicly traded provider of console video game accessories. He holds a B.B.A. in Finance from the University of Texas and an M.S. in Accountancy from San Diego State University.

Mr. Sperling joined us in April 1989 and has been our Director of Software Engineering since April 1992. He assumed the Chief Technology Officer position in September 1999. Mr. Sperling began his professional career as a software engineer with us and he currently has two patents and three patents pending for various telephony and Internet technologies. Mr. Sperling holds a B.S. degree in Computer Science and an MBA from the University of California, Irvine.

Mr. Kahn joined the company with the acquisition of Allume Systems, Inc. in July 2005. Prior to the acquisition, Mr. Kahn was President of Allume. Mr. Kahn was one of the co-founders of Aladdin Systems, Inc. which later became Allume Systems. Mr. Kahn was Chairman, President and Chief Executive Officer of Monterey Bay Tech, Inc (OTC BB:MBYI), a public company from 1999 to May 2005 until its merger with SecureLogic Inc. Mr. Kahn is a member of the Digital River Advisory Board and is a graduate of the University of Rhode Island with a B.A. in Economics. Mr. Kahn assumed the position as Executive Vice President Business Operations in late 2007.

Mr. Elliott joined the company in May of 1999 and soon after was appointed General Manager of Smith Micro s Mac Division, then later as Vice President of Corporate Marketing, which he has held to date. An experienced technology and marketing leader with over fifteen years of executive level experience managing business units in the information technology industry, he has held executive level positions with Informix Software, DataStorm Technologies and QuarterDeck Corporation. Mr. Elliott is a graduate of Northwood University, Midland, MI.

Currently, all of our directors hold office until the next annual meeting of our stockholders and until their successors have been duly elected and qualified. Our officers are elected and serve at the discretion of our board of directors. There are no family relationships among any of our directors and executive officers.

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COMPENSATION DISCUSSION AND ANALYSIS

Overview

This compensation discussion and analysis explains the material elements of the compensation awarded to, earned by, or paid during our last completed fiscal year to each of William W. Smith, Jr., our President and Chief Executive Officer, Andrew C. Schmidt, our Vice President and Chief Financial Officer, David P. Sperling, our Vice President and Chief Technical Officer, Jonathan Kahn, our Executive Vice President Business Operations, and Robert Elliott, our Vice President and Chief Marketing Officer. These individuals are also referred to herein as our named executive officers.

Compensation Program Objectives and Philosophy

The compensation committee of our board of directors currently oversees the design and administration of our executive compensation program. Our compensation committee s primary objectives in structuring and administering our executive officer compensation program are to:

1. attract, motivate and retain talented and dedicated executive officers;

2. tie annual and long-term cash and stock incentives to achievement of measurable corporate and individual performance objectives; and

3. reinforce business strategies and objectives for enhanced stockholder value.

To achieve these goals, our compensation committee maintains compensation plans that tie a portion of executives overall compensation to key strategic goals such as financial and operational performance, as measured by metrics such as revenue and sales. Our compensation committee evaluates individual executive performance along with our Chief Executive Officer (other than with respect to his own performance) as part of the review process. The committee seeks to establish overall compensation (including cash and equity awards) at levels the committee believes are roughly comparable with average levels of compensation for executives at other fast-growing technology companies of similar size. The committee also seeks to maintain internal equity among executives based on their individual roles while setting compensation packages that are necessary to attract experienced executives who can manage a larger, more complex organization. Our compensation committee performs at least annually a review of our executive officers compensation to determine whether we provide adequate incentives and motivation to our executive officers and whether we adequately compensate our executive officers relative to comparable officers in other similarly situated companies.

The principal elements of our executive compensation program are base salary, cash bonus awards, long-term equity incentives in the form of stock options and restricted stock, other benefits and perquisites, post-termination severance and acceleration of stock option and restricted stock vesting for certain named executive officers upon termination and/or a change in control. Our other benefits and perquisites consist of life and health insurance benefits and a qualified 401(k) savings plan.

We view these components of compensation as related but distinct. Although our compensation committee does review total compensation, we do not believe that significant compensation derived from one component of compensation should negate or offset compensation from other components. We determine the appropriate level for each compensation component based in part, but not exclusively, on competitive benchmarking consistent with our recruiting and retention goals, our view of internal equity and consistency, and other considerations we deem relevant, such as rewarding extraordinary performance.

When determining compensation for our Chief Executive Officer, our compensation committee gives significant consideration to Mr. Smith s role in founding our company over 25 years ago, the significant liquidity he has received since our initial public offering in 1995, and his continuing ownership of a significant portion of our stock.

Role of Executive Officers in Compensation Decisions

Our compensation committee reviews and approves the compensation paid to our Chief Executive Officer. With regard to the compensation paid to each executive officer other than the Chief Executive Officer, the Chief Executive Officer reviews, on an annual basis, the compensation paid to each such executive officer during the past year and submits to the compensation committee his recommendations regarding the compensation to be paid to such persons during the next year. Following a review of such recommendations, the committee will take such action regarding such compensation as it deems appropriate, including approving compensation in an amount the compensation committee deems reasonable.

Management plays a significant role in the compensation-setting process for executive officers, other than the Chief Executive Officer, by:

- evaluating employee performance;
- recommending business performance targets and establishing objectives; and
- recommending salary levels, bonuses and equity-based awards.

Management also prepares meeting information for most compensation committee meetings, and the Chief Executive Officer participates in committee meetings at the compensation committee s request to provide:

- background information regarding our strategic objectives;
- his evaluation of the performance of the executive officers; and
- compensation recommendations as to executive officers (other than himself).

Benchmarking of Compensation

The compensation committee believes it is important when making its compensation-related decisions to be informed as to current practices of similarly situated companies. As part of establishing compensation levels for 2007, the compensation committee informally reviewed third-party surveys and other information collected from public sources relating to compensation levels of executive officers at peer companies. Such review was not used to establish compensation levels, but rather as a market check to ensure that our overall compensation levels (including cash and equity awards) are roughly comparable to average levels of compensation for executives at other fast-growing technology companies of similar size. Historically, the compensation committee has not engaged third party consultants to advise the compensation committee on compensation matters.

In 2008, following the completion of a number of important acquisitions in fiscal 2007 and early 2008, the compensation committee engaged a third party consultant to prepare a compensation study to assist the committee as it seeks to ensure that we are appropriately compensating our executives, given the increased size and complexity of the company. The compensation study peer group included 19 wireless/communications companies (software and hardware) with revenues of between $80 million and $200 million, similar market capitalization and employee size ranges. The study focused on three primary aspects of executive compensation; base salary, total target cash compensation, and equity awards. The compensation committee s target pay positioning for our executives, as compared with our peer group, is the 50th percentile for base pay and total cash compensation and greater than 50th percentile for equity awards. Our philosophy is to provide an overall competitive executive compensation package with a bias towards equity rather than cash compensation in order to align our executives goals with that of our shareholders.

The results of the 2008 benchmark study show that our executives base salaries fall between the 25th and 50th percentiles as compared to our peers, while total cash compensation, including cash bonuses generally fall below the 25th percentile, and that our executive equity compensation is above the 75th percentile as compared with our peer group.

Base Compensation

We provide our named executive officers and other executives with base salaries that we believe enable us to hire and retain individuals in a competitive environment and to reward individual performance and contribution to our overall business goals, while taking into account the unique circumstances of our company. We review base salaries for our named executive officers annually and increases are generally based on our performance and individual performance. We also take into account the base compensation that is payable by companies that we believe to be our competitors and by other public companies with which we believe we generally compete for executives.

The following table identifies actions taken during fiscal year 2007 with respect to annual base salaries of the named executive officers:

Named Executive Officer	***Changes in Annual Base Salary***
William W. Smith, Jr.	No change, base salary remains at $350,000
Andrew C. Schmidt	Increased from $240,000 to $260,000, effective February 2007
David P. Sperling	Increased from $200,000 to $210,000, effective February 2007
Jonathan Kahn	No change, base salary remains at $200,000
Robert Elliott	Increased from $140,000 to $160,000, effective February 2007

The annual base salaries of Mr. Schmidt, Sperling and Elliott were increased based on the Board s decision to make their salaries more competitive with other technology companies and to recognize the value of their overall services to the company. The Board took into account each of their job responsibilities, historical salary levels, the performance of the company, individual contributions, competitive conditions in the marketplace and the relationship of their compensation levels to other officers of Smith Micro Software, and determined that the increases were appropriate to reward performance, ensure retention and maintain appropriate compensation differentials among officers of Smith Micro Software. With respect to Mr. Smith, the board believed his base salary to be fair and adequate and as a result did not provide for an increase in 2007. Mr. Kahn s base salary was consistent with his employment agreement and therefore not increased.

Cash Bonus Awards

As part of our compensation program and in order to maintain appropriate financial incentives, our executive officers are eligible for cash bonus compensation pursuant to an annual cash bonus plan. Under the plan, cash bonuses are determined and paid each fiscal year on a quarterly basis based upon the achievement of certain performance objectives. Our cash bonus plan is designed to focus our management on achieving key corporate financial objectives, to motivate certain desirable behaviors and to reward achievement of our key corporate financial objectives and individual goals. Under the terms of the bonus plan, the compensation committee establishes performance objectives and annual target bonus amounts for each named executive officer. In determining the appropriate level of target bonus for each officer the compensation committee considers information provided through independent, third-party surveys and other information collected from public sources for similar positions at peer companies, relative base salary and bonus amounts for each individual and the recommendations of our Chief Executive Officer.

2007 Bonus Plan

In the first quarter of 2007, the compensation committee worked with senior management to establish the annual target bonus amounts and performance objectives under the bonus plan. For each performance objective the committee assigned a relative weighting to provide guidelines for setting actual cash payouts for each executive officer based on a percentage of the individual s target bonus.

The compensation committee retained wide discretion to interpret the terms of the bonus plan, including interpreting and determining whether the performance objectives had been met and the amount of cash bonus that may be paid pursuant to the bonus plan.

Our bonus plan contains between one and two performance objectives with a dollar value ascribed to each objective so that the sum total equals the approved cash bonus potential for each executive officer. In 2007 the objective(s) (i) for Messrs. Smith and Schmidt were: (1) revenue achievement, and (2) profitability achievement; (ii) for Messrs. Sperling, Kahn and Elliot was revenue achievement. The revenue and profitability targets for each of these individuals was set at the consensus estimates of analysts for each quarter, and was updated quarterly. Bonuses were awarded based on the percentage by which the goal was attained. We believe that the performance objectives are moderately difficult to achieve and that performance at a high level while devoting full time and attention to their responsibilities is required for our executive officers to earn their respective cash bonuses. We believe that the performance objectives are moderately difficult to achieve and that performance at a high level while devoting full time and attention to their responsibilities is required for our executive officers to earn their respective cash bonuses.

For 2007, based on the achievement of the objectives for our executive officers under our bonus plan, we paid bonuses of $54,095 to Mr. Smith, $43,276 to Mr. Schmidt, $43,105 to Mr. Sperling, $65,708 to Mr. Kahn, and $37,091 to Mr. Elliott. The cash bonuses paid to our chief executive officer accounted for approximately 1.6% of his total compensation in 2007. For our other named executive officers in 2007, their cash bonuses, on average, accounted for 2.2% to 4.4% of their total compensation.

2007 Discretionary Bonuses

The compensation committee may also award discretionary bonuses based on our achievements and the individual s contributions to those achievements. For 2007, Mr. Smith and Mr. Schmidt received a $25,000 discretionary bonus for their efforts in helping the company achieve a successful common stock offering in December 2006.

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Equity Compensation

We believe that for growth companies in the technology sector, equity awards are a significant compensation-related motivator in attracting and retaining executive-level employees. Accordingly, we have provided our named executive officers and other executives with long-term equity incentive awards that incentivize those individuals to stay with us for long periods of time, which in turn should provide us with greater stability over such periods than we would experience without such awards. While the majority of our long-term equity compensation awards historically have also been in the form of stock options, we provided grants of restricted stock to each of our executive officers in 2007. We felt that granting restricted stock in 2007 provided additional incentive to our executives by providing them with immediate stock ownership, which helped align their interests with those of our stockholders.

We grant equity compensation to our executive officers and other employees under the 2005 Plan. We account for equity compensation paid to our employees under the rules of SFAS No. 123R, which requires us to estimate and record compensation expense over the vesting period of the award. All equity awards to our employees, including executive officers, and to our directors have been granted and reflected in our consolidated financial statements, based upon the applicable accounting guidance, at fair market value on the grant date.

Generally, we grant long-term equity awards to our named executive officers upon commencement of their employment, and the terms of those awards typically vest over four years. Additionally, from time to time, we grant subsequent long-term equity awards to our named executive officers based upon a number of factors, including: rewarding executives for superior performance, maintaining a sufficient number of unvested long-term equity awards as a means to retain the services of such executives, providing increased motivation to such executives and ensuring that the total long-term equity awards are competitive with those of other companies competing for our named executive officers. We typically grant equity awards at scheduled meetings of the compensation committee, and option awards typically carry an exercise price equal the closing price of our common stock on the day of grant. We do not have a program, plan or practice to time the grant of stock options in coordination with the release of material non-public information.

In February, 2007 we granted shares of Restricted Stock and stock options to each of our named executive officers as follows:

	Shares of Restricted Stock	Stock Options
William W. Smith, Jr.	100,000	200,000
Andrew C. Schmidt	50,000	100,000
David P. Sperling	30,000	100,000
Jonathan Kahn	30,000	100,000
Robert Elliott	30,000	100,000

In 2007, the committee approved grants of restricted stock and options as a retention tool and due to the committee s sense that our total cash compensation paid to our named executive officers was at the lower end of the market for technology companies of similar size. Differing levels of restricted stock awards were made to executives based on the individuals relative duties and responsibilities. In addition, the company awarded new stock options to the named executive officers during 2007. The primary reason for these new stock option grants was to maintain internal equity of our existing executives with new executives that were hired through our acquisitions of Ecutel Systems and Insignia Solutions in early 2007. The stock options were granted at a regularly scheduled compensation committee meeting. The exercise price of these option awards is the closing price of our common stock on the Nasdaq Global Market on the date of grant.

Our stock options have a 10-year contractual term. In general, the option grants are also subject to post-termination and change in control provisions. These terms are more fully described below in Employment Agreements and Potential Payments upon Termination or Change in Control.

Executive Benefits and Perquisites

We provide the opportunity for our named executive officers and other executives to receive certain perquisites and general health and welfare benefits. We also offer participation in our defined contribution 401(k) plan. We provide a 20% match on all eligible employee contributions to our 401(k) plan. We provide these benefits to create additional incentives for our executives and to remain competitive in the general marketplace for executive talent.

Change in Control and Severance Benefits

We provide the opportunity for certain of our named executive officers to receive additional compensation or benefits under the severance and change in control provisions contained in their employment agreements. We provide this opportunity to attract and retain

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an appropriate caliber of talent in key positions. Our severance and change in control provisions for certain of our named executive officers are summarized below in Employment Agreements and Potential Payments Upon Termination or Change in Control.

Code Section 162(m)

It is our policy generally to qualify compensation paid to executive officers for deductibility under Section 162(m) of the Internal Revenue Code. Section 162(m) generally prohibits us from deducting the compensation of officers that exceeds $1,000,000 unless that compensation is based on the achievement of objective performance goals. We believe our 2005 Plan is structured to qualify stock options, restricted share and stock unit awards under such plan as performance-based compensation and to maximize the tax deductibility of such awards. However, we reserve the discretion to pay compensation to our officers that may not be deductible.

2008 Compensation Decisions

For 2008, we have made changes to our named executive s compensation consistent with the findings of our benchmarking study discussed above, while taking into account the individual performance and relative responsibility of our named executives.

The following table identifies actions taken during the second quarter of 2008 with respect to annual base salaries of the named executive officers:

Named Executive Officer	***Changes in Annual Base Salary***
William W. Smith, Jr.	Increased from $350,000 to $400,000, effective May 2008
Andrew C. Schmidt	Increased from $260,000 to $300,000, effective May 2008
David P. Sperling	Increased from $210,000 to $225,000, effective May 2008
Jonathan Kahn	Increased from $200,000 to $240,000, effective May 2008
Robert Elliott	Increased from $160,000 to $180,000, effective May 2008

The annual base salaries of Mr. Smith, Schmidt, Sperling, Kahn and Elliott were increased based on the findings of the compensation study referenced above and to recognize the value of their overall services to the company. The Board took into account each of their job responsibilities, historical salary levels, the performance of the company, individual contributions, competitive conditions in the marketplace and the relationship of their compensation levels to other officers of Smith Micro Software, and determined that the increases were appropriate to reward performance, ensure retention and maintain appropriate compensation differentials among officers of Smith Micro Software.

The following table identifies actions taken during the second quarter of 2008 with respect to annual cash based bonus eligibility of the named executive officers:

Named Executive Officer	***Changes in Cash Based bonus eligibility***
William W. Smith, Jr.	Increased from $50,000 to $75,000, effective May 2008
Andrew C. Schmidt	Increased from $40,000 to $50,000, effective May 2008
David P. Sperling	Increased from $46,000 to $60,000, effective May 2008
Jonathan Kahn	No change, remains at $60,000 for 2008
Robert Elliott	Increased from $40,000 to $50,000, effective May 2008

The changes noted above were made consistent with the findings of our compensation study which determined that our total cash based compensation for our executives fell below the 50th percentile compared with our peer group, and that our cash based bonus pool compensation fell below the 25th percentile. While the changes above represent increases, the net resulting cash bonus pool for each named executive officer remains at or below the 25th percentile as compared with our peer group.

Consistent with the Board s compensation philosophy, the changes to the 2008 total cash compensation of our executives remains below the 50th percentile as compared to our peer group. Taking this into account, the Board approved the issuance of a restricted stock grant for our named executive officers. Mr. Smith received a grant of 150,000 shares, Mr. Schmidt 75,000 shares, and Mr. Sperling, Kahn, and Elliot each received grants of 50,000 shares. However, based on our benchmarking study, the Board increased the vesting period of this restricted stock offering from a 2 year vesting to a 4 year vesting. The grants were also effective May of 2008.

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Summary Compensation Table

The following table shows information concerning the annual compensation for services provided to us by our named executive officers during 2007 and 2006.

Name and Principal Position	Year	Salary ($)	Bonus ($)	Stock Awards ($) (1)	Option Awards ($) (2)	Non-Equity Incentive Plan Compensation ($) (3)	All Other Compensation ($)	Total ($)
William W. Smith, Jr.	2007	$350,000	$25,000	$1,147,258	$1,360,000	$54,095	$499,304(4)	$3,435,657
President and CEO	2006	337,500		355,762		45,527	161,542(5)	900,331
Andrew C. Schmidt	2007	256,666	25,000	681,373	680,000	43,276	288,950(6)	1,975,265
VP and Chief Financial Officer	2006	236,667		239,794		34,494	103,598(7)	614,553
David P. Sperling	2007	208,333		379,250	680,000	43,105	162,203(8)	1,472,891
VP and Chief Technical Officer	2006	196,647		123,825		63,149	63,876(9)	447,497
Jonathan Kahn	2007	200,000		379,250	680,000	65,708	162,203(10)	1,487,161
EVP Business Operations	2006	200,000		123,825		48,500	54,825(11)	427,150
Robert Elliott	2007	155,000		379,250	680,000	37,091	162,203(12)	1,413,544
VP and Chief Marketing Officer	2006	121,667		123,825		35,853	54,947(13)	336,292

(1) The amounts shown in this column represents the income reported by the named executive for vesting of restricted stock which is the number of shares vesting times the closing stock price on the vesting date.

(2) The amounts shown in this column represents the compensation costs of options for financial

reporting purposes pursuant to FAS 123R. The assumptions we used with respect to the valuation of stock and option grants are set forth in Note 1 to our consolidated financial statements included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2007

(3) The amounts in this column reflect the cash awards paid pursuant to our 2007 bonus plan

(4) Consists of $481,298 tax gross-up, $14,906 of income tax preparation fees and $3,100 of 401K matching contributions.

(5) Consists of $149,249 tax gross-up, $9,293 of income tax preparation fees and $3,000 of 401K matching contributions.

(6) Consists of $285,850 tax

gross-up and $3,100 of 401K matching contributions.

(7) Consists of $100,598 tax gross-up and $3,000 of 401K matching contributions.

(8) Consists of $159,103 tax gross-up and $3,100 of 401K matching contributions.

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(9) Consists of $51,947 tax gross-up, $8,929 of reimbursement for educational expenses and $3,000 of 401K matching contributions.

(10) Consists of $159,103 tax gross-up and $3,100 of 401K matching contributions.

(11) Consists of $51,947 tax gross-up and $2,878 of 401K matching contributions.

(12) Consists of $159,103 tax gross-up and $3,100 of 401K matching contributions.

(13) Consists of $51,947 tax gross-up and $3,000 of 401K matching contributions.

Grants of Plan Based Awards in 2007

The following table provides information with regard to potential cash bonuses paid or payable in 2007 under our performance-based, non-equity incentive plan, and with regard to the options to purchase common stock and shares of restricted stock granted to our named executive officers during 2007.

	Estimated Future Payouts Under Non-Equity	All Other Option Awards: Number of	Exercise or Base

Name	Grant Date	Incentive Plan Awards(1) Target ($)	All Other Stock Awards; Number of Shares of Stock	Securities Underlying Options(#)	Price of Option Awards ($)	Grant Date Fair Value of Stock and Option Awards (2)
William W. Smith, Jr.		$ 50,000				
	02/19/07		100,000			1,255,000
	02/19/07			200,000	12.55	1,360,000
Andrew C. Schmidt		40,000				
	02/19/07		50,000			627,500
	02/19/07			100,000	12.55	680,000
David P. Sperling		56,000				
	02/19/07		30,000		12.55	376,500
	02/19/07			100,000		680,000
Jonathan Kahn		60,000				
	02/19/07		30,000		12.55	376,500
	02/19/07			100,000		680,000
Robert Elliott		40,000				
	02/19/07		30,000		12.55	376,500
	02/19/07			100,000		680,000

(1) Amounts shown in these columns are the estimated possible payouts under the 2007 bonus plan based on certain assumptions about the achievement of company and individual performance objectives. The actual amounts paid pursuant to the 2007 bonus plan are reported in the Summary Compensation Table under the column entitled Non-Equity Incentive Plan

Compensation. The performance objectives under the 2007 bonus plan, as well the compensation committee s pay-out determinations for the 2007 bonus plan, are detailed above under Cash Bonus Awards *2007 Bonus Plan*.

(2) The amounts shown in this column represent the compensation costs of options for financial reporting purposes pursuant to FAS 123R. The assumptions we used with respect to the valuation of option grants are set forth in Note 1 to our consolidated financial statements included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2007.

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Outstanding Equity Awards at December 31, 2007

The following table summarizes the number of securities underlying outstanding equity awards for each named executive officer as of December 31, 2007, as well as the number of outstanding unvested shares of restricted stock held by our named executive officers as of December 31, 2007.

	Option awards				Stock Awards	
Name	Number of Securities Underlying Unexercised Options Exercisable (#)	Number of Securities Underlying Unexercised Options Unexercisable (#)	Option Exercise Price	Option Expiration Date	Number of Shares or Units of Stock that Have Not Vested (#)	Market Value of Shares or Units of Stock that Have Not Vested ($) (1)
William W. Smith, Jr.	12,500(2)		$ 0.24	2/15/2012		
	41,667(2)	14,583	1.91	7/1/2014		
	120,833(2)	79,167	4.95	7/27/2015		
	(2)	200,000	12.55	2/19/2007		
					69,583(3)	$589,368
Andrew C. Schmidt	(2)	100,000	12.55			
					37,292(3)	315,863
David P. Sperling	8,334(2)	14,583	1.91	7/1/2014		
	35,417(2)	39,583	4.95	7/27/2015		
	(2)	100,000	12.55	2/19/2017		
					22,500(3)	190,575
Jonathan Kahn	69,250(4)		4.95	7/27/2015		
	(2)	100,000	12.55	2/18/2017		
					22,500(3)	190,575
Robert Elliott	6,250(2)	10,937	1.91	7/1/2014		
	10,417(2)	39,583	4.95	7/27/2015		
	(2)	100,000	12.55	2/19/2017		
					22,500(3)	190,575

(1) Determined by multiplying the number of shares by $8.47, the closing price for our stock on the Nasdaq Global Market on December 31, 2007.

(2) 25% vested after one year, the balance over 36 successive monthly installments.

(3) Vests in 24 equal monthly installments.

(4) 25% vested after six months, the balance over 18 successive monthly installments.

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Option Exercises and Stock Vested

The following table provides information regarding exercises of stock options and vesting of restricted stock held by each of our named executive officers during 2007.

	Option Awards		Stock Awards	
Name	Number of Shares Acquired on Exercise (#)	Value Realized on Exercise ($)(1)	Number of Shares Acquired on Vesting (#)	Value Realized On Vesting ($) (2)
William W. Smith, Jr.		$	77,500	$1,147,258
Andrew C. Schmidt	45,833	520,698	46,250	681,373
David P. Sperling	62,083	921,654	26,250	379,250
Jonathan Kahn	30,750	352,216	26,250	379,250
Robert Elliott	78,125	1,114,109	26,250	379,250

(1) Represents the difference between the exercise price and the fair market value of the common stock on the date of exercise.

(2) Represents the market value per share times the number of shares vested on the vesting date.

Employment Agreements

Letter Agreement with Andrew C. Schmidt

Effective on June 14, 2005 we entered into a letter agreement with Andrew C. Schmidt, our Chief Financial Officer. The agreement provides for an initial base salary of $220,000 per annum and eligibility to receive bonus awards at the discretion of the compensation committee of the board of directors. Mr. Schmidt is also eligible to participate in any and all plans providing general benefits to our employees, subject to the provisions, rules and regulations applicable to each such plan. Mr. Schmidt s base salary is currently set at $260,000.

Mr. Schmidt s employment letter agreement also provides that he is eligible to participate in our 2005 Plan. In 2006 Mr. Schmidt received grants of 55,000 shares of restricted stock, which vest ratably over 24 months. In 2007, Mr. Schmidt was granted options to purchase 100,000 shares of stock at an exercise price of $12.55. These options vest over four years. Mr. Schmidt was also granted 50,000 shares of restricted stock in 2007.

Mr. Schmidt s employment may be terminated at any time, with or without cause and with or without notice, by Mr. Schmidt or by us. If Mr. Schmidt s employment is terminated by us without cause within twelve months following a Corporate Transaction (as defined in the agreement), we will provide Mr. Schmidt payment of salary for the six months following the termination of employment.

The letter agreement states that Mr. Schmidt s employment is of no set duration.

Employment Agreement with Jonathan Kahn

We entered into an employment agreement on July 1, 2005 with Jonathan Kahn in connection with our purchase of Allume Systems, Inc., where Mr. Kahn was President. The employment agreement provides for an initial base salary of $200,000 per annum, plus an annual bonus based on the attainment of certain targets. Mr. Kahn is also eligible to participate in any and all plans providing general benefits to our employees, subject to the provisions, rules and regulations applicable to each such plan. The Board approved changes to his commission schedule, effective on April 1, 2007, in lieu of making any changes to his base compensation. The employment agreement is for a term of three years.

Mr. Kahn s employment may be terminated at any time, with or without cause and with or without notice, by Mr. Kahn or by us. If Mr. Kahn s employment is terminated by us other than for cause (as defined in the agreement) or if Mr. Kahn terminates his employment for good reason following a Change of Control (as defined in the agreement), we will provide Mr. Kahn a severance payment equal to eighteen months at his then-current base salary. Such amount shall be payable in equal monthly increments over the period following termination. In addition, if we terminate Mr. Kahn without cause or if he terminates his employment for good reason following a Change of Control: (i) we will provide Mr. Kahn with continuation of medical, health and life insurance benefits, at the same benefit level at which he was participating on the date of termination, for such eighteen month period, and (ii) all of Mr. Kahn s unvested stock options will immediately vest and be exercisable in full within two years of termination.

Agreement with William W. Smith, Jr.

In June 2005, we entered into an agreement with William W. Smith, Jr., Chief Executive Officer, pursuant to which we agreed to a lifetime payment of $6,000 annually, subject to annual increases of 5%, in connection with his future retirement or resignation from employment. The agreement provides that we may, at our option, discharge our obligations under the agreement by purchasing a single premium annuity for the benefit of Mr. Smith, the estimated cost of which was approximately $150,000.

Other than as disclosed above, none of the named executive officers has an employment agreement with us, and the employment of each of the named executive officers may accordingly be terminated at any time at the discretion of the Board of Directors.

Potential Payments Upon Termination or Change in Control

The compensation committee believes that change in control agreements are appropriate and serve an important business purpose for the company. The committee believes that these benefits aid in recruiting and retaining talent in a competitive market. Also, benefits are provided in the event of termination of employment following a change in control, which are intended to motivate executive officers to remain with the company despite the uncertainty and dislocation that arises in the context of change in control situations. The change in control agreements are an important part of our overall compensation objectives, particularly our goal of retaining the best qualified executive officers, and do not affect the decisions made with respect to other compensation elements.

Mr. Schmidt

Pursuant to the employment letter agreement with Mr. Schmidt, if his employment is terminated without cause within twelve months following a Corporate Transaction he is entitled to a severance benefit equal to six months base salary, subject to required withholding and payable in accordance with our regular and customary payroll practices. In addition, pursuant to his stock option and restricted stock agreements, he is entitled to accelerated vesting of options and restricted stock in the event of a Corporate Transaction. Assuming the employment of Mr. Schmidt were to be terminated without cause within twelve months following a Corporate Transaction as of December 31, 2007, he would be entitled to an aggregate of $445,863 in change in control benefits, consisting of (i) $130,000 to be paid over the six month period following such termination, subject to required withholding and in accordance with our regular and customary payroll practices, (ii) accelerated vesting of 100,000 outstanding stock options with a value of $0 (based on the number of shares times the December 31, 2007 closing market price for our stock, less the exercise price of the options), and (iii) accelerated vesting of 37,292 shares of restricted stock with a value of $315,863 (based on the number of shares times the December 31, 2007 closing market price for our stock). We are not required to make any cash payments to Mr. Schmidt if his employment is terminated by us for cause or on account of death or disability or by Mr. Schmidt.

For purposes of Mr. Schmidt s employment letter agreement, (i) Corporate Transaction is defined as any of the following stockholder approved transactions to which we are a party: (a) a merger or consolidation in which securities possessing more than fifty percent (50%) of the total combined voting power of our outstanding securities are transferred to a person or persons different from the persons holding those securities immediate prior to such transaction, or (b) the sale, transfer or other disposition of all or substantially all of our assets in complete liquidation or dissolution of Smith Micro; and (ii) cause is not defined. We gave these benefits to Mr. Schmidt in order to retain his services.

Mr. Schmidt is bound by the terms of a Proprietary Information and Inventions Agreement which survives the termination of his employment. This agreement provides in part that he will not disclose our confidential information to any third party.

Mr. Kahn

Pursuant to the employment agreement with Mr. Kahn, if we terminate him without cause or if he terminates his employment for good reason upon a change of control, we are obligated to provide Mr. Kahn a severance payment equal to eighteen months at his then-current base salary. Such amount shall be payable in equal monthly increments over the period following termination. In addition, if we terminate Mr. Kahn without cause or if he terminates his employment for good reason upon a Change of Control, we will provide Mr. Kahn with continuation of medical, health and life insurance benefits, at the same benefit level at which he was participating on the date of termination, for such eighteen month period. In addition, the employment agreement provides that all of Mr. Kahn s unvested stock options will immediately vest and be exercisable in full within two years of the date we terminate him without cause or he terminates his employment for good reason upon a Change of Control.

Assuming either a Change of Control occurred on December 31, 2007 and Mr. Kahn terminated his employment as a result thereof, Mr. Kahn would be entitled to an aggregate of $490,575 of change in control benefits, consisting of (i) $300,000 to be paid over the eighteen month period following such termination in accordance with our regular payroll practices, (ii) approximately $26,000 in continuance of medical, health and life insurance benefits for the eighteen month period following termination, and (iii) accelerated vesting of 100,000 outstanding stock options with a value of $0 (based on the number of shares times the December 31, 2007 closing market price for our stock, less the exercise price of the options), and (iii) accelerated vesting of 22,500 shares of restricted stock with a value of $190,575 (based on the number of shares times the December 31, 2007 closing market price for our stock).

For purposes of Mr. Kahn s employment agreement, (i) Change of Control means a change in a majority of the membership of our board of directors, the sale of all or substantially all of our assets or the merger or consolidation of our company as a result of which Mr. Kahn does not remain at least a Senior Vice President, and (ii) cause means Mr. Kahn s conviction of, or plea of guilty or no contest to, a felony involving turpitude, persistent dishonesty or fraud, persistent willful breaches of the material terms of the agreement, or willful neglect of the duties which he is required to perform under his agreement.

Mr. Smith

We have an agreement with Mr. Smith pursuant to which we agreed to a lifetime payment of $6,000 annually, subject to annual increases of 5%, in connection with his future retirement or resignation from employment; provided that we may, at our option, discharge our obligations under the agreement by purchasing a single premium annuity for the benefit of Mr. Smith, the estimated cost of which was approximately $150,000. Assuming Mr. Smith s employment was terminated as of December 31, 2007, and further assuming that we determined to satisfy our obligations under his agreement by purchasing a single premium annuity for the benefit of Mr. Smith, we would have been obligated to expend $150,000 to purchase the annuity.

Stock Options and Restricted Stock

Each of our named executive officers holds options and shares of restricted stock that would vest, subject to the satisfaction of certain other conditions included in the option agreements and restricted stock agreements, upon a Corporate Transaction. For purposes of these agreements, Corporate Transaction is defined as either of the following stockholder-approved transactions to which we are a party: (i) a merger or consolidation in which securities possessing more than fifty percent (50%) of the total combined voting power of our outstanding securities are transferred to a person or persons different from the persons holding those securities immediately prior to such transaction, or (ii) the sale, transfer or other disposition of all or substantially all of our assets in our complete liquidation or dissolution. We provide this benefit in order to properly incent our executives to support a Corporate Transaction that would be deemed beneficial to our shareholders.

Assuming a Corporate Transaction occurred as of December 31, 2007 and the other conditions included in the options agreements were satisfied, the following individuals would be entitled to accelerated vesting of their outstanding stock options as described in the table below:

Name	Value of accelerated option awards following Change in Control
William W. Smith, Jr.	Immediate vesting of 93,750 options with a value of $374,332 (1).
Andrew C. Schmidt	Immediate vesting of 100,000 options with a value of $0 (1).
David P. Sperling	Immediate vesting of 54,166 options with a value of $234,996 (1).
Jonathan Kahn	Immediate vesting of 100,000 options with a value of $0 (1).
Robert Elliott	Immediate vesting of 50,520 options with a value of $211,079 (1).

(1) Based on the number of shares times the December 31, 2007 closing market price, less the exercise price of the options.

Assuming a Corporate Transaction occurred as of December 31, 2007 and the other conditions included in the restricted stock agreements were satisfied, the following individuals would be entitled to accelerated vesting of the following shares of restricted stock:

Name	**Value of accelerated stock awards following Change in Control**
William W. Smith, Jr.	Immediate vesting of 69,583 shares with a value of $589,368 (1).
Andrew C. Schmidt	Immediate vesting of 37,292 shares with a value of $315,863 (1).
David P. Sperling	Immediate vesting of 22,500 shares with a value of $190,575 (1).
Jonathan Kahn	Immediate vesting of 22,500 shares with a value of $190,575 (1).
Robert Elliott	Immediate vesting of 22,500 shares with a value of $190,575 (1).

(1) Based on the December 31, 2007 closing market price of $8.47.

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Director Compensation

The following table summarizes compensation that our directors (other than directors who are named executive officers) earned during 2007 for services as members of our board of directors.

Name	Fees earned or paid in cash ($)	Stock Awards ($)	Option Awards ($) (1)	Total ($)
Thomas G. Campbell(2)	$ 10,000	$ 125,500	$ 19,964	$155,464
Samuel Gulko(3)	10,000	125,500	19,964	155,464
Ted. L. Hoffman(4)	10,000	125,500	19,964	155,464
William C. Keiper(5)	10,000	125,500	19,964	155,464
Gregory J. Szabo(6)	10,000	125,500	19,964	155,464

(1) Valuation based on the dollar amount of option grants recognized for financial statement reporting purposes pursuant to SFAS 123R with respect to 2007. The assumptions we used with respect to the valuation of option grants are set forth in Note 1 to our consolidated financial statements contained in our Annual Report on Form 10-K for the year ended December 31, 2007.

(2) Mr. Campbell has no options to purchase

shares outstanding as of December 31, 2007.

(3) Mr. Gulko has options to purchase 10,000 shares outstanding as of December 31, 2007.

(4) Mr. Hoffman has options to purchase 20,000 shares outstanding as of December 31, 2007.

(5) Mr. Keiper has options to purchase 15,000 shares outstanding as of December 31, 2007.

(6) Mr. Szabo has options to purchase 20,000 shares outstanding as of December 31, 2007.

Summary of Director Compensation

Non-employee members of the Board of Directors receive fees of $2,500 quarterly for Board and committee service, and are reimbursed for their out-of-pocket expenses in connection with service on the Board of Directors. Non-employee members of the Board of Directors are eligible to receive periodic option grants pursuant to the Automatic Option Grant Program in effect under our 2005 Plan and are eligible to receive discretionary awards under the Plan s Discretionary Option Grant and Stock Issuance Programs.

Each non-employee director will receive an option grant for 10,000 shares in connection with his or her initial appointment to the Board of Directors. Each such option will have an exercise price per share equal to the closing sale price per share of common stock on the grant date and a maximum term of 10 years measured from the grant date. Each option will be immediately exercisable for all the option shares, but any shares purchased under the option will be subject to repurchase by us, at the option exercise price paid per share, in the event the optionee ceases to serve as a member of the Board of Directors prior to vesting in the option shares. The option shares will vest in a series of four successive equal annual installments over the optionee s period of service on the Board of Directors, with the first installment to vest upon his or her completion of one year of serving as a member of the Board of Directors measured from the grant date. The option shares will immediately vest in full upon certain changes in control or ownership or upon the optionee s death or disability while still serving as a member of the Board of Directors.

At each Annual Meeting of Stockholders, each individual who will continue to serve as a non-employee member of the Board of Directors will receive an additional option grant for 5,000 shares, provided such individual has served on the Board of Directors for at least six months. Each option will have an exercise price per share equal to the closing sale price per share of common stock on the date of the Annual Meeting and a maximum term of 10 years measured from such date, subject to earlier termination upon the optionee s

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cessation of service on the Board of Directors. The option will be immediately exercisable for all the option shares, but any shares purchased under the option will be subject to repurchase by us, at the option exercise paid per share, should the optionee stop serving as a member of the Board of Directors prior to the completion of one year of service measured from the grant date. On February 19, 2007, each director received a special discretionary grant of 10,000 shares of Restricted Stock valued at $12.55 per share and vesting in equal installments over the next 12 months.

Compensation Committee Interlocks and Insider Participation

In fiscal 2007, the members of our Compensation Committee were Messrs. Campbell, Hoffman and Keiper, who are all non-employee directors. None of such committee members (i) was, during fiscal 2007, an officer or employee of us or any of our subsidiaries, or (ii) is formerly an officer of us or any of our subsidiaries.

Report of the Compensation Committee

The compensation committee establishes and oversees the design and functioning of our executive compensation program. We have reviewed and discussed the foregoing Compensation Discussion and Analysis with the management of the Company. Based on this review and discussion, we recommended to the Board of Directors that the Compensation Discussion and Analysis be included in our Annual Report on Form 10-K for the year ended December 31, 2007.

COMPENSATION COMMITTEE

Thomas G. Campbell
Ted L. Hoffman
William C. Keiper

Certain Relationships and Related Transactions, and Director Independence

Since January 1, 2007, there has not been, nor is there currently proposed, any transaction or series of similar transactions to which we were or are a party in which the amount involved exceeds $120,000 and in which any director, executive officer or beneficial holder of more than 5% of any class of our voting securities or members of such person s immediate family had or will have a direct or indirect material interest.

Procedures for Approval of Related Party Transactions

Pursuant to the charter of our audit committee, all transactions between us and any of our directors, executive officers or related parties are subject to review by our audit committee.

Board Member Independence

The Board of Directors has determined that, except for Mr. Smith, all of the members of the Board of Directors are independent as independence is defined in the Nasdaq Stock Market qualification standards. Mr. Smith is not considered independent because he is currently employed by the Company.

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Securities Exchange Act of 1934 requires our executive officers, directors and persons who beneficially own more than 10% of our common stock to file initial reports of ownership and reports of changes in ownership with the SEC. Such persons are required by SEC regulations to furnish us with copies of all Section 16(a) forms filed by such person.

Based solely on our review of such forms furnished to us and written representations from such reporting persons, we believe that all filing requirements applicable to our executive officers, directors and more than 10% stockholders were met in a timely manner.

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ANNUAL REPORT

Our Annual Report on Form 10-K for the 2007 fiscal year, filed with the Securities and Exchange Commission on March 17, 2008, is being mailed along with this Proxy Statement to all stockholders entitled to notice of and to vote at the Annual Meeting. The Annual Report is not incorporated into this Proxy Statement and is not considered proxy solicitation material. Stockholders may also obtain a copy of the Annual Report, without charge, by writing to Mr. Robert Elliott, Vice President, at our principal executive offices located at 51 Columbia, Aliso Viejo, California 92656. We will furnish upon request any exhibits to the Form 10-K upon the payment by the requesting stockholder of our reasonable expenses in furnishing such exhibits. Our Annual Report on Form 10-K, as well as certain other reports, proxy statements and other information regarding Smith Micro, are also available on our website at http://www.smithmicro.com or the Securities and Exchange Commission s public website at http://www.sec.gov.

OTHER MATTERS

We know of no other matters to be brought before the Annual Meeting. If any other matter is properly presented for consideration at the Annual Meeting, it is intended that the proxies will be voted by the persons named therein in accordance with their judgment on such matters. Discretionary authority with respect to such other matters is granted by the execution of the enclosed Proxy.

All stockholders are urged to complete, sign, date and return the accompanying Proxy Card in the enclosed envelope.

By Order of the Board of Directors,

Corporate Secretary
Aliso Viejo, California
July 11, 2008

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PROXY CARD
SMITH MICRO SOFTWARE, INC.
PROXY
Annual Meeting of Stockholders, August 14, 2008
This Proxy is Solicited on Behalf of the Board of Directors of
Smith Micro Software, Inc.

The undersigned revokes all previous proxies, acknowledges receipt of the Notice of the Annual Meeting of Stockholders to be held August 14, 2008, and the Proxy Statement and appoints William W. Smith, Jr. and Andrew C. Schmidt, and each of them, the Proxy of the undersigned, with full power of substitution, to vote all shares of Common Stock of Smith Micro Software, Inc. (the Company) which the undersigned is entitled to vote, either on his or her own behalf or on behalf of any entity or entities, at the Annual Meeting of Stockholders of the Company to be held at the offices of Reed Smith LLP, located at 355 South Grand Avenue, 28th Floor, Los Angeles, California 90071 on Thursday, August 14, 2008, at 10:00 a.m. Pacific Time (the Annual Meeting), and at any adjournment or postponement thereof, with the same force and effect as the undersigned might or could do if personally present thereat. The shares represented by this Proxy shall be voted in the manner set forth on this proxy card.

1. To elect two directors, each to serve for a three-year term ending at the 2011 Annual Meeting of Stockholders or until his successor is duly elected and qualified;

	FOR	WITHHOLD AUTHORITY TO VOTE
William W. Smith, Jr.		
William C. Keiper		

	FOR	AGAINST	ABSTAIN
2. To ratify the appointment of Singer Lewak Greenbaum and Goldstein, LLP as independent registered public accounting firm of the Company for the fiscal year ending December 31, 2008.	o	o	o
3. In accordance with the discretion of the proxy holders, to act upon all matters incident to the conduct of the meeting and upon other matters as may properly come before the meeting or any adjournment or postponement thereof.	o	o	o

The Board of Directors recommends a vote IN FAVOR OF the directors listed above and a vote IN FAVOR OF each of the listed proposals. This Proxy, when properly executed, will be voted as specified above. **If no specification is made, this Proxy will be voted IN FAVOR OF the election of the directors listed above and IN FAVOR OF the other proposals.**

Please print the name(s) appearing on each share certificate(s) over which you have voting authority:

(Print name(s) on certificate)

Please sign your name: Date:

(Authorized Signature(s))

=2> $44,297 100% $11,479 35%

License and implementation. License and implementation revenue increased $9.9 million from $20.6 million for the nine months ended September 30, 2006 to $30.6 million for the nine months ended September 30, 2007, representing a 48% increase. As we began implementation of software products, we began recognizing the related revenue. For the nine months ended September 30, 2007, license and implementation revenue from industries other than the airline industry made up 66% of total license and implementation revenue as compared to 64% during the same period in 2006.

Maintenance and support. Maintenance and support revenue increased $1.5 million from $12.2 million for the nine months ended September 30, 2006 to $13.7 million for the nine months ended September 30, 2007, representing a 13% increase. The increase was a result of our completion of implementations of our software products after September 30, 2006 following which we were able to begin recognizing maintenance and support revenue related to those implementations.

Cost of revenue and gross profit

	Nine months ended September 30					
	2006		2007			
(Dollars in thousands)	**Amount**	**As a percentage of related revenue**	**Amount**	**As a percentage of related revenue**	**Variance $**	**Variance %**
Cost of license and implementation revenue	$8,549	41%	$9,683	32%	$1,134	13%
Cost of maintenance and support revenue	2,713	22%	3,459	25%	746	28%
Total cost of revenue	$11,262	34%	$13,142	30%	$1,880	17%
Gross profit	$21,556	66%	$31,155	70%	$9,599	45%

Cost of license and implementation revenue. Cost of license and implementation revenue increased $1.1 million from $8.6 million for the nine months ended September 30, 2006 to $9.7 million for the nine months ended September 30, 2007 representing a 13% increase. The increase in cost of license and implementation revenue is attributable to a $641,000 increase in personnel costs, a $594,000 increase in travel expenses and a $158,000 increase in stock-based compensation expense from options issued in 2007, partially offset by decreases in other expenses. The increase in personnel and travel expenses is related to an increase in the number and size of our in-progress implementations. License and implementation gross margin increased from 59% to 68% in the nine months ended September 30, 2007 due to improvements in our implementation processes and the standardization of our software products. Cost of license and implementation revenue may vary from period to period depending on a number of factors, including the amount of implementation services required to deploy our products.

Cost of maintenance and support revenue. Cost of maintenance and support revenue increased $746,000 from $2.7 million for the nine months ended September 30, 2006 to $3.5 million for the nine months ended September 30, 2007, representing a 28% increase. The increase in cost of maintenance and support revenue is primarily attributable to an increase in average support personnel in 2007. Maintenance and support gross margins decreased from 78% to 75% for the nine months ended September 30, 2007, which resulted from an overall increase in resources dedicated to maintenance and support projects and support personnel headcount in 2007 to provide increased levels of support to our current and future installed customer base.

Gross profit. Gross profit increased $9.6 million from $21.6 million for the nine months ended September 30, 2006 to $31.2 million for the nine months ended September 30, 2007, representing a 45% increase. The increase in our overall gross margin was attributable to the improvement in our license and implementation gross margins, partially offset by a reduction in our maintenance and support gross margin.

Operating expenses

	Nine months ended September 30					
	2006		2007			
(Dollars in thousands)	**Amount**	**As a percentage of total revenue**	**Amount**	**As a percentage of total revenue**	**Variance $**	**Variance %**
Selling, general and administrative	$10,047	31%	$11,530	26%	$1,483	15%
Research and development	7,075	22%	12,394	28%	5,319	75%
Total operating expenses	$17,122	52%	$23,924	54%	$6,802	40%

Selling, general and administrative. Selling, general and administrative expenses increased $1.5 million from $10.0 million for the nine months ended September 30, 2006 to $11.5 million for the nine months ended September 30, 2007, representing a 15% increase. The increase in selling, general and administrative expenses is primarily attributable to an increase of $504,000 in stock-based compensation expenses from options granted in 2007, $325,000 of expenses associated with being a publicly traded company, primarily professional fees, and $208,000 of selling and marketing expenses, including personnel expenses.

Research and development. Research and development expenses increased $5.3 million from $7.1 million for the nine months ended September 30, 2006 to $12.4 million for the nine months ended September 30, 2007, representing a 75% increase. The increase in research and development expenses is principally attributable to a $4.7 million increase in compensation and benefits and related overhead expenses resulting from an increase in our product development and product management activities related to our software products, a $270,000 increase in stock-based compensation expense from options granted in 2007 and $200,000 of third party professional fees.

Interest income, net

(Dollars in thousands)	2006 Amount	2007 Amount	Variance $	Variance %
Interest income, net	$1,405	$232	$(1,173)	(84)%

Interest income, net decreased $1.2 million from $1.4 million for the nine months ended September 30, 2006 to $232,000 for the nine months ended September 30, 2007, representing a 84% decrease. The decrease was the result of interest expense of $869,000 for the nine months ended September 30, 2007 as compared to $0 for the nine months ended September 30, 2006. The interest expense in 2007 was the result of the interest on the $20.0 million term loan and the expensing of $397,000 of deferred financing costs resulting from the retirement of the $20.0 million term loan in connection with our initial public offering. Interest expense, net also reflected lower interest earned on a smaller average cash and cash equivalent balances over the period due to the redemption of the preferred stock in the amount of $17.4 million and the payment of a one-time cash dividend of $41.3 million to all common stockholders in March 2007.

Income tax provision

	Nine months ended September 30	
(Dollars in thousands)	2006 Amount	2007 Amount
Effective tax rate	20%	5%
Income tax provision	$1,151	$398

Our income tax provision decreased $753,000 from $1.2 million for the nine months ended September 30, 2006 to $398,000 for the nine months ended September 30, 2007, representing a 65% decrease. In the third quarter of 2007, we recognized a tax benefit of $1.1 million upon the reversal of a valuation allowance previously recorded against our deferred tax assets. This reversal was the result of our determination during the third quarter that it was more likely than not that the associated deferred tax assets would be realized. Without this reversal our effective tax rate would have been 20%. Our effective tax rate historically has been lower than the statutory rate of 34% largely due to the application of general business tax credits.

Year ended December 31, 2005 compared to year ended December 31, 2006

Revenue

	Year ended December 31					
	2005		2006			
(Dollars in thousands)	**Amount**	**As a percentage of total revenue**	**Amount**	**As a percentage of total revenue**	**Variance $**	**Variance %**
License and implementation	$ 20,190	57%	$ 29,604	64%	$ 9,414	47%
Maintenance and support	14,940	43%	16,423	36%	1,483	10%
Total	$ 35,130	100%	$ 46,027	100%	$ 10,897	31%

License and implementation. License and implementation revenue increased $9.4 million from $20.2 million in 2005 to $29.6 million in 2006, representing a 47% increase. Beginning in 2005 and continuing in 2006, we began to experience significantly increased sales of our software products. As we began implementing those software products in late 2005 and 2006, we began recognizing the related revenue. During 2006, license and implementation revenue from the airline industry decreased as a percentage of total license and implementation revenue.

Maintenance and support. Maintenance and support revenue increased $1.5 million from $14.9 million in 2005 to $16.4 million in 2006, representing a 10% increase. The increase was the result of our completion of implementations of our software products in 2006 following which we were able to begin recognizing maintenance and support revenue for those implementations.

Cost of revenue and gross profit

	Year ended December 31					
	2005		2006			
(Dollars in thousands)	**Amount**	**As a percentage of related revenue**	**Amount**	**As a percentage of related revenue**	**Variance $**	**Variance %**
Cost of license and implementation revenue	$10,071	50%	$12,079	41%	$2,008	20%
Cost of maintenance and support revenue	3,310	22%	3,526	21%	216	7%
Total cost of revenue	$13,381	38%	$15,605	34%	$2,224	17%
Gross profit	$21,749	62%	$30,422	66%	$8,673	40%

Cost of license and implementation revenue. Cost of license and implementation revenue increased $2.0 million from $10.1 million in 2005 to $12.1 million in 2006, representing a 20% increase. The increase in cost of license and implementation revenue is attributable to a $1.1 million increase in personnel costs and allocated overhead in 2006, a $572,000 increase in travel expenses and the reduction of cost of license and implementation revenue in 2005 associated with a $304,000 settlement with a third party vendor. These increased expenses were related to a need to service the increase in our implementations. License and implementation gross margin increased from 50% to

59% in 2006 due to improvements in our implementation processes and the standardization of our software products.

Cost of maintenance and support revenue. Cost of maintenance and support revenue increased $216,000 from $3.3 million in 2005 to $3.5 million in 2006, representing a 7% increase. The entire increase in cost of maintenance and support revenue is attributable to an increase in personnel costs and allocated overhead in 2006 to provide increased levels of support to our larger installed customer base. Maintenance and support gross margin remained relatively unchanged from 2005 to 2006.

Gross profit. Gross profit increased $8.7 million from $21.7 million in 2005 to $30.4 million in 2006, representing a 40% increase. The increase in our overall gross margin was the result of the improvement in our license and implementation gross margin. In addition, the increase in maintenance and support revenue also contributed to the increase in our overall gross margin, as maintenance and support revenue had a higher gross margin than license and implementation revenue.

Operating expenses

	Year ended December 31					
	2005		2006			
(Dollars in thousands)	**Amount**	**As a percentage of total revenue**	**Amount**	**As a percentage of total revenue**	**Variance $**	**Variance %**
Selling, general and administrative	$12,010	34%	$13,261	29%	$1,251	10%
Research and development	6,399	18%	10,332	22%	3,933	61%
Total operating expenses	$18,409	52%	$23,593	51%	$5,184	28%

Selling, general and administrative. Selling, general and administrative expenses increased $1.3 million from $12.0 million in 2005 to $13.3 million in 2006, representing a 10% increase. The increase is attributable to a $1.2 million increase in incentives and personnel involved in sales activities.

Research and development. Research and development expenses increased $3.9 million from $6.4 million in 2005 to $10.3 million in 2006, representing a 61% increase. The increase in research and development expenses is attributable to a $3.3 million increase in compensation and benefits resulting from an increase in our product development and product management activities related to our pricing analytics and pricing execution software products.

Interest income, net

	Year ended December 31			
	2005	2006		
(Dollars in thousands)	**Amount**	**Amount**	**Variance $**	**Variance %**
Interest income, net	$1,074	$1,921	$847	79%

Interest income, net increased $847,000 from $1.1 million in 2005 to $1.9 million in 2006, representing a 79% increase. The increase was the result of additional interest earned on our increased average cash and cash equivalent balances in 2006.

Income tax provision

	Year ended December 31	
	2005	2006
(Dollars in thousands)	Amount	Amount
Effective tax rate	22%	20%
Income tax provision	$975	$1,725

Our income tax provision increased $750,000 from $975,000 in 2005 to $1.7 million in 2006, representing a 77% increase. The increase in our income tax provision primarily resulted from the $4.3 million increase in our taxable income. Our effective tax rate decreased from 22% of taxable income in 2005 to 20% of taxable income in 2006. The decrease in our effective tax rate was primarily attributable to an increase in our deductions related to developing our software products.

Year ended December 31, 2004 compared to year ended December 31, 2005

Revenue

	Year ended December 31					
	2004		2005			
(Dollars in thousands)	Amount	As a percentage of total revenue	Amount	As a percentage of total revenue	Variance $	Variance %
License and implementation	$20,015	62%	$20,190	57%	$175	1%
Maintenance and support	12,431	38%	14,940	43%	2,509	20%
Total	$32,446	100%	$35,130	100%	$2,684	8%

License and implementation. License and implementation revenue increased $175,000 from $20.0 million in 2004 to $20.2 million in 2006, representing less than a 1% increase. Although we sold additional software products in 2005, we did not begin recognizing significant revenue from those sales until implementation began in late 2005 and during 2006.

Maintenance and support. Maintenance and support revenue increased $2.5 million from $12.4 million in 2004 to $14.9 million in 2005, representing a 20% increase. The increase was the result of the completed implementations of software products in 2005 following which we were able to commence recognizing maintenance and support revenue related to those implementations.

Cost of revenue and gross profit

	Year ended December 31					
	2004		2005			
(Dollars in thousands)	**Amount**	**As a percentage of related revenue**	**Amount**	**As a percentage of related revenue**	**Variance $**	**Variance %**
Cost of license and implementation revenue	$10,639	53%	$10,071	50%	$(568)	(5)%
Cost of maintenance and support revenue	2,750	22%	3,310	22%	560	20%
Total cost of revenue	13,389	41%	13,381	38%	$(8)	0%
Gross profit	$19,057	59%	$21,749	62%	$2,692	14%

Cost of license and implementation revenue. Cost of license and implementation revenue decreased $568,000 from $10.6 million in 2004 to $10.1 million in 2005, representing a 5% decrease. The decrease in 2005 was largely due to a $304,000 settlement with a third party vendor that was credited to cost of license and implementation revenue in that year. License and implementation gross margin increased 47% to 50% in 2005 due to improvements in our implementation processes and the standardization of our software products.

Cost of maintenance and support revenue. Cost of maintenance and support revenue increased $560,000 from $2.8 million in 2004 to $3.3 million in 2005, representing a 20% increase. The entire increase in cost of maintenance and support revenue is attributable to an increase in average support personnel headcount and allocated overhead in 2005 to provide increased levels of support to our larger installed customer base. Maintenance and support gross margin remained unchanged from 2004 to 2005.

Gross profit. Gross profit increased $2.7 million from $19.1 million in 2004 to $21.7 million in 2005, representing a 14% increase. The increase in our overall gross margin was the result of the improvement in our license and implementation gross margin. In addition, the increase in maintenance and support revenue also contributed to the increase in our overall gross margin, as maintenance and support revenue had a higher gross margin than license and implementation revenue.

Operating expenses

	Year ended December 31					
	2004		2005			
(Dollars in thousands)	**Amount**	**As a percentage of total revenue**	**Amount**	**As a percentage of total revenue**	**Variance $**	**Variance %**
Selling, general and administrative	$8,969	28%	$12,010	34%	$3,041	34%
Research and development	6,262	19%	6,399	18%	137	2%
Total operating expenses	$15,231	47%	$18,409	52%	$3,178	21%

Selling, general and administrative. Selling, general and administrative expense increased $3.0 million from $9.0 million in 2004 to $12.0 million in 2005, representing a 34% increase. The increase was attributable to a $1.8 million increase in compensation and benefits related to the increased number of personnel involved in sales activities and an increase of $251,000 in travel expenses. The increase was also due to a $497,000 increase in our marketing costs, including a $160,000 increase related to our annual conference and attendance at industry trade shows, a $150,000 increase in industry analyst costs and a $187,000 increase in other marketing related costs. In addition, the increase was attributable to an increase in general and administrative expenses of $193,000 related to additional professional fees, including accounting and legal fees.

Research and development. Research and development expense remained relatively constant in 2005 as compared to 2004, but grew on a quarterly basis during 2005 as we began increasing our spending to enhance our software product offerings.

Interest income, net

	2004	2005		
(Dollars in thousands)	**Amount**	**Amount**	**Variance $**	**Variance %**
Interest income, net	$366	$1,074	$708	193%

Interest income, net increased $708,000 from $366,000 in 2004 to $1.1 million in 2005, representing a 193% increase. The increase was attributable to an increase in overall market interest rates and in our average cash and cash equivalent balances in 2005.

Income tax provision

	Year ended December 31	
	2004	**2005**
(Dollars in thousands)	**Amount**	**Amount**
Effective tax rate	13%	22%
Income tax provision	$536	$975

Our income tax provision increased from $536,000 in 2004 to $975,000 in 2005 representing a 82% increase. The $438,000 increase in 2005 was attributable to a tax benefit of $212,000 in 2004 resulting from a reduction in our valuation allowance and an increase in our taxable income of $222,000 in 2005. During 2004, we determined that it was more likely than not that future taxable income would be sufficient to realize the portion of the deferred tax asset related to our temporary differences and as a result reversed a portion of the valuation allowance and recorded an income tax benefit of approximately $212,000.

Selected quarterly data

(Dollars in thousands)	2005				2006				2007		
	March 31	June 30	Sept. 30	Dec. 31	March 31	June 30	Sept. 30	Dec. 31	March 31	June 30	Sept. 30
Revenue											
License and implementation	$4,745	$4,533	$5,045	$5,867	$5,707	$6,657	$8,275	$8,965	$9,023	$9,894	$11,661
Maintenance and support	3,635	3,703	3,684	3,918	3,911	4,078	4,190	4,244	4,429	4,522	4,768
Total revenue	8,380	8,236	8,729	9,785	9,618	10,735	12,465	13,209	13,452	14,416	16,429
Cost of Revenue											
License and implementation	3,055	2,530	1,954	2,532	2,406	2,861	3,281	3,531	3,189	3,218	3,276
Maintenance and support	733	774	865	938	866	953	894	813	989	1,105	1,365
Total cost of revenue	3,788	3,304	2,819	3,470	3,272	3,814	4,175	4,344	4,178	4,323	4,641
Gross profit	4,592	4,932	5,910	6,315	6,346	6,921	8,290	8,865	9,274	10,093	11,788
Gross margin	54.8%	59.9%	67.7%	64.5%	66.0%	64.5%	66.5%	67.1%	68.9%	70.0%	71.8%
Operating expenses											
Selling, general and administrative	3,032	3,004	2,830	3,144	3,362	3,207	3,477	3,214	3,148	3,777	4,605
Research and development	1,126	1,517	1,858	1,898	2,147	2,257	2,671	3,257	3,741	4,324	4,329
Total operating expenses	4,158	4,521	4,688	5,042	5,509	5,464	6,148	6,471	6,889	8,101	8,934
Income from operations	434	411	1,222	1,273	837	1,457	2,142	2,394	2,385	1,992	2,854
Interest income (expense), net	187	244	286	357	430	477	498	516	516	(380)	95
Interest income taxes	621	655	1,508	1,630	1,267	1,934	2,640	2,910	2,901	1,612	2,949
Income tax provision (benefit)	137	145	333	360	250	381	520	574	606	344	(552)
Net income	$484	$510	$1,175	$1,270	$1,017	$1,553	$2,120	$2,336	$2,295	$1,268	$3,501
Net earnings attributable to common stockholders per share:											
Basic	$0.02	$0.03	$0.07	$0.06	$0.05	$0.07	$0.10	$0.11	$0.11	$0.06	$0.14
Diluted	$0.02	$0.03	$0.06	$0.06	$0.04	$0.07	$0.10	$0.11	$0.11	$0.06	$0.13

License and implementation revenue increased on a quarterly basis as sales increased in 2005, 2006 and the nine months ended September 30, 2007 over the previous period's levels. Maintenance and support revenue increased on a quarterly basis as implementations were completed and the related maintenance period began.

License and implementation gross margins generally increased on a quarterly basis principally due to the increasing standardization of our products and implementation efficiencies. Prior to 2007, maintenance and support gross margins were in the 76-81% range across all quarters. In 2007, we began to invest in the expansion of our infrastructure to support our growing installed base of customers, which resulted in a reduction of maintenance and support gross margins in the second and third quarters of 2007. The increase in gross margin in the three months ended September 30, 2005 was partially attributable to a reduction in cost of license and implementation revenue associated with a $304,000 settlement with a third party vendor. Overall gross margin improvements were driven by improvements in license and implementation gross margin and the increase of maintenance and support revenue. Selling, general and administrative expenses fluctuate from quarter to quarter based on timing of sales and marketing activities and increased substantially in the third quarter of 2007 in large part as a result of additional expenses associated with being a public company. Research and development expenses increased on a quarterly basis through the second quarter of 2007 principally due to an overall increase in average product development and product management personnel related to our increased investment in the development of our products.

Liquidity and capital resources

In June 1998, we raised $25.0 million from certain individuals and funds associated with TA Associates and JMI Equity through the issuance of convertible preferred stock. In August 2005, those investors converted the convertible preferred stock into 9,750,000 shares of our common stock and 3,921,312 shares of redeemable preferred stock. In August 2006, we redeemed 1,294,030 shares of our redeemable preferred stock for approximately $8.4 million. In March 2007, we redeemed the remaining 2,627,282 shares of redeemable preferred stock for $17.4 million. Based on our cash position, our belief in our ability to generate future cash flows from operations to support and grow our business and the fact that a substantial portion of our common stock had been held for over eight years without liquidity, we paid, in March 2007, a one-time cash dividend in a total amount of $41.3 million to our common stockholders. In March 2007, we incurred $20.0 million in long-term debt to help finance the payment of this cash dividend. In July 2007, we completed our initial public offering and received net proceeds before offering expenses of approximately $52.4 million, of which approximately $20.1 million was used to retire the debt incurred in March 2007 plus accrued interest and $1.8 million was used for expenses related to the offering. Our cash and cash equivalents, combined with our positive cash flow from operating activities are our principal sources of liquidity.

As of September 30, 2007, we had $40.0 million of cash and cash equivalents and $28.1 million in working capital as compared to $42.5 million of cash and cash equivalents and $27.6 million in working capital at December 31, 2006. Historically, we have financed our operations through cash flow from operations. We believe that our existing cash and cash equivalents and our cash flow from future operating activities will be sufficient to meet our anticipated cash needs for the next 12 months.

	Year ended December 31			Nine months ended September 30	
(Dollars in thousands)	**2004**	**2005**	**2006**	**2006**	**2007**
				(unaudited)	**(unaudited)**
Cash provided by (used in) operating activities	$(21,087)	$34,949	$13,519	$ 6,430	$ 6,758
Cash used in investing activities	(1,293)	(766)	(1,090)	(749)	(1,656)
Cash provided by (used in) financing activities	(176)	17	(8,378)	(8,385)	(7,631)
Cash and cash equivalents (end of period)	4,290	38,490	42,540	35,786	40,012

The decrease in cash and cash equivalents from December 31, 2006 to September 30, 2007 can be attributed to net cash used in financing activities of $7.6 million representing our $17.4 million redemption of preferred stock, $41.3 million payment of an one-time cash dividend to our stockholders and $1.6 million of initial public offering costs, partially offset by $52.4 million of net proceeds received from our initial public offering. The use of cash in financing and investing activities was partially offset by cash flow generated from operating activities of $6.8 million in the nine months ended September 30, 2007.

Sources of cash from operating activities for the nine months ended September 30, 2007 consisted of (a) $7.1 million of net income, which includes a $1.1 million non-cash tax benefit resulting from the reversal of a valuation allowance previously recorded against our deferred tax assets, (b) $1.8 million of non-cash expense comprised of depreciation and non-cash compensation related to the issuance of stock options in 2007, (c) a $1.2 million increase in deferred revenue and (d) a $418,000 non-cash expense of deferred financing costs. Uses of cash from operating activities for the nine months ended September 30, 2007 consisted of (a) an $815,000 increase in prepaid expenses, (b) a $723,000 increase in unbilled receivables from unbilled implementations in process, (c) a $654,000 increase in accounts payable and accrued liabilities and (d) a $409,000 increase in accounts receivable.

Cash used by operating activities in 2004 includes the purchase of marketable securities of $28.0 million and cash provided by operating activities in 2005 includes the maturities of these marketable securities. Excluding the purchase and the maturities of these marketable securities, cash provided by operations in 2004 was $6.9 million and in 2005 was $6.9 million.

The increase in cash and cash equivalents from December 31, 2005 to December 31, 2006 of $4.1 million is primarily attributable to net cash provided by operating activities of $13.5 million. Sources of cash provided by operating activities in 2006 consisted primarily of (a) a $12.3 million increase in deferred revenue due to an increase in invoiced amounts on contracts in progress; (b) $7.0 million of net income, which included $1.3 million of non-cash expenses comprised principally of depreciation and amortization and (c) a $1.9 million increase in accrued expenses and accounts payable resulting from an increase in accrued employee payroll costs and an increase in accrued contract labor expenses. Uses of cash in operating activities in the same period consisted principally of (a) a $5.3 million increase in accounts receivable due to an increase in invoiced amounts on contracts in progress, net of cash collected; (b) a $1.4 million increase in prepaid and other assets; (c) a $1.2 million increase in deferred taxes and (d) a $1.1 million increase in unbilled accounts receivable. In 2006, net cash used in investing activities was $1.1 million as a result of the purchase of property and equipment, and net cash used in financing activities was $8.4 million primarily due to the partial redemption of our redeemable preferred stock in August 2006.

The increase in cash and cash equivalents from December 31, 2004 to December 31, 2005 of $34.2 million was primarily attributable to net cash provided by operating activities of $34.9 million.

Sources of cash from operating activities in 2005 consisted primarily of (a) $28.0 million of maturities of marketable securities purchased in 2004 that were classified as trading securities; (b) $3.4 million of net income, which included $1.5 million of non-cash expenses comprised principally of depreciation and amortization and (c) a $1.4 million decrease in accounts receivable. Uses of cash in operating activities in the same period consisted primarily of (a) a $478,000 increase in unbilled receivables due to the timing of contractual milestones for which we can bill customers and (b) a $336,000 increase in prepaid and other assets due to deferred costs from fixed term subscriptions. In 2005, net cash used in investing activities was $766,000 as a result of the purchase of property and equipment, and net cash provided by financing activities was $17,000 due to the exercise of the stock options.

Credit facilities

In March 2007, our indirect wholly-owned subsidiary, PROS Revenue Management, L.P., entered into a $28.0 million credit facility, consisting of an $8.0 million revolving credit facility and a $20.0 million term loan, each maturing in five years. The revolving credit facility included borrowing capacity for up to $1.0 million letters of credit and up to $500,000 of same-day swing line loans. All obligations under the credit facility were guaranteed by us and by our other subsidiaries and were collateralized by substantially all of our assets and the assets of our subsidiaries.

Borrowings under this credit facility bore interest at a rate equal to an applicable margin plus, at our option, either a base rate or a Eurodollar rate. The applicable margin for borrowings under the credit facility was 1.5% for base rate borrowings and 2.75% for Eurodollar rate borrowings. In addition to paying interest on outstanding principal under the credit facility, we were required to pay (a) a quarterly fee equal to 0.5% per annum on unused commitments under the revolving credit facility; (b) an annual administration fee of $20,000 and (c) customary letter of credit fees.

In July 2007, we used $20.1 million of proceeds from the initial public offering to retire the remaining $20.0 principal balance of the credit facility and related accrued interest totaling $116,000. In connection with the retirement and termination of the credit facility, deferred financing costs in the amount of $397,000 were expensed in the third quarter of 2007.

Contractual obligations

The following table sets forth our contractual obligations as of December 31, 2006:

	Payments due by period			
(Dollars in thousands)	**Total**	**Less than 1 year**	**1 to 3 years**	**3 to 5 years**
Contractual obligations				
Operating leases	$5,227	$1,004	$3,519	$704
Total	$5,227	$1,004	$3,519	$704

Our only significant operating lease obligation relates to our corporate headquarters in Houston, Texas which we lease under a single non-cancelable operating lease agreement. In March 2006, we executed an amendment to the lease that extended the lease term until July 31, 2011.

Off-balance sheet arrangements

We do not have any relationships with unconsolidated entities or financial partnerships, such as variable interest entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes.

Quantitative and qualitative disclosures about market risk

Foreign currency risk

A small percentage of our contracts are denominated in foreign currencies and therefore a portion of our revenue is subject to foreign currency risks. Our cash flows are subject to minor fluctuations due to changes in foreign currency exchange rates. The effect of an immediate 10% adverse change in exchange rates on foreign denominated receivables as of December 31, 2006 would result in a loss of approximately $29,000. To date, we have not entered into any hedging contracts although we may do so in the future. Fluctuations in currency exchange rates could harm our business in the future.

Interest rate sensitivity

We had cash and cash equivalents totaling $42.5 million at December 31, 2006. These amounts have been invested primarily in short-term interest bearing obligations with original maturities less than 90 days and money market funds. Unrestricted cash and cash equivalents are held for working capital purposes. We do not enter into investments for trading or speculative purposes. We believe that we do not have any material exposure to changes in the fair value as a result of changes in interest rates. Declines in interest rates, however, will reduce future investment income. If overall interest rates fell by 10% in 2006, our interest income would have declined by approximately $192,000, assuming consistent investment levels.

Recent accounting pronouncements

In June 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109,* or FIN 48. FIN 48 clarifies the accounting for uncertainties in income taxes recognized in an enterprise's financial statements. FIN 48 requires that we determine whether it is more likely than not that a tax position will be sustained upon examination by the appropriate taxing authority. If a tax position meets the "more likely than not" recognition criteria, FIN 48 requires the tax position be measured at the largest amount of benefit greater than 50% likely of being realized upon ultimate settlement. We adopted the provisions of FIN 48 on January 1, 2007. As a result of the adoption of FIN 48, we did not incur a tax liability. Any interest and penalties accrued related to uncertain tax positions will be recognized in our income tax provision.

In September 2006, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Current Year Misstatements*, or SAB 108. SAB 108 provides guidance on the approach that companies must follow in quantifying misstatements of their financial statements. SAB 108 requires analysis of misstatements using both an income statement (rollover) approach and a balance sheet (iron curtain) approach in assessing materiality and provides for a one-time cumulative effect transition adjustment. The adoption of SAB 108 did not have a material effect on our consolidated financial position, results of operations or cash flows.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurement,* which defines fair value, establishes a framework for measuring fair value in GAAP and expands disclosures about fair value measurements. SFAS No. 157 does not require any new fair value measurements, but provides guidance on how to measure fair value by providing a fair value hierarchy used to classify the source of the information. SFAS No. 157 is effective for our fiscal year beginning January 1, 2008. We are currently evaluating the impact of adopting SFAS No. 157.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115*. This pronouncement permits entities to use the fair value method to measure certain financial assets and liabilities by electing an irrevocable option to use the fair value method at specified election dates. After election of the option, subsequent changes in fair value would result in the recognition of unrealized gains or losses as period costs during the period the change occurred. SFAS No. 159 becomes effective as of the beginning of the first fiscal year that begins after November 15, 2007, with early adoption permitted. However, entities may not retroactively apply the provisions of SFAS No. 159 to fiscal years preceding the date of adoption. We are currently evaluating the effect that SFAS No. 159 may have on our financial position, results of operations and cash flows.

Business

Overview

We are a leading provider of pricing and revenue optimization software, an emerging category of enterprise applications designed to allow companies to improve financial performance by enabling better pricing. By using our software products, our customers gain insight into their pricing strategies, identify detrimental pricing practices, optimize their pricing decision-making and improve their business processes and financial performance. Our software products incorporate advanced pricing science, which includes operations research, forecasting and statistics. Our innovative science-based software products analyze, execute and optimize pricing strategies using data from traditional enterprise applications, often augmenting it with real-time and historical data. Our software also uses data elements that are determined using advanced pricing science and are stored in our database. We provide professional services to configure our software products to meet the specific pricing needs of each customer.

We had 96 customers in the manufacturing, distribution, services, hotel and cruise, and airlines industries in 43 countries with over 200 implementations of our software products as of September 30, 2007. Many of our customers process large volumes of individually priced business-to-consumer and business-to-business transactions every day. Our high-performance, real-time, dynamic pricing products differ from static retail pricing products by delivering the relevant pricing information at the time the price is quoted, the deal is negotiated and the sale transaction is made. Our software products are also used to provide optimized price lists and goal-driven price guidance. While companies in our target industries differ in the wide range of business-to-business and business-to-customer products and services that they provide, many are similar in their need to optimally and dynamically price each individual transaction.

We recorded revenue of $35.1 million, $46.0 million and $44.3 million in 2005, 2006, and the nine months ended September 30, 2007, respectively, and have achieved eight consecutive years of profitability. Approximately 60%, 63% and 65% of our total revenue came from customers outside the United States in 2005, 2006 and the nine months ended September 30, 2007, respectively. In 2005, 2006 and the nine months ended September 30, 2007, 56%, 66% and 66%, respectively, of our license and implementation revenue was derived from companies in the manufacturing, distribution, services and hotel and cruise industries and the remainder was derived from companies in the airline industry.

Industry background

Pricing is an important component of an enterprise's business processes and financial performance. Companies in the manufacturing, distribution, services, hotel and cruise, and airline industries can face a variety of pricing problems such as unnecessary discounting and quoting prices below breakeven. We believe that improving pricing is one of the most strategic and powerful ways for companies to improve their business and financial performance. According to a 2006 Gartner Research report, on average, a 1% improvement in price translated to an 11% increase in profitability. By contrast, according to the same report, a 1% improvement in fixed costs or in variable costs only increases profitability by 3% and 7%, respectively.

The need for better pricing

A variety of trends are accelerating the need for better pricing, including:

Increasingly complex markets and business models. Globalization of business organizations and proliferation of product SKUs, lines, business-to-business and business-to-consumer distribution channels and customer segments have led to complexity in achieving optimal pricing.

Increased sophistication of purchasers. With the advent of better communication channels, purchasers have increased access to pricing-related market information and to greater technology resources to determine lowest pricing. Thus, purchasers have a high level of pricing transparency, which gives them advantages relative to vendors in purchasing processes.

Proliferation of pricing entities and competitive alternatives. Technological advances, in particular the Internet, have driven an increase in the number of potential vendors, distribution channels and product alternatives. This proliferation has exponentially increased the amount of price information that companies must track in order to ensure their offerings are competitively and optimally priced.

Increase in the quantity of enterprise data. Widespread adoption of enterprise applications, such as enterprise resource planning, or ERP, customer relationship management, or CRM, and supply chain management, or SCM, systems has produced a substantial amount of enterprise data, including information about individual sale transactions. We believe that companies need ways to aggregate and use this raw data to improve pricing strategies.

Diminishing return from traditional enterprise applications. Companies use ERP, CRM and SCM software products to improve efficiency and drive increased profitability through lower costs. However, as these software products become more widely adopted, companies are experiencing diminishing returns from additional investments in these technologies. We believe companies are looking for new ways to improve their financial results. Pricing and its impact on revenue have received comparatively little attention, and we believe companies have the potential to generate a high return on investment by improving price.

The pricing problem

We believe most companies have yet to develop and implement pricing technology solutions that improve financial performance. We believe this failure creates a pricing problem, the key components of which include:

Limited visibility into the pocket price and pocket margin. The pocket price is a measure of the effective price paid by the customer in a particular transaction after accounting for all relevant discounts, promotions, rebates and allowances. The pocket margin is a measure of the profitability of a particular transaction determined after subtracting direct product costs and other costs attributed to a customer, or customer cost-to-serve, from the pocket price. Companies can face challenges in determining the pocket price and pocket margin of their products due in part to the lack of timely access to relevant data. Without an accurate view of the pocket price and pocket margin, it is difficult for companies to determine the profit contributions of products, customers or individual transactions. Additionally, many companies are often unaware of trends in pocket prices and pocket margins. As a result, such companies may have difficulty in determining the economic impact of changing prices, optimizing current prices or forecasting future prices.

Lack of uniform pricing strategies throughout the enterprise. We believe most companies do not have a centralized process for managing overall pricing or communicating and enforcing pricing policies consistently across business-to-business and business-to-consumer sales channels and business segments. As a result, we believe that sales representatives often negotiate and quote prices that do not support corporate business goals or financial targets. The absence of uniform pricing policies and goals across an organization leads to conflicting practices among various internal functions, such as sales, marketing and finance.

Unscientific, ad-hoc approach to pricing. Most companies rely on a combination of manual processes, external consultants, spreadsheets or internally developed software tools to conduct pricing activities. Our experience with customers leads us to believe that current pricing decision support tools often are unable to efficiently process large volumes of data in a timely fashion, lack sophisticated mathematical tools or generate inaccurate pricing information. Because of the difficulty in analyzing data in a scientific manner and setting optimal prices, we believe many companies often set prices in an ad-hoc manner. As a result, they may also be unable to track prices and analyze pricing performance, such as the response in demand due to price changes.

Lack of complete, relevant and timely data. Companies have access to large quantities of data generated by traditional enterprise applications spread across complex global information technology environments. This dispersed data is difficult to aggregate, analyze or make available in a timely fashion. Additionally, internal systems often lack market data and the capability for real-time processing over numerous complex transactions. As a result, most companies today do not have the necessary and relevant information to make data-driven pricing decisions at the time of sale or to individually price each transaction.

Market opportunity

The potential for business and financial improvement from pricing software solutions has generated increasing focus on addressing the pricing problem through pricing and revenue optimization software products. We believe companies have only begun to realize the benefits from these solutions.

We believe a comprehensive pricing software solution should provide:

Pricing analytics. The ability to analyze enterprise and market data to gain insights into pricing strategies and practices.

Pricing execution. The ability to disseminate pricing decisions to either users or to other enterprise applications, such as ERP, CRM or SCM applications, in order to offer a sales force easy-to-use guidelines that help select a profitable price.

Pricing optimization. The ability to determine and forecast the price sensitivity of a product or a market segment and to generate optimal pricing strategies to achieve corporate business goals or financial targets.

A leading provider of pricing and revenue optimization solutions must also be able to implement and support these systems on a global basis across multiple industries and in complex and changing IT and business environments.

We believe the market for pricing and revenue optimization solutions is a large and rapidly growing opportunity that spans most major industries. An August 2006 AMR Research report estimated that the price management applications market will be $348 million in 2007 and will grow to approximately $1.1 billion in 2010, a compound annual growth rate of 46%. We believe that the overall pricing and revenue optimization software market includes additional elements not considered in this AMR Research report.

Our solution

The PROS Pricing Solution Suite is our set of integrated software products that enables enterprises in the manufacturing, distribution, services, hotel and cruise, and airline industries to apply pricing science to determine, analyze and execute optimal pricing strategies. Our software products support pricing decisions through the aggregation and analysis of extensive enterprise application data, transactional data and market information. Our PROS Pricing Solution Suite addresses three areas necessary to implement and execute an effective pricing solution:

Pricing analytics. Our pricing analytics software product provides dynamic visibility into pricing data and performance across the different segments of a business. These analytics help companies understand the pocket margin and its components and locate detrimental pricing trends and underperforming segments of their businesses.

Pricing execution. Our pricing execution software products help companies set and implement pricing policies throughout an enterprise and improve execution through pricing decision and negotiation support. Our execution software products allow our customers to strategically manage a large number of prices, which helps to institutionalize pricing best practices and enforce compliance with pricing policies.

Pricing optimization. Our pricing optimization software products provide companies with pricing-related predictive analytics in order to optimize their pricing decision-making. Using market and company data, our optimization software products enable our customers to forecast and determine an optimal price within a given set of objectives, such as maximizing market share, revenue or profit.

Key benefits

Our software products help our customers improve their business and financial performance through several key benefits, which include:

Science-based approach to pricing. Our software products enable our customers to apply advanced pricing science to identify and address their unique and complex pricing challenges. Our software products include a variety of advanced pricing analytics and forecasting and optimization engines that incorporate our pricing expertise and support real-time, high volume, individually priced transactions with accurate pricing information.

Improved business insight. Our software products enable our customers to gain insight into their business strategy, segment and product profitability and pricing challenges. As a result, our customers can identify and characterize the relative attractiveness of products, customers, geographies and even individual transactions based on sales volume and overall profitability.

Enhanced planning and decision making. Our software products enhance our customers' ability to process and implement pricing policies in a systematic manner. As a result, they are able to pursue more sophisticated and effective pricing strategies and make more informed pricing decisions. Additionally, our software products help companies implement best practices uniformly throughout an enterprise, from sales to marketing to finance.

Our strengths

We believe the following key strengths differentiate us:

Extensive experience in pricing and revenue optimization. We have a 20-year track record of providing pricing and revenue optimization software products to numerous customers in a variety of industries. Our software products are integrated into our customers' systems and processes, allowing us to gain significant insight into the most complex and demanding pricing problems. We believe that our experience in delivering pricing software products that are strategically important to our customers has enabled us to build a strong reputation within the pricing and revenue optimization market.

Thought leadership in pricing and revenue optimization science. We focus exclusively on the pricing and revenue optimization market. We employ a team of 30 scientists who actively participate in the pricing research community and work closely with our customers to improve pricing methodologies. As a result, we have developed extensive expertise in pricing, and we believe our thought leadership in pricing science enables us to develop and deliver leading pricing and revenue optimization software products.

High-performance software architecture with proven scalability. Our software products currently operate in some of the largest, most complex and demanding information technology environments. In high volume transaction applications, PROS software products can handle hundreds of simultaneous users and transactions per second and individually price each transaction. We continue to invest in improving the scalability, reliability and performance of our software products for large global customers.

Broad pricing and revenue optimization capabilities. Our PROS Pricing Solution Suite addresses analytics, execution and optimization in an integrated platform. Our software products offer a broad feature set and are designed to be configurable to the unique needs of our customers across industries. We also provide a range of services to our customers that include analyzing a company's current pricing processes, identifying detrimental pricing practices and implementing our software products to improve pricing strategies.

Global diversified customer base across industries. Our software is used by customers around the world across a number of industries, including manufacturing, distribution, services, hotel and cruise, and airline. As of September 30, 2007, we had 96 customers across five industries in 43 countries with over 200 implementations of our software products. Our software accommodates global requirements such as currency conversion, units of measure and unique country-specific pricing processes.

Our strategy

Our objective is to be the leading global provider of pricing and revenue optimization software. To achieve this goal, we are pursuing the following strategies:

Continue to penetrate our five vertical markets. We believe the strategic importance of our pricing and revenue optimization solutions will help us attract new customers in our five vertical markets. We intend to expand our customer base by growing our sales force to acquire new customers in these markets.

Continue to sell additional products to existing customers. We develop close relationships with our customers by identifying and addressing their high value pricing needs during the implementation of our software products and by enabling pricing best practices within their organizations. Over the past three years, customers have renewed an average of 96% of the maintenance and support revenue that was up for renewal. Our focus on customer service creates opportunities to sell additional pricing solutions and increase penetration within an organization.

Extend our pricing thought leadership through science innovations. We plan to extend our thought leadership in pricing science by working on our customers' demanding pricing problems and increasing our investment in advanced scientific pricing research. We also plan to promote the use of pricing software products through our research publications and pricing conferences.

Extend our technology leadership through product innovations. We intend to extend our technology leadership by increasing our investment in research and development to deliver more advanced pricing software solutions to our customers. We also intend to make further investments to enhance the scalability of our pricing software products, which we believe is a key differentiator of our solutions. In addition, we will continue to include new functionality in our software products based on our knowledge of our customers' pricing problems.

Products

Our PROS Pricing Solution Suite consists of our pricing analytics, pricing execution and pricing optimization software products. The design of our PROS Pricing Solution Suite allows our customers to deploy all of the products at once or to implement our products incrementally. Our pricing analytics software product is the base product that is present in all implementations. Our pricing execution products, pricing manager and deal manager, extend the usability of the base analytics product and provide real-time transaction level optimized prices by customer and product. Our pricing optimization products help companies arrive at an optimal price by analyzing the relationships among demand, price and profit margin. By deploying multiple products, our customers can analyze their pricing trends, execute consistent pricing policies, effectively negotiate prices and optimize their prices to support organizational goals.

Our PROS Pricing Solution Suite uses our PROS Database, which includes pricing data elements determined using advanced pricing science, including the pocket price, pocket margin, customer willingness-to-pay, customer cost-to-serve, win-loss ratios, market price, stretch price and other relevant information. Data sources also include our customers' enterprise applications and external market data sources. Our PROS Database uses our internally developed data loaders to import data from these data sources for access by our PROS Pricing Solution Suite. The users of our PROS Pricing Solution Suite include executives, sales and marketing personnel, pricing managers and finance personnel. Hundreds of man-years of development and science effort are contained in one common set of code, which we believe allows us to configure our software products to meet each of our customer's unique requirements.

Pricing analytics

Our pricing analytics software product helps companies gain insight into their pricing performance, allowing them to take action to correct poor performance and take advantage of time-sensitive opportunities. Our pricing analytics software product enables our customers to:

- determine pocket price and pocket margins by discrete metrics, such as by customer, product, channel, plant, sales territory and country;
- understand how various price and cost elements contribute to the pocket margin;
- identify and understand detrimental pricing trends;
- understand the components of margin variance, including price, cost, volume, product mix and exchange rate effects;
- understand differences in segment purchasing behavior;
- proactively monitor pricing performance and market conditions; and
- determine how individual customers contribute to overall revenue and profitability.

Pricing execution

Our pricing execution software products consist of the pricing manager and deal manager products.

Pricing manager. Our pricing manager product allows companies to streamline pricing processes and institute control of pricing policies to support corporate business goals. It allows organizations to create multiple rules-based price lists and quickly modify prices or guidelines in response to changes in business conditions or strategy. Our pricing manager product enables our customers to:

- create and manage pricing policies and rules that are aligned with corporate strategies;
- automatically generate mass price updates when pricing inputs change, including costs, competitor prices, market indices, supply availability or demand metrics;
- set up and manage field pricing and discounting guidelines based on pricing policies and benchmarks; and
- manage pricing approval and exception thresholds and the pricing approval workflow to ensure consistency in the pricing process and maintain transaction histories.

Deal manager. Our deal manager product provides pricing decision-makers with guidelines, additional context and information to negotiate better prices. Specifically, the deal manager product enables our customers to:

- more accurately understand transaction economics including the impact of discounts, rebates, allowances, shipping terms, payment terms, replacement costs and other factors that can influence the profitability of a transaction;
- communicate price targets, price floors and profitability guidelines to appropriate decision-makers within an organization;
- consider important transaction context to aid in better price negotiations, including insight into customer price history and willingness-to-pay, current and planned inventory levels and recent trends in demand, supply, cost or competition; and
- evaluate transaction scenarios and allow comparisons to previous transactions and peer group benchmarks based on relevant metrics.

Pricing optimization

Our pricing optimization software products help companies arrive at an optimal price by analyzing the relationships among demand, price and profit margin taking into account operational and financial constraints. Our pricing optimization software products use advanced statistical techniques to determine optimal prices consistent with pricing strategies. These products utilize optimization and forecasting engines to solve many distinct pricing problems. Our pricing optimization software products enable our customers to:

- analyze and understand factors that influence demand in conjunction with price;
- understand customer or segment price elasticities and customer indifferences or cluster customers into segments based on purchasing behavior;
- construct and execute price testing to systematically manage and evaluate results of price changes;
- forecast demand and response to demand using a library of forecasting algorithms that support a vast number of business scenarios and that consider relevant variables; and

run optimization algorithms and apply appropriate methodology to recommend optimized prices or other business controls.

Technology

Software architecture. Our software architecture is based on open standards such as Java, XML and HTTP. We have created a component-based design in a service-oriented architecture to develop a flexible, layered framework. This framework supports evolution and innovation in technologies and product features.

Optimization. We have developed robust science-based forecasting and optimization engines, leveraging the deep expertise and research of our science and research group. These engines are industry-independent and are validated using our internally-developed verification and testing processes.

Configuration vs. customization. Rather than developing custom code for each customer, our PROS Pricing Solution Suite can be configured to meet each customer's business needs. The configuration capabilities include defining user workflows, executive dashboards, analytic views, approval processes, alerts and data, including hierarchical dimensions and measures.

Performance and scalability. Our solutions operate in some of the largest and most demanding enterprise environments. The scalability of our technology has been tested at leading vendor benchmark performance centers, which validated the ability of our software products to scale to large data volumes and high request rates. For example, in one implementation of our real-time pricing execution product, our software products handled over 300 requests per second with 250 millisecond average response times. Another implementation of our pricing execution product handles 750 concurrent users. Also, an implementation of our pricing optimization product refreshes and maintains a data set with over one billion forecast entries and 150 million optimization results.

Data integration. The data needed to execute pricing and revenue optimization functionality typically resides in a company's ERP, SCM and CRM systems, industry-specific transaction systems, office productivity tools such as spreadsheets and external market data sources. Rarely can the data needed to formulate and execute optimal pricing strategies be found in a single data source within a company. Our data integration capabilities utilize web services and file-based data interfacing to bring data from these disparate sources together into a single cohesive database to support our PROS Pricing Solution Suite. Our data integration capabilities allow us to quickly deploy our solutions to our customers.

User interface. Our technology provides a rich, browser-based interface that supports local and remote users. The user interface supports a wide variety of highly interactive charts and other data views and provides a comprehensive data security model based on user roles and scope of responsibility.

Platform support. Our software products run on most standard information technology platforms including Microsoft SQL Server and Oracle databases, 32-bit and 64-bit processors from HP, SUN, Intel, AMD and IBM, and the HP-UX, Solaris, Linux, Windows and AIX operating systems.

Science and research

We believe that our long-term investment in pricing science differentiates us from our competitors. As our customers realize value from our pricing software products, we believe that they will seek to address more complex pricing problems through the use of our products.

We employ 30 scientists, 17 of whom are PhDs, all of whom are dedicated to the advancement of pricing and revenue optimization technology and its implementation in our software products. These scientists have specialties including operations research, management science, statistics, econometrics and computational methods. PROS also has a Science Advisory Council, which is comprised of faculty from major research universities to advise on the development of pricing science in our software products. Our scientists regularly interact with our customers, and our product development, sales and marketing, and professional services staff, to keep our science efforts relevant to real-world demands.

Services

Pricing and implementation professional services. Our pricing services personnel are responsible for planning the implementations of our software products and our implementation services personnel are responsible for the configuration and the technical deployment of our software products. We have extensive experience implementing our software products in global enterprises across multiple industries, and we have developed a standardized and tested implementation process. Our pricing professional services include analyzing a customer's current pricing processes, identifying specific high-value pricing needs and relevant pricing data and configuring our software products to the customer's specific business. Our implementation professional services include implementing our software products to configuration specifications, assisting customers in loading and validating pricing data and supporting organizational activities to assist our customers' transition from awareness of their pricing challenges to adoption of pricing excellence best practices. We also provide training services to help use and maintain our software products.

Customer support. After our software products are installed and training is complete, our customer support personnel provide ongoing support and maintenance of our software products. We provide customer support on a centralized basis from our headquarters in Houston, Texas. Our customer support personnel are responsible for providing product support for our customers through our SupportWeb Portal, a web-based interface for submitting and tracking issues, distributing software releases and bug fixes and hosting our knowledge base. In addition, our customer support personnel respond to customer issues promptly using an escalation process that prioritizes reported issues based on a defined set of severity levels and assist customers in deploying our standard releases for each software product by providing release web seminars and documentation.

Customers

We provide our software products to customers in the manufacturing, distribution, services, hotel and cruise, and airline industries. Our customers are generally large global enterprises, although we have customers that are smaller. All of our customers have over $200 million in revenue, and over half of our customers have over $1.0 billion in revenue. Our top 10 customers in 2004, 2005, 2006 and the nine months ended September 30, 2007 represented 58%, 56%, 44% and 49% of our revenue, respectively. In 2006, we had no single customer that accounted for 10% or more of revenue. In 2005, The Hertz Corporation accounted for approximately 10% of our revenue.

Approximately 52%, 60%, 63% and 65% of our revenue in 2004, 2005, 2006 and the nine months ended September 30, 2007, respectively, was attributable to customers located outside of the United States. We currently do not have any significant assets outside of the United States to support our operations. For information regarding our revenue by geographic area and risk associated thereto, see Note 9 to the consolidated financial statements and "Risk factors Our international sales subject us to risks that may adversely affect our operating results."

Case studies

Manufacturing. One of our customers is a global integrated manufacturer of petroleum products and operates hundreds of distribution terminals across the U.S. Our customer experienced difficulty gaining visibility into the price-demand relationships in its business, because doing so required hundreds of different prices to be calculated and disseminated in a short span of time. While the customer had the necessary raw data, the customer did not have the ability to process this information in a timely manner and therefore could not evaluate the effectiveness of pricing decisions. Our software products automated pricing recommendations and forecasts of next days' demand at relative price points and competitor price postings for each distribution terminal. As a result of implementing our software products, our customer experienced a significant decrease in sales volume volatility and realized increased profits in the distribution terminals business.

Distribution. One of our customers is a Fortune 500 company that distributes building products and employs approximately 750 sales people with full pricing autonomy quoting tens of thousands of prices everyday. With tens of thousands of products marketed and sold across multiple U.S. regions, our customer found it difficult to aggregate and analyze timely market data to implement effective pricing. Our software products were implemented to provide key market and cost information, market pricing benchmarks and customer-specific decision support during real-time negotiations. This allowed costs and profitability to be accessible at the time of quote. As a result of implementing our software products, the customer improved sales force productivity, reduced variance across regions, increased deal capture percentages and increased profits.

Services. One of our customers is a global car rental company that maintains a fleet of hundreds of thousands of cars across multiple classes and makes. Our customer faced significant pricing challenges in executing demand forecasting, analyzing the relevant opportunity costs of fleet movements and optimizing profit opportunities at the local level. Our software products provide demand forecasting, pricing optimization and insight into fleet management terms to deliver integrated recommendations on pricing, distribution and fleet acquisition. As a result of implementing our software products, our customer improved its return on assets, reduced fleet idle capacity and recaptured its investment in our software products in the first year after completion of implementation.

Airlines. One of our customers is a global passenger airline that serves diverse, segmented markets in multiple countries and across multiple currencies. Due to the complex nature of the airline industry, the customer faced a variety of extremely challenging pricing demands, including managing seating inventory and setting millions of real-time prices everyday. Our software products allowed our customer to perform real-time seat inventory optimization by market segment, monitor and analyze passenger traffic flows and optimize revenue across its entire network. As a result of implementing our software products, our customer achieved improved seat utilization rates across multiple routes, optimization of segmented pricing and generated increased profit.

Sales and marketing

We sell and market our software products primarily through our direct sales force from our headquarters in Houston, Texas. Our sales force is organized by our target markets of manufacturing, distribution, services, hotel and cruise, and airline and is responsible for the worldwide sale of our products to new customers. Our sales force works in concert with our professional services personnel for selling and product demonstrations to new customers. Sales to our existing customers are the responsibility of our professional services personnel.

Our marketing activities consist of a variety of programs designed to generate sales leads and build awareness of PROS and our pricing and revenue optimization software products. We host a conference for pricing and revenue optimization professionals, host informational web seminars and we participate in and sponsor other industry conferences.

Competition

The market for price and revenue optimization solutions is competitive, fragmented and rapidly evolving. We believe the following factors are the principal basis of competition in the pricing and revenue optimization software market:

- ability to offer integrated high-value solutions;
- pricing focus and domain expertise;
- organizational change management expertise;
- product architecture, functionality, performance, reliability and scalability;
- breadth and depth of product offerings;
- time to value for the customer;
- services organization and customer support;
- existing enterprise relationships;
- large and referenceable customer base;
- vendor viability; and
- price.

We compete with several privately held pricing and revenue optimization software vendors such as Rapt, Revenue Technologies, Symphony-Metreo, Vendavo and Zilliant. We believe we are able to compete successfully with these vendors due to our long history of providing pricing and revenue optimization software products, the scope of our offerings and the flexibility and scalability of our architecture.

There are also several large enterprise application providers, such as JDA Software, Oracle and SAP that have developed offerings that include pricing and revenue optimization functionality. JDA Software and Oracle entered the market primarily through their acquisitions of Manugistics and Siebel Systems, respectively, and SAP resells Vendavo's products. We believe these vendors do not provide all of the pricing and revenue optimization functionality needed to support a pricing-focused organization. These vendors may seek to compete on price by bundling their pricing and revenue optimization applications with other enterprise applications. We distinguish ourselves from these vendors with the breadth and depth of the functionality of our products.

In addition, there are a number of vendors that provide pricing and revenue optimization software for specific industries. In the hotel industry, we compete with IDeaS and Easy RMS, and in the airline industry, we compete with Sabre Airline Solutions and Lufthansa Systems. One industry in which we do not compete is retail, where vendors include DemandTec, JDA Software, Oracle and SAP. Oracle and SAP entered this retail market through their acquisitions of ProfitLogic and Khimetrics, respectively.

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Our products also compete with solutions developed internally by businesses. These businesses rely upon a combination of manual processes, external consultants, spreadsheets or internally developed software tools to conduct pricing activities.

Some of our current and potential competitors have significantly greater financial, technical, marketing, service and other resources than we have. In addition, many of these companies also have a larger installed base of users, longer operating histories and greater brand recognition than we have. Competitors with greater financial resources may be able to offer lower prices, additional products or services or other incentives that we cannot match or offer. These competitors may be in a stronger position to respond quickly to new technologies and may be able to undertake more extensive marketing campaigns. Moreover, if one or more of our competitors were to merge or partner with another of our competitors, the change in the competitive landscape could adversely affect our ability to compete effectively.

Intellectual Property

Our success and ability to compete is dependent in part on our ability to develop and maintain the proprietary aspects of our technology and operate without infringing upon the proprietary rights of others. We rely primarily on a combination of copyright, trade secret, confidentiality procedures, contractual provisions and other similar measures to protect our proprietary information. Due to the rapidly changing nature of applicable technologies, we believe that the improvement of existing products, reliance upon trade secrets and unpatented proprietary know-how and development of new products are generally more advantageous than patent and trademark protection.

As of the date of this filing, we have two issued U.S. patents and three pending U.S. patent applications. We have not pursued patent protection in any foreign countries. We do not know whether any of our pending patent applications will result in the issuance of patents or whether the examination process will require us to narrow our claims.

We also use contractual provisions to protect our intellectual property rights. We license our software products directly to customers. These license agreements, which address our technology, documentation and other proprietary information, include restrictions intended to protect and defend our intellectual property. We also require all of our employees, contractors and many of those with whom we have business relationships to sign non-disclosure and confidentiality agreements.

Our products also include third-party software that we obtain the rights to use through license agreements. While this software comprises important elements of our product offerings, these applications are commercially available, and we are aware of substitute applications we could integrate with our products that are also commercially available on reasonable terms. In certain cases we believe we could develop substitute technology to replace these products if these third-party licenses were no longer available on reasonable terms.

Research and development expense

Our research and development program involves creating new products and modifying existing products to add new functionality and meet other market demands. Our research and development expense includes costs associated with our product management, product development and science and research groups. Our research and development expense was $6.3 million, $6.4 million, $10.3 million and $12.4 million in 2004, 2005, 2006 and the nine months ended September 30, 2007, respectively.

Employees

As of September 30, 2007, we had 319 employees and 18 independent contractors. None of our employees is represented by a labor union or covered by a collective bargaining agreement. We have not experienced any work stoppages and consider our employee relations to be good.

Facilities

We lease approximately 73,200 square feet of office space for our headquarters in Houston, Texas. This lease expires in July 2011. We may add new facilities and expand our existing facility as we add employees, and we believe that suitable additional or substitute space will be available as needed to accommodate any such expansion of our operations.

Legal proceedings

We are not party to any material legal proceeding at this time. From time to time, we may be subject to legal proceedings and claims in the ordinary course of our business.

Management

Executive officers, directors and key employees

Our executive officers, directors and key employees, and their ages and positions as of November 1, 2007 are as follows:

Name	Age	Position
Albert E. Winemiller*	64	Chairman of the Board, President and Chief Executive Officer
Charles H. Murphy*	62	Executive Vice President and Chief Financial Officer
Ronald F. Woestemeyer*	62	Executive Vice President, Strategic Business Planning and Director
Surain R. Adyanthaya**	42	Senior Vice President, Product Management
Peter P. Kiernan**	60	Senior Vice President, Professional Services
Andres D. Reiner**	36	Senior Vice President, Product Development
John M. Riddell**	64	Senior Vice President, Pricing Solutions
Jeffrey E. Robinson**	40	Senior Vice President, Pricing Solutions
Jeffrey L. Wannamaker**	51	Vice President, Technical Services
Benson B. Yuen**	46	Senior Vice President, Business Development
Harry S. Gruner(2)(3)	48	Director
Kurt R. Jaggers(1)(3)	49	Director
Greg B. Petersen(1)(2)(3)	44	Director
Timothy V. Williams(1)(2)(3)	58	Director
Mariette M. Woestemeyer(3)	56	Director

*
Executive officer

**
Key employee

(1)
Member of the compensation committee

(2)
Member of the audit committee

(3)
Member of the nominating and governance committee

Albert E. Winemiller joined us in 1999 as our President and Chief Executive Officer and has served as Chairman of our board of directors since October 2000. Mr. Winemiller began his career as a software engineer at IBM and has over 19 years experience as an executive for information services and software products companies. Mr. Winemiller's experience includes serving as President of infoUSA, a provider of business and consumer information and research services and as Senior Vice President for Automatic Data Processing, a provider of transaction processing and information-based business solutions. Mr. Winemiller holds BS and MS degrees from the University of Missouri and an MBA from Harvard Business School.

Charles H. Murphy joined us in 1998 and has served as our Executive Vice President and Chief Financial Officer since March 2001. Prior to joining us, Mr. Murphy spent 13 years in chief financial officer positions with Expert Software, a publicly traded software company, Merchant International, a software company, and Packaging Machinery Company, a publicly traded manufacturer of packaging machinery. He was Vice President-Treasurer with Coleco Industries, a publicly traded toy and video game company, and began his career with Coopers & Lybrand where he was a certified public accountant. He holds a BS degree from Bentley College.

Ronald F. Woestemeyer co-founded the Company in 1985 with his wife, Mariette Woestemeyer, and has been a director since our founding and our Executive Vice President since 1997. From 1985 to 1997, Mr. Woestemeyer served as our Chief Executive Officer. Prior to founding PROS, Mr. Woestemeyer spent 14 years at Texas International Airlines in various management and executive positions with responsibility over sales and marketing. Mr. Woestemeyer holds a BBA degree from the University of Houston.

Surain R. Adyanthaya joined us in 1993 and has served as our Senior Vice President, Product Management since January 2004. Mr. Adyanthaya was a software developer from 1993 to 1997 and our Vice President, Software Development from 1997 to 1999. He served as our Senior Vice President, Software Development from 1999 to 2004. Prior to joining us, Mr. Adyanthaya was a consulting engineer at Texaco Oil Company. Mr. Adyanthaya holds an MS degree in operations research from Stanford University and a BS degree in mechanical engineering from the University of Houston.

Peter P. Kiernan joined us in 1996 and has served as our Senior Vice President, Professional Services since 2000. From 1997 to 2000, Mr. Kiernan was our Vice President, Client Services and from 1996 to 1997, he served as our Staff Vice President, Airline. Prior to joining us, Mr. Kiernan held several positions at Pan American World Airways including Staff Vice President, Revenue Management, Director, Pricing Automation and Director, Revenue Accounting. Mr. Kiernan holds a BS degree in business administration from California Coast University.

Andres Reiner joined us in 1999 and has served as our Senior Vice President, Product Development since March 2007. From 2003 to 2007, Mr. Reiner was our Vice President, Product Development, from 2000 to 2003, he served as our Director, Software Development, and from 1999 to 2000, he served as our Development Manager. Mr. Reiner held various software engineer roles at Platinum Technology, a database management software company, ADAC Laboratories, a high-technology healthcare product company, and Kinesix, an interface software for complex data company, before joining us. Mr. Reiner holds a BS degree in computer science from the University of Houston.

John M. Riddell joined us in 1998 as a Senior Scientist and has served as our Senior Vice President, Pricing Solutions since 2004. From 2001 to 2004, Mr. Riddell was our Vice President, Pricing and from 2000 to 2001, he served as our Director, New Market Development. Prior to 1998, Mr. Riddell was Director of Research and Development at OPUS 2 Revenue Technologies, a yield management software company. Mr. Riddell holds an MS degree in operations research from the US Naval Postgraduate School and a BS degree in civil engineering from the University of Mississippi.

Jeffrey E. Robinson joined us in 2000 and has served as our Senior Vice President, Pricing Solutions since 2006. From 2004 to 2006, Mr. Robinson was our Vice President, Pricing Solutions and from 2000 to 2003, he served as our Director, Business Development. Prior to joining us, Mr. Robinson held several positions with ADAC Healthcare Information Systems, a subsidiary of ADAC Laboratories. Mr. Robinson holds a BA degree from Brigham Young University and an MBA from Rice University.

Jeffrey L. Wannamaker joined us in 1998 and has served as our Vice President, Technical Services since 2001. Mr. Wannamaker was our Director, Tech Services from 2000 to 2001 and from 1998 to 2000, he served as our Director, Software Development. Mr. Wannamaker was the Engineering Manager at Dynasty Technologies, a software company. Prior to joining us, Mr. Wannamaker holds a BSEE degree from the University of Houston.

Benson B. Yuen joined us in 1988 and has served as our Senior Vice President, Business Development since 1999. From 1995 to 1999, Mr. Yuen was our Senior Vice President, Sales, Marketing and Consulting Services, and from 1988 to 1994, he served as our Vice President, Customer Services and Professional Services. Prior to joining us, Mr. Yuen held several positions with Florida Express, an air transportation company, including Director Pricing, Inventory and Director, Market Planning. Mr. Yuen holds a BSBA from the University of Central Florida.

Harry S. Gruner has served as a director of the Company since 1998. Since 1992, Mr. Gruner has been a founding general partner of JMI Equity, a private equity investment partnership. Prior to co-founding JMI Equity, Mr. Gruner specialized in advising software companies as a principal in the corporate finance department of Alex. Brown & Sons, an investment bank. Mr. Gruner is also a director of several privately-held companies. Mr. Gruner holds an MBA from Harvard Business School and a BA degree from Yale University.

Kurt R. Jaggers has served as a director of the Company since 1998. Mr. Jaggers has been a Managing Director of TA Associates since 1997, was a Principal of TA Associates from January 1993 to December 1996 and Vice President of TA Associates from 1990 to 1992. He is currently a director of Visual Sciences, a provider of Internet behavior information and analysis, as well as several privately-held companies. Mr. Jaggers holds BS and MS degrees in electrical engineering and an MBA from Stanford University.

Greg B. Petersen has served as a director of the Company since July 2007. Mr. Petersen is currently a private investor. Previously, Mr. Petersen served as Executive Vice President from 2005 to January 2007 and as Senior Vice President and Chief Financial Officer from 2001 to 2005 of Activant Solutions, a provider of business management solutions to retail and wholesale distribution businesses. From 2000 until 2001, Mr. Petersen served as Vice President of Finance of Trilogy Software, a provider of enterprise software and business services, and as its Treasurer from 1999 until 2000. From 1997 to 1999, Mr. Petersen was Senior Vice President of Planning and Business Development of RailTex, a shortline and regional rail service provider. From 1989 to 1997, Mr. Petersen held various finance and strategy positions at American Airlines, most recently as managing director of corporate development. Mr. Petersen holds a BA in economics from Boston College and an MBA from the Fuqua School of Business at Duke University.

Timothy V. Williams has served as a director of the Company since July 2007. Mr. Williams serves as Senior Vice President and Chief Financial Officer of Blackbaud, a provider of software and services to non-profit organizations, and has held this role since 2001. From 1994 to 2001, he served as Executive Vice President and Chief Financial Officer of Mynd (now a subsidiary of Computer Sciences Corporation), a provider of software and services to the insurance industry. Prior to that, Mr. Williams worked at Holiday Inn, most recently as Executive Vice President and Chief Financial Officer. Mr. Williams holds a BA from the University of Northern Iowa.

Mariette M. Woestemeyer co-founded the Company in 1985 with her husband, Mr. Woestemeyer, and has served as a director since our founding. Mrs. Woestemeyer was the Chief Financial Officer of Metro Networks, a broadcasting company, from 1983 to 1985 and held various financial roles with Continental Airlines and its predecessor, Texas International Airlines, prior to 1983. Mrs. Woestemeyer holds a BBA degree and an MBA from the University of Houston.

Board of directors

Mrs. Woestemeyer and Messrs. Gruner, Jaggers, Petersen, Williams, Winemiller and Woestemeyer currently serve as our directors. Our certificate of incorporation and bylaws authorize a board of directors of seven members. All of our current directors, except for Messrs. Petersen and Williams, were elected pursuant to agreements we have entered into with Mr. and Mrs. Woestemeyer, TA Associates and JMI Equity and agreements between Mr. Winemiller, Mr. Murphy and Mr. and Mrs. Woestemeyer, all of which terminated upon the closing of our initial public offering. Our board of directors has determined that Messrs. Gruner, Petersen and Williams meet the independence requirements of the New York Stock Exchange and federal securities laws.

The New York Stock Exchange rules require that a majority of the board of directors of listed companies be independent and that their audit, compensation and nominating and governance committees be comprised solely of independent directors. We are relying on the transition periods provided by Section 303A.00 of the New York Stock Exchange rules, which provide for phase-in compliance for companies that listed on the exchange in connection with their initial public offering. Our audit committee is comprised of all independent directors, and our compensation committee and nominating and governance committee is each comprised of a majority of independent directors. We plan to have a majority of independent directors on our board and all independent directors on our compensation and nominating and governance committees by June 27, 2008.

Committees of the board of directors

Our board of directors has established an audit committee, a compensation committee and a nominating and governance committee.

Audit committee

The current members of our audit committee are Messrs. Gruner, Petersen and Williams. Our board of directors has determined that each member meets the independence requirements of the New York Stock Exchange and Rule 10A-3(b) of the Securities Exchange Act of 1934, as amended, or the Exchange Act, and that each qualify as an audit committee financial expert within the meaning of SEC regulations and the rules of the New York Stock Exchange. In arriving at this determination, the board has examined each member's scope of experience and the nature of their employment in the corporate finance sector.

The audit committee oversees our accounting and financial reporting processes and the audits of our financial statements. Specific responsibilities of our audit committee include:

- reviewing and providing oversight over the qualification, independence and performance of our independent auditor and determining whether to retain or terminate its services;
- approving the terms of engagement of our independent auditor and pre-approving the engagement of our independent auditor to perform permissible non-audit services;
- reviewing and discussing with management and our independent auditor the results of the annual audit and the independent auditor's review of our annual and quarterly financial statements and reports;

- reviewing with management and our independent auditor matters that have a significant impact on our financial statements;
- conferring with management and our independent auditors regarding the scope, adequacy and effectiveness of our internal control over financial reporting;
- establishing procedures for the receipt, retention and treatment of complaints received by us regarding accounting, internal control or auditing matters and for the confidential, anonymous submission by our employees of concerns regarding questionable accounting or auditing matters; and
- reviewing and approving all related party transactions.

Compensation committee

The current members of our compensation committee are Messrs. Jaggers, Petersen and Williams. Each member of our compensation committee is a non-employee director, as defined in Rule 16b-3 promulgated under the Exchange Act, and an outside director, as defined pursuant to Section 162(m) of the Internal Revenue Code of 1986, as amended, or the Internal Revenue Code. Our board of directors has determined that Messrs. Petersen and Williams each meet the independence requirements of the New York Stock Exchange and federal securities laws.

The compensation committee discharges the responsibilities of our board of directors relating to the compensation and benefits for our executive officers and directors. Specific responsibilities of our compensation committee include:

- determining and reviewing all forms of compensation for our executive officers and directors, including, among other things, annual salaries, bonuses, equity awards, severance arrangements, change in control protections and other compensatory arrangements;
- reviewing and approving corporate performance goals and objectives relevant to such compensation;
- administering our equity incentive plans and granting awards of options and other equity-based awards to our executive officers, directors and employees;
- reviewing our compensation discussion and analysis and compensation committee report required by the rules of the SEC; and
- evaluating and recommending to our board of directors the compensation plans and programs advisable for us, and evaluating and recommending the modification or termination of existing plans and programs.

Nominating and governance committee

The members of the nominating and governance committee are Messrs. Gruner, Jaggers, Petersen and Williams. The board has determined that Messrs. Gruner, Petersen and Williams each meet the independence requirements of the New York Stock Exchange. Specific responsibilities of our nominating and governance committee include:

- identifying, evaluating and recommending to our board of directors candidates to serve as members of our board of directors and considering the nomination of our incumbent directors for reelection;
- evaluating stockholder nominations of candidates for election to our board of directors;

reviewing our general policy relating to selection of director candidates and members of committees of our board of directors, including an assessment of the performance of our board of directors; and

reviewing and making recommendations to our board of directors regarding corporate governance principles and director compensation.

Compensation committee interlocks and insider participation

No member of our compensation committee and none of our executive officers has any relationships that would constitute an interlocking relationship with executive officers and directors of any another entity.

Director compensation

Under our director compensation policy, each non-employee member of our board of directors is entitled to receive a grant of an option to purchase 30,000 shares of our common stock upon the election or appointment of the non-employee board member to the board or, in the case of non-employee directors serving prior to our initial public offering, upon the closing of that offering, an annual retainer of $20,000 and a retainer of $7,500 if such director also serves on our audit committee or compensation committee. The chair of the audit and compensation committees are entitled to an annual retainer of $12,500. In addition, each non-employee director is entitled to receive $1,000 per in-person meeting of the board, $500 per telephonic meeting of the board or any committee that is not an in-person meeting and $750 per in-person meeting of any of our audit, compensation or nominating and governance committees if such director also serves on one or more of those committees. All fees are paid on a quarterly basis. We have also agreed to reimburse our non-employee directors for reasonable out-of-pocket expenses incurred in connection with their attendance of our board or committee meetings.

Executive compensation

Compensation discussion and analysis for named executive officers

Our mission is to help our customers improve business and financial performance by providing them with our pricing and revenue optimization software products. Implementing our mission relies on delivering these software products successfully and competitively, as well as our ability to help our customers address their pricing and revenue optimization needs. As a result, it is critical that we are able to attract, motivate and retain highly talented individuals who are committed to us and our mission and are willing to identify and exploit opportunities to grow our business. Consequently, the goals of our executive compensation program are to align our executive officers' compensation with our mission and the interests of our stockholders, to provide incentives and rewards to our executive officers for our success and to reflect the teamwork philosophy of our executive management team.

As a private company, our compensation committee did not rely any benchmark studies of comparable companies in establishing executive compensation. Rather, we relied upon the experience and expertise of management and the members of our compensation committee to adopt executive compensation programs. In particular, Messrs. Jaggers and Gruner, each of whom were members of our compensation committee prior to our initial public offering, are partners with venture capital firms and have served on the boards of directors and compensation committees of numerous private technology companies across the country. The compensation committee took into consideration our financial condition and operating results, our operating plan, our geographic location and the objectives of our executive compensation policies described below, and established an executive compensation program that the compensation committee members believed, based on their experience, is the most appropriate to motivate, retain and reward our executive officers.

The objectives of our executive compensation policy

Our executive compensation programs are designed to achieve the following objectives:

- attract and retain talented and experienced executives in the highly competitive and dynamic pricing and revenue software market;
- motivate and reward executives whose knowledge, skills and performance are critical to our success;
- align the interests of our executive officers and stockholders by motivating executive officers to increase stockholder value;
- provide a competitive compensation package which is weighted heavily towards pay for performance, and in which total compensation is primarily determined by company/team and individual results and the creation of stockholder value;
- ensure fairness among the executive management team by recognizing the contributions each executive makes to our success;
- foster a shared commitment among our management team by coordinating their respective teams and individual goals; and
- compensate our executives to manage our business to meet our long-range objectives.

Role of the compensation committee in setting executive compensation

The responsibility for establishing, administering and interpreting our policies governing the compensation and benefits for our executive officers lies with our compensation committee, which consists entirely of non-employee directors. See "Management Committees of the board of directors Compensation committee."

Our compensation committee has taken the following steps to ensure that our executive compensation and benefit policies are consistent with both our compensation philosophy and our corporate governance guidelines:

- evaluated our compensation practices and assisted in developing and implementing the executive compensation policy;

- established a practice, in accordance with the rules of the New York Stock Exchange, of reviewing the performance and determining the compensation earned, paid or awarded to our chief executive officer independent of input from him; and

- established a policy, in accordance with the rules of the New York Stock Exchange, to review on an annual basis the performance of our other executive officers with assistance from our chief executive officer and determining what we believe to be appropriate total compensation for these executive officers.

Basis of executive compensation

Based on our goals and the experience of our board and management, we established the following elements of executive compensation: base salary, cash incentive bonuses and long-term incentive awards, each as further described below.

We have chosen these components of our executive compensation program because we believe that they reward both long-term and short-term success while providing retention value. We also believe that these components are fairly standard for technology companies generally.

We have not retained a compensation consultant to review our policies and procedures with respect to executive compensation. Our compensation committee typically considers the recommendations of our chief executive officer and/or other members of management and determines the use and weight of each compensation element based on the subjective importance of each element in meeting our overall objectives. We elect to put a significant amount of each executive's total potential compensation "at risk" based on our financial and the executive's performance, which is reflected in our mix of short-term and long-term incentive components.

As we continue to evolve and have different priorities, we will evaluate our compensation packages and these components on a quantitative and qualitative basis to determine if they are still appropriate on at least a yearly basis or as circumstances dictate. We anticipate making new awards and adjustments to our compensation elements on an annual basis in connection with our yearly review and the recommendations of our chief executive officer and/or other members of management.

Components of executive compensation

Base salaries

Base salaries for our executive officers are reviewed on a yearly basis. For 2006, our executive officers' base salaries were set by reviewing their then current salaries in light of 2005 company performance and individual performance, scope of their responsibilities, the experience of the members of our compensation committee with similar stage companies and general economic factors. We use base salaries primarily to retain our executives.

In April 2007, our board reviewed the responsibilities and performance of Mr. Winemiller and Mr. Murphy, their tenure with us, their existing compensation packages and their expected contributions and responsibilities for 2007. Based on this review and the additional responsibilities of these executives in connection with our plans to become a publicly-traded company, our board approved an increase in the base salary for Mr. Winemiller from $275,000 to $300,000 and for Mr. Murphy from $245,000 to $275,000 effective January 1, 2007.

Cash incentive bonus

We have an annual cash incentive bonus plan for our executive officers under which bonuses may be paid shortly after the end of each year based on our performance in meeting our corporate objectives for the year and each individual's performance and contribution in meeting our corporate objectives. Bonuses are intended to compensate our executive officers for achieving financial and operational goals and for achieving individual and company performance objectives. The bonuses are paid in cash and will generally be paid in the first quarter following completion of a given year. Our compensation committee does not have the discretion to increase the targets or decrease the amounts payable to any of our executives, but it does have the discretion to lower the targets and increase the amounts payable under this cash incentive plan. Traditionally, the committee has not exercised this discretion nor did it exercise it in 2006.

Bonuses are determined based on the achievement of certain financial and operational benchmarks. Each component of this bonus is independent of the other components and has minimum and maximum target levels. The target bonus amounts are payable under this cash bonus plan if we hit our target levels for each component. If we hit the minimum goals, our executive officers would be entitled to half of the target bonus amount, and if we achieve the maximum target level, they would be entitled to receive twice their target bonus amount for such component. Actual results between the minimum, target and the maximum goal levels would be pro-rated. We use our yearly cash incentive bonus plan to align our executive's performance with our financial results and to motivate our executives to achieve our goals.

Long-term incentive award programs

Our base salary and cash incentive bonus plans are intended to compensate and motivate for the short-term. We believe that providing our executive officers with an ownership stake through participation in our long-term incentive plans will encourage long-term performance and help align their interests with those of our stockholders. We have only granted stock options since we believe that these types of equity awards are what is considered competitive in our industry and are best understood by our executives and employees.

1997 stock option plan and 1999 equity incentive plan. Our 1997 stock option plan and 1999 equity incentive plan authorized us to grant options to purchase shares of common stock to our employees, directors and consultants. Our compensation committee was the administrator of these plans. Stock option grants under these plans were usually made at the commencement of employment and, occasionally, following a significant change in job responsibilities or to meet other special retention or performance objectives. The compensation committee reviewed and approved stock option awards to executive officers based upon a review of competitive compensation data, its assessment of individual performance, a review of each executive's existing long-term incentives and retention considerations. Periodic stock option grants were made at the discretion of the compensation committee to eligible employees and, in appropriate circumstances, the compensation committee considered the recommendations of our CEO and other members of management. No options were awarded in 2006 since the compensation committee had determined there was sufficient retention value in the outstanding options and common stock subject to restrictions held by our executive officers. Stock options granted by us have an exercise price equal to the fair market value of our common stock on the day of grant, typically vest 25% on the first anniversary and monthly thereafter, based upon continued employment over a four-year period, and generally expire ten years after the date of grant. Incentive stock options also include certain other terms necessary to assure compliance with the Internal Revenue Code. Our 1997 stock option plan was terminated in April 1999 and our 1999 equity incentive plan was terminated in March 2007 for purposes of granting any future equity awards under those plans. There were issued and outstanding stock options to purchase 325,681 shares of our common stock under these plans on November 1, 2007. None of these options were held by our executive officers.

2007 equity incentive plan. Our 2007 equity incentive plan, or 2007 plan, was adopted in March 2007. The purpose of the 2007 plan is to promote our long-term growth and profitability. The 2007 plan is intended to make available incentives that will help us to attract, retain and reward employees whose contributions are essential to our success. We may provide these incentives through the grant of:

- restricted stock awards;
- restricted stock unit awards;
- stock options;
- stock appreciation rights;
- phantom stock; and
- performance awards.

A total of 1,870,000 shares have been reserved for issuance under the 2007 plan with an evergreen provision that allows for an annual increase equal to the lesser of (a) 3.5% of our outstanding shares (b) 900,000 shares or (c) any lesser amount determined by our board of directors. As of September 30, 2007, 492,500 shares remain available for grant or award under the 2007 plan. The compensation committee of our board has been designated to administer the 2007 plan. Under the 2007 plan, our employees, officers, directors and other individuals providing services to us or any of our affiliates are eligible to receive awards. The committee has the authority, consistent with the provisions of the 2007 plan, to determine which eligible participants will receive awards, the form of the awards and the number of shares of our common stock covered by each award. The committee may impose terms, limits, restrictions and conditions upon awards, and may modify, amend, extend or renew awards, accelerate or change the timing of exercise of awards or waive any restrictions or conditions of an award. As of November 1, 2007, we had outstanding equity awards to acquire 1,377,500 shares of our common stock held by our employees and consultants under the 2007 plan.

Stock options. Our 2007 plan permits the granting of options to purchase shares of our common stock intended to qualify as incentive stock options, under Section 422 of the Internal Revenue Code, and nonqualified stock options. The option exercise price and the term of each option are determined by the compensation committee. The compensation committee also determines at what time or times each option may be exercised and the period of time, if any, after retirement, death, disability or termination of employment during which options may be exercised. In general, options granted under this plan vest at the rate of 25% on the one year anniversary of the vesting commencement date and in equal monthly installments thereafter over the next three years.

Stock appreciation rights. The compensation committee may grant a right to receive a number of shares or, in the discretion of the compensation committee, an amount in cash or a combination of shares and cash, based on the increase in the fair market value of the shares underlying the right during a stated period specified by the compensation committee.

Restricted stock awards and units. The compensation committee may award shares of our common stock to participants at no cost or for a purchase price or restricted stock units that are settled in shares of our common stock. These restricted stock and restricted stock unit awards may be subject to restrictions or may be free from any restrictions under our 2007 plan. The purchase price of the shares, if any, and any applicable restrictions, are determined by the compensation committee.

Phantom stock. The compensation committee may grant stock equivalent rights, or phantom stock, which entitles the recipient to receive credits which are ultimately payable in the form of cash, shares of our common stock or a combination of both. Phantom stock does not entitle the holder to any rights as a stockholder.

Performance awards. The compensation committee may grant performance awards to participants entitling the participants to receive cash, shares of our common stock or a combination of both, upon the achievement of performance goals and other conditions determined by the compensation committee. The performance goals may be based on our operating income or on one or more other business criteria selected by the compensation committee.

In the event of any stock split, stock dividend or similar transaction, the shares subject to the 2007 plan and any outstanding awards will automatically be adjusted. The 2007 plan will continue in effect until the tenth anniversary of its approval by our board, unless earlier terminated earlier. The compensation committee may amend, terminate or modify the plan at any time.

In the event of certain significant corporate transactions, including a change in control of the Company, any then-outstanding equity award or option under the 2007 plan may be assumed, continued or substituted for by any surviving or acquiring entity (or its parent company). If the surviving or acquiring entity (or its parent company) elects to assume, continue or substitute for such awards or options and the holder of such award or option is terminated without cause or resigns for good reason within 18 months of a change of control of the Company, such awards or options shall vest in full. If the surviving or acquiring entity (or its parent company) elects not to assume, continue or substitute for the equity awards or options under the 2007 plan, all outstanding equity awards and options under the 2007 plan will vest in full and become fully exercisable.

The compensation committee believes that the use of stock options and equity awards offers the best approach to achieve our compensation goals with respect to long-term compensation and currently provides tax and other advantages to our employees relative to other forms of equity compensation. We believe that our equity incentive program is an important retention tool for our employees.

At the beginning of 2007, the compensation committee conducted an annual review of the compensation packages of our executive officers, including the retention value of their compensation components, their contributions to our business and their ability to continue to provide leadership to us and to maintain our success. The compensation committee believed it was in our best interests to provide additional stock options to our executive officers to incentivize them and to provide additional retention value. We issued no stock options in 2006 and only Mr. Murphy had stock options that remained subject to vesting. In April 2007 we granted to each of our Chief Executive Officer and Chief Financial Officer a stock option under our 2007 plan to purchase 150,000 shares of our common stock at $6.00 per share. Mr. Woestemeyer was not granted any stock options at this time because the compensation committee believed that his significant equity ownership was sufficient for motivation and retention.

These stock options provide for the full acceleration of the vesting upon our change in control, the officer's termination without cause or resignation for good reason and otherwise vest as to 25% of the shares in April 2008 and monthly thereafter based on continued employment over the following three years. These stock options also allow our executives to exercise them prior to the vesting of such options, which allows our executives to begin their tax holding period. If the executive officer exercises and holds the underlying shares for over a year after such exercise and over two years after the date of grant, the executive officer may be able to take advantage of the long-term capital gain tax rate. The long-term capital gain rate is lower than the short-term capital gain tax rate that may otherwise be applicable. Our standard stock options to our non-executive employees do not contain this immediately exercisable feature. Our belief is that this practice of granting immediately exercisable options for executive officers is fairly standard across our industry and, as a result, is another mechanism to retain our executives and ensure that their compensation packages are competitive. These grants were made because our board believes it is an appropriate incentive mechanism to encourage retention in the long-term. In determining the number of shares subject to stock options granted to the executive officers, the compensation committee took into account each executive officer's position, scope of responsibility, ability to affect stockholder value and historic and recent performance.

Benefits. We provide our executive officers the following benefits, generally on the same terms as we provide our other employees.

- health, dental, travel, accident insurance and vision;
- life insurance;
- employee assistance plan;
- medical and dependant care flexible spending account;
- short-and long-term disability, accidental death and dismemberment;
- a 401(k) plan;
- paid time off and vacations;
- sick days; and
- tuition reimbursement.

We believe these benefits are consistent with companies with which we compete for employees.

401(k) Plan. In May 1996, we adopted a tax-qualified employee savings and retirement plan, or 401(k) plan, which generally covers our full-time employees. The plan is intended to qualify under Section 401(a) of the Internal Revenue Code. Contributions, and income earned thereon, are not taxable to employees until withdrawn from this plan. Under this plan, employees may elect to reduce their current compensation up to the statutorily prescribed annual limit and have the amount of the reduction contributed to the plan. This plan also permits us to make matching contributions to the plan on behalf of participants. Since January 2000, we have matched up to 50% of an employee's contribution up to 6% of the employee's eligible income contributed to our 401(k) plan.

Severance and termination provisions

We provide our executive officers severance packages if they are terminated without "cause" (as defined in their employment or severance agreements) in order to attract and retain them. The amount of severance benefits is described below. The Compensation committee reviews the potential payouts to ensure their market-competitiveness in order to incentivize our executive officers to maintain focus on both daily and long-term efforts.

We entered into employment agreements with Mr. Winemiller, our Chief Executive Officer, and Mr. Murphy, our Chief Financial Officer, on September 30, 2005. Both of these agreements were originally for a two year term and automatically renew for one year terms unless the Company decides not to renew them. The base salaries payable to each of Mr. Winemiller and Mr. Murphy are subject to periodic review by our compensation committee. Both Mr. Winemiller and Mr. Murphy are entitled to 12 months of severance, up to 12 months of health benefits and 12 months of acceleration of the vesting on their stock options granted prior to April 2, 2007 if their employment with us is terminated without "cause" or they resign with "good reason" as defined in those agreements. On April 2, 2007, our board amended these employment agreements to also provide for the full acceleration of vesting, or lapse of all repurchase rights, of any options or other equity awards granted to these executive officers on or after April 2, 2007, if any of these officers is terminated without "cause," resigns for "good reason" or if a change of control of the Company occurs. In addition, the amended employment agreements provide for 18 months of severance and 18 months of health benefits if such officer is terminated without "cause" or if such officer resigns for "good reason" within six months prior to or any time after of a change in control transaction of the Company. Mr. Winemiller and Mr. Murphy are subject to non-competition and non-solicitation restrictions during the term of their employment and for the 12-month period following the termination of their employment.

In January 1999, we entered into an employment agreement with Mr. Woestemeyer, our Executive Vice President. This agreement was originally for a two-year term and automatically renews for one year terms unless the Company decides not to renew. Under this agreement, Mr. Woestemeyer's salary is subject to periodic review by our compensation committee, and he is entitled to 12 months of severance if he is terminated without "cause" as defined in his agreement or we decide not to renew his agreement without giving him notice. If we decide not to renew this agreement and we provide 60-days notice of non-renewal to Mr. Woestemeyer, he is entitled to 10 months of severance. In addition, Mr. Woestemeyer is subject to non-competition and non-solicitation restrictions during the term of his employment and for the severance period following the termination of his employment.

"Cause" is defined in these employment agreements as a breach by our officer of his duties of confidentiality which causes a material harm to us, his conviction of, or a plea of guilty or no contest to, a felony or his failure to perform his duties after notice and a cure period. In addition, for Mr. Winemiller and Mr. Murphy, "cause" also includes an intentional wrongdoing by them that adversely affects us. Mr. Winemiller and Mr. Murphy can resign for "good reason" and be entitled to severance. "Good reason" is defined in their employment agreements as the assignment of duties to them that are substantially inconsistent with their current roles with us, the relocation of their offices to more than 50 miles from our present location, a material reduction in their base salaries and our failure to provide them with similar benefits that we provide to our other employees.

Components of executive compensation for 2006 and 2007

Executive compensation activities in 2006. Our 2006 cash incentive bonus plan was based on target levels of financial performance across three components. The 2006 components of the cash bonus plan were financial measures tied to revenue, operating income and year end sales backlog and each component was independent of the others. In setting each component's target level, the compensation committee reviewed our financial performance for the prior year, management's performance against prior year targets, our plan for the next fiscal year and the potential total compensation afforded to each executive officer.

The potential payouts were based on our performance as a company within a range of each component's target. No bonus is earned below the target threshold and the maximum bonus is earned at the target maximum. The ranges for each component as well as the weighting of revenue, operating income and year end sales backlog as a percentage of the total bonus payment in 2006 are set forth in the following table:

Component	**Target threshold**	**Target maximum**	**Weighting of component as a % of bonus payment**
Revenue	90% of Target	120% of Target	40%
Operating income	90% of Target	120% of Target	20%
Year-end sales backlog	90% of Target	120% of Target	40%

The compensation committee set such ranges to incentivize management to achieve or exceed the component targets. In 2006, we achieved the maximum operating income and year-end sales backlog targets and exceeded the revenue target but did not hit the maximum. The committee weighted revenue and year end sales backlog greater than operating income to focus our executive officers more closely on growing our sales and revenue while still rewarding them for managing our operating expenses and taking into account a level of expenses appropriate for the growth in our business. The following table sets forth our revenue, operating income and year-end sales backlog targets for 2006:

Component (In millions)	**Target (non-GAAP)**
Revenue	$47.0
Operating income	5.6
Year-end sales backlog	42.5

As a private company, we had a practice of recognizing the achievement of incentive goals based on the above operational milestones rather than using GAAP operating results. Our non-GAAP revenue and operating income targets included certain revenue and related expenses based on the timing of recognition of these amounts. We believe that the use of such operational milestones in the past was more meaningful in reflecting our operational performance than the use of GAAP operating results. Commencing in 2007, we are using GAAP operating results and sales as our performance targets.

The committee set the amount of each bonus payment as a percentage of the base salary of each executive officer as set forth in the following table:

Executive officer	At target threshold	At target	At target maximum
Albert E. Winemiller	30%	60%	120%
Charles H. Murphy	22.5%	45%	90%
Ronald F. Woestemeyer	7.5%	15%	30%

The committee set these payouts based on competitive market pay levels for our executive officers' respective positions and responsibilities within our company and in consideration of the total compensation of each executive officer. The actual annual cash incentive awards made to our named executive officers pursuant to our cash incentive bonus plan for the fiscal year ended December 31, 2006 are set forth below in the Summary Compensation Table. See " Summary compensation table for 2006."

Executive compensation activities in 2007. In April 2007, our compensation committee adopted our 2007 cash incentive bonus plan and applied an analysis to setting components and targets similar to the analysis the committee applied in 2006. The committee reviewed our financial performance for the prior year, management's performance against prior year targets, our plan for the next fiscal year and the total compensation potential afforded the executive officers considering all elements of the executive officers' compensation.

The compensation committee replaced the year end sales backlog component with sales during the period because year end sales backlog can include prior period sales, and the committee believed that focusing the bonus plan on sales during the relevant period was a more accurate measurement of our executive officers' performance during the period.

The potential payouts under the bonus plan were based on our performance as a company within a range of each component's target. No bonus will be earned below the target threshold and the maximum bonus will be earned at the target maximum. The ranges for each component are set forth in the following table:

Component	Target threshold	Target maximum (in millions)
Revenue	90% of Target	$ 62.0
Operating income	90% of Target	10.5
Sales	90% of Target	48.0

Sales has a higher maximum target range than revenue and operating income because the committee believed that emphasizing sales growth remains important to build long-term growth in our business.

Following the growth of our business in 2006 versus 2005, the committee sought to set 2007 targets consistent with our operating plan for the 2007 fiscal year and at sufficiently high levels to motivate the executive officers to continue to grow the business and manage expenses, with an emphasis on increasing sales. The following table sets forth our revenue, operating income and sales targets for 2007:

Component (In millions)	Target (GAAP)(1)
Revenue	$61.0
Operating income	9.5
Sales	40.0

(1) The targets set forth in this table were established and are disclosed only as performance objectives for our executive officers, and do not constitute guidance regarding our expected future operating results. Our actual operations results for 2007 are subject to significant risks, uncertainties and contingencies, including those risks set forth in "Risk factors" beginning on page 6. Our actual results for 2007 will likely vary from such performance targets, which variance may be material and adverse. See "Special note regarding forward-looking statements" on page 22.

As in 2006, each of the components are independent of the others, but the weighting of the components as they relate to potential bonus payouts are set forth in the following table:

Component	Weighting of component as a % of bonus payment
Revenue	33.3%
Operating income	33.3%
Sales	33.3%

The committee weighted the components equally because the committee sought to retain the motivational benefits of growing the sales and customer base but also determined that the executive officers should be equally motivated to manage the business in such a way to achieve high operating income. Sales has a higher maximum target range than revenue and operating income because the committee believed that emphasizing sales growth remains important to build long-term growth in our business.

As in 2006, the committee set the amount of each bonus payment as a percentage of the base salary of each executive officer as set forth in the following table:

Executive officer	At target threshold	At target	At target maximum
Albert E. Winemiller	50%	100%	146%
Charles H. Murphy	40%	80%	117%
Ronald F. Woestemeyer	22.5%	45%	66%

The committee increased these percentages in 2007 based on its analysis and observations of competitive market pay levels for the respective officers and in consideration of the total compensation of each executive officer.

As described above in " 2007 incentive equity plan", on April 2, 2007, our board approved stock options to Mr. Winemiller and Mr. Murphy to purchase 150,000 shares of our common stock each at $6.00 per share. These options provide that if a change in control occurs, if the officer is terminated without "cause" or if he resigns for "good reason," the vesting of these options would accelerate in full. The board also amended Mr. Winemiller's and Mr. Murphy's employment agreements to provide for 18 months of severance and 18 months of health benefits if such officer is terminated without "cause" or if such officer resigns for "good reason" within six months prior to or at anytime after a change in control of the Company as described above in " Severance and termination provisions."

Tax considerations

We are subject to Internal Revenue Code Section 162(m), which limits the amount that we may deduct for compensation paid to our chief executive officer and to each of our four most highly compensated officers to $1,000,000 per person per year, unless certain exemption requirements are met. Exemptions to this deductibility limit may be made for various forms of "performance-based" compensation approved by our stockholders. In addition to salary and bonus compensation that is not "performance-based," the exercise of stock options may cause an officer's total compensation to exceed $1,000,000. However, compensation from options that meet certain requirements will be exempt from the $1,000,000 cap on deductibility. In the past, annual cash compensation to our executive officers has not exceeded $1,000,000 per person. Although we do not currently anticipate such compensation to exceed the $1,000,000 limit, our officer compensation could in the future exceed this limit, and we may not be able to deduct the compensation amount in excess of $1,000,000. While the compensation committee cannot predict how the deductibility limit may impact our compensation program in future years, the compensation committee intends to maintain an approach to executive compensation that strongly links pay to performance.

Summary compensation table for 2006

Name and principal position	Year	Salary ($)	Non-equity incentive plan compensation ($)(1)	All other compensation ($)(2)	Total ($)
Albert E. Winemiller *President and Chief Executive Officer*	2006	275,000	291,060	8,250	574,310
Charles H. Murphy *Executive Vice President and Chief Financial Officer*	2006	245,000	194,481	7,350	446,831
Ronald F. Woestemeyer *Executive Vice President*	2006	233,750	61,850	7,013	302,613

(1) Payment for 2006 performance made in March 2007 under the cash incentive bonus plan. No bonus was earned or paid in 2006 to a named executive officer except as part of our cash incentive bonus plan.

(2) Represents matching contributions for each individual's 401(k) plan contributions.

Mr. Winemiller's compensation package consists of a larger salary, cash incentive bonus participation and stock options than our other executive officers as a result of, and, we believe, commensurate with, his duties as our president and chief executive officer. We also believe that Mr. Murphy's and Mr. Woestemeyer's compensation packages are each appropriate and reflective of their duties and responsibilities that their titles convey.

The salary and bonus of our executive officers constituted most of their compensation for 2006. The reason for this weighted composition was the decision by our compensation committee not to grant any stock options in 2006 after the committee's review of the executives' stock options, the vesting remaining on those options, the amount of our stock that they held and the value of their equity in us. We have also entered into employment agreements with each of our executive officers. See "Compensation discussion and analysis for named executive officers" for a description of these agreements.

Grants of plan-based awards for 2006

Name	Grant date	Estimated future payouts under non-equity incentive plan awards(1) Threshold ($)	Target ($)	Maximum ($)
Albert E. Winemiller	3/8/06	82,500	165,000	330,000
Charles H. Murphy	3/8/06	55,125	110,250	220,500
Ronald F. Woestemeyer	3/8/06	17,531	35,063	70,125

(1) The cash incentive bonus plan for 2006 was based on us achieving a minimum of 90% of our targets for revenue, operating income and backlog and a maximum at 120% of those targets. Equal weight is given to the revenue and backlog measures (40% of the bonus amount) and the remaining 20% of the bonus is dependent upon the operating income goal.

Options exercised and stock vested for 2006

Name	Option awards Number of shares acquired on exercise (#)	Value realized on exercise ($)
Albert E. Winemiller		
Charles H. Murphy(1)	100,000	$ 271,000
Ronald F. Woestemeyer		

(1) In September 2005, Mr. Murphy was granted an immediately exercisable stock option for 100,000 shares. Mr. Murphy exercised this stock option on May 1, 2006 for 33,333 shares and on August 11, 2006 for 66,667 shares at an exercise price of $0.43 per share, which is reflected in this table. Of these shares, 50,000 shares of this option grant were vested at December 31, 2006. We would have had the right on December 31, 2006 to repurchase 50,000 shares if Mr. Murphy had been terminated for cause or resigned without good reason on December 31, 2006. Mr. Murphy vests in these shares, and our right of repurchase lapses, at a rate of 2,083 shares per month until December 31, 2008 when these shares vest in full.

We had no outstanding stock options held by executive officers at December 31, 2006. Mr. Murphy exercised his outstanding stock options in 2006 as set forth in footnote (1) to the above table. All of Mr. Winemiller's stock options granted prior to 2006 were fully vested and exercised prior to 2006. We have not granted Mr. Woestemeyer any stock options because of his equity position in us.

Potential payments upon termination or change in control

Under the employment agreements with Mr. Murphy, Mr. Winemiller and Mr. Woestemeyer, discussed under "Compensation discussion and analysis of executive officers" above, our executive officers are entitled to certain payments if they are terminated.

Under these agreements for Mr. Murphy and Mr. Winemiller, as amended in April 2007, if either of them is terminated without "cause," or if any one of them resign for good reason, such executive will be entitled to receive:

- 12 months of severance (or 18 months if within six months prior or anytime after a change in control);
- up to 12 months of health benefits (or 18 months if within six months prior or anytime after a change in control);
- 12 months of acceleration of the vesting of their stock option awards and equity awards granted prior to April 2, 2007; and
- full acceleration on the vesting of any stock option award or equity award granted on or after April 2, 2007.

Under Mr. Woestemeyer's employment agreement, he is entitled to up to 12 months of severance if we terminate his employment without "cause" or do not renew without notice his employment agreement. If Mr. Winemiller and Mr. Murphy had been terminated without cause, resigned for good reason, other than in connection with a change of control, or their employment agreements were not renewed, and Mr. Woestemeyer had been terminated without cause, in each case, on December 31, 2006, they would have been entitled to the following:

Executive officer	Severance	Health benefits	SFAS 123R Fair value of vesting acceleration(1)	Total
Albert E. Winemiller	$ 275,000	$ 10,058	$ 463,500	$ 748,558
Charles H. Murphy(2)	245,000	10,479	531,250	786,729
Ronald F. Woestemeyer	275,000			275,000

(1) Includes the value of the full acceleration of the vesting on stock options to acquire 150,000 shares of our common stock granted to each of Mr. Winemiller and Mr. Murphy on April 2, 2007.

(2) Includes the value of the acceleration of vesting of 25,000 shares of our common stock, which would have otherwise been subject to our repurchase right.

If Mr. Winemiller and Mr. Murphy had been terminated on December 31, 2006 within six months of a change in control transaction or after a change in control transaction, they would have been entitled to the following:

Executive officer	Severance	Health benefits	SFAS 123R Fair value of vesting acceleration(1)	Total

Albert E. Winemiller	$	412,500	$	15,087	$	463,500	$	891,087
Charles H. Murphy(2)		367,500		15,719		599,000		982,219

(1) Includes the value of the full acceleration of the vesting on stock options to acquire 150,000 shares of our common stock granted to each of Mr. Winemiller and Mr. Murphy on April 2, 2007.

(2) Includes the value of the acceleration of vesting of 50,000 shares of our common stock, which would have otherwise been subject to our repurchase right.

Certain relationships and related party transactions

Since March 2004, there has not been, nor is there currently proposed, any transaction or series of similar transactions to which we were or are a party in which the amount involved exceeded or exceeds $120,000 and in which any of our directors, executive officers, holders of more than 5% of any class of our voting securities, or any member of the immediate family of any of the foregoing persons, had or will have a direct or indirect material interest, other than compensation arrangements with directors and executive officers, which are described where required under the "Management" section of this prospectus, and the transactions described below.

Relationship with management, founders and investors

Ownership. Albert E. Winemiller, our chief executive officer, president and director, and Ronald F. Woestemeyer, our executive vice president, director and one of our founders, each hold more than 5% of our common stock prior to this offering. Mariette Woestemeyer, who is married to Mr. Woestemeyer, serves on our board of directors along with her husband. In addition, the funds affiliated with TA Associates and JMI Equity are considered holders of more than 5% of our common stock. Both Kurt Jaggers, who is a managing director of TA Associates, and Harry Gruner, who is a general partner at JMI Equity, also serve on our board of directors.

After completion of this offering, Messrs. Winemiller and Woestemeyer, TA Associates and its affiliates, and JMI Equity and its affiliates will beneficially own approximately 7%, 18%, 13%, and 4%, respectively, of our outstanding common stock, assuming no exercise of the underwriters' over-allotment option.

Board of directors. Mr. Jaggers, a managing director of TA Associates, Mr. Gruner, a general partner at JMI Equity, and Mrs. Woestemeyer are three of our directors and each serves on our nominating and governance committee. Mr. Jaggers also serves on our compensation committee. Mr. Gruner also serves on our audit committee. Mr. Woestemeyer and Mr. Winemiller also serve as directors on our board.

Registration rights. TA Associates, JMI Equity and Mr. and Mrs. Woestemeyer have piggyback registration rights with respect to shares of common stock that they hold. In addition, TA Associates and JMI Equity have demand and other registration rights for their shares of our common stock under the Stock Purchase and Stockholders Agreement described further below. For a description of these registration rights, see "Description of capital stock."

Stock Purchase and Stockholders Agreement. In June 1998, we entered into a Stock Purchase and Stockholders Agreement with TA Associates, JMI Equity and other individuals to whom we issued our convertible preferred stock. This agreement provides the investors registration rights and other rights relating to their investment in us.

Redemption of preferred stock. On August 15, 2005, TA Associates and JMI Equity converted the outstanding shares of our convertible preferred stock into 9,750,000 shares of our common stock and 3,921,312 shares of our redeemable preferred stock. In 2006, TA Associates and JMI Equity as holders of approximately 75% and 24%, respectively, of our redeemable preferred stock, elected to have us redeem 1,294,030, or 33%, of the outstanding redeemable preferred stock in accordance with the rights of the redeemable preferred stock. We redeemed those shares for $8.4 million. In March 2007, we redeemed all 2,627,282 shares of our remaining redeemable preferred stock for a total redemption price of $17.4 million, including $5.6 million in accrued and unpaid dividends on our redeemable preferred stock, in accordance with a redemption agreement between us and the holders of our redeemable preferred stock. In connection with the redemption in 2006, TA Associates and JMI Equity received $6.4 million and $2.0 million, respectively. In connection with the redemption in 2007, TA Associates and JMI Equity received $13.0 million and $4.0 million, respectively. See "Dividend Policy."

Dividend. On March 30, 2007, we declared and paid a one-time cash dividend of $2.00 per share on our common stock. As a result of such dividend, Messrs. Winemiller, Murphy and Woestemeyer (their relatives and trusts for the benefit of their relatives) and entities associated with TA Associates and JMI Equity received a total of $3.9 million, $1.2 million, $12.3 million, $14.7 million and $4.6 million, respectively. See "Dividend policy."

Warrants. On October 16, 2007, Mr. and Mrs. Woestemeyer exercised warrants to purchase an aggregate of 200,000 shares of our common stock at a price of $2.05 per share.

Indemnification agreements. We have entered into indemnification agreements with each of our current directors and executive officers. These agreements require us, among other things, to indemnify these individuals to the fullest extent permitted under Delaware law against liabilities that may arise by reason of their service to us, and to advance expenses incurred as a result of any proceeding against them as to which they could be indemnified. We also intend to enter into indemnification agreements with our future directors and executive officers.

Stock options granted to directors and executive officers. For more information regarding the grant of stock options to our directors and executive officers, please see "Management Director compensation" and "Executive compensation."

Employment arrangements. We have entered into an employment agreement with each of Mr. Winemiller, Mr. Murphy and Mr. Woestemeyer, our executive officers, which address, among other things, the terms of their employment. See "Compensation discussion and analysis for named executive."

Procedures for related party transactions

Under our code of business conduct and ethics, our employees and officers are discouraged from entering into any transaction that may cause a conflict of interest for us. In addition, they must report any potential conflict of interest, including related party transactions, to their managers or our compliance officer who then reviews and summarizes the proposed transaction for our audit committee. Pursuant to its charter, our audit committee must then approve any related-party transactions, including those transactions involving our directors. In approving or rejecting such proposed transactions, the audit committee considers the relevant facts and circumstances available and deemed relevant to the audit committee, including the material terms of the transactions, risks, benefits, costs, availability of other comparable services or products and, if applicable, the impact on a director's independence. Our audit committee will approve only those transactions that, in light of known circumstances, are in, or are not inconsistent with, our best interests, as our audit committee determines in the good faith exercise of its discretion. A copy of our code of business conduct and ethics and audit committee charter may be found at our website http://www.prospricing.com.

Principal and selling stockholders

The following table sets forth information regarding the beneficial ownership of our common stock as of November 1, 2007 by:

each person known by us to beneficially own more than 5% of our outstanding shares of common stock;

each of our current directors;

each of our current executive officers;

all of our current executive officers and directors as a group; and

each selling stockholder.

The percentage of beneficial ownership for the following table is based on 26,004,063 shares of our common stock outstanding as of November 1, 2007. The percentage of beneficial ownership after the offering is based on 26,069,063 shares of our common stock outstanding after this offering, assuming no exercise of the underwriters' over-allotment option.

Beneficial ownership is determined under the rules and regulations of the Securities and Exchange Commission and does not necessarily indicate beneficial ownership for any other purpose. Under these rules, beneficial ownership includes those shares of common stock over which the stockholder has sole or shared voting or investment power. It also includes shares of common stock that the stockholder has a right to acquire within 60 days of November 1, 2007 through the exercise of any option or other right. The percentage ownership of the outstanding common stock, however, is based on the assumption, expressly required by the rules and regulations of the SEC, that only the person or entity whose ownership is being reported has exercised options or warrants into shares of our common stock.

Unless otherwise indicated, the principal address of each of the stockholders below is c/o PROS Holdings, Inc., 3100 Main Street, Suite 900, Houston, Texas 77002.

	Shares beneficially owned prior to offering			**Shares beneficially owned after offering**	
Name of beneficial owner	**Number**	**Percent**	**Shares being offered hereby**	**Number**	**Percent**
Executive officers and directors					
Albert E. Winemiller(1)	2,100,000	8.0%	315,000	1,785,000	6.8%
Charles H. Murphy(2)	735,000	2.8	100,000	635,000	2.4
Ronald F. Woestemeyer(3)	5,325,543	20.5	650,000	4,675,543	17.9
Harry S. Gruner(4)	1,953,369	7.5	1,000,000	953,369	3.7
Kurt R. Jaggers(5)	6,120,671	23.5	2,730,000	3,390,671	13.0
Mariette M. Woestemeyer(6)	5,325,543	20.5	650,000	4,675,543	17.9
Greg B. Petersen(7)	35,000	*		35,000	*
Timothy V. Williams(8)	30,000	*		30,000	*
All executive officers and directors as a group (8 persons)(9)	16,299,583	61.6%	4,795,000	11,504,583	43.4%
Other selling stockholders					
Entities affiliated with TA Associates(10)	6,090,671	23.4	2,730,000	3,360,671	12.9

JMI Equity Fund III, L.P.(11)	1,923,369	7.4	1,000,000	923,369	3.5
Benson Yuen(12)	228,804	*	60,000	168,804	*
E. Andrew Boyd(13)	189,210	*	52,000	137,210	*
Peter Kiernan(14)	93,865	*	28,000	65,865	*

*
Represents less than one percent.

(1)

Consists of (a) 400,000 shares held of record by Albert E. Winemiller Limited Partnership; (b) 1,500,000 shares held of record by Albert E. Winemiller Jr. 2006 Irrevocable Trust; (c) 25,000 shares held of record by Debra Ann Winemiller; (d) 25,000 held of record by Debra Ann Winemiller Revocable Family Trust; and (e) stock options to acquire 150,000 shares of our common stock, which were granted to Mr. Winemiller on April 2, 2007, which are immediately exercisable and which vest as to 25% on April 2, 2008 and the remainder monthly thereafter based on continued employment through April 2, 2011. Mr. Winemiller disclaims beneficial ownership of the shares held of record by Albert E. Winemiller Limited Partnership, Albert E. Winemiller Jr. 2006 Irrevocable Trust, Debra Ann Winemiller and Debra Ann Winemiller Revocable Family Trust, except to the extent of his pecuniary interest therein.

(2)

Consists of (a) 423,000 shares held of record by Charles H. Murphy; 29,168 of which are subject to a repurchase option we hold as of November 1, 2007; (b) 50,000 shares held of record by Emily L. Murphy; (c) 40,000 shares held of record by Bryan M. Murphy; (d) 40,000 shares held of record by Jessica K. Murphy; (e) 8,000 shares held of record by Mary Ann Burek; (f) 8,000 shares held of record by Steven McDonald; (g) 8,000 shares held of record by Dorothy Ann McDonough; (h) 8,000 shares held of record by John F. Murphy and (i) stock options to acquire 150,000 shares of our common stock, which were granted on April 2, 2007, which are immediately exercisable and which vest as to 25% on April 2, 2008 and the remaining monthly thereafter based on continued employment through April 2, 2011. Excludes 1,500,000 shares held of record by Albert E. Winemiller Jr. 2006 Irrevocable Trust, of which Mr. Murphy serves as the trustee and has sole voting and investment power. Mr. Murphy disclaims beneficial ownership of the shares held of record by Albert E. Winemiller Jr. 2006 Irrevocable Trust, Bryan M. Murphy, Jessica K. Murphy, Mary Ann Burek, Steven McDonald, Dorothy Ann McDonough and John F. Murphy.

(3)

Consists of (a) 1,795,543 shares held of record by Ronald F. Woestemeyer and Mariette Woestemeyer; (b) 1,500,000 shares held of record by Ronald F. Woestemeyer, as Trustee of the Ronald F. Woestemeyer 2007 Annuity Trust; (c) 1,000,000 shares held of record by Mariette M. Woestemeyer, as Trustee of the Mariette M. Woestemeyer 2007 Annuity Trust; (d) 1,000,000 shares held of record by Joetta W. Moulden, Trustee of the Woestemeyer 1999 Gift Trust; and (e) 30,000 shares issuable upon the exercise of stock options granted to Mrs. Woestemeyer on June 27, 2007, which are immediately exercisable and which vest in equal monthly installments over a three year period. Mr. Woestemeyer disclaims beneficial ownership of the shares held of record by Joetta W. Moulden, Trustee of the Woestemeyer 1999 Gift Trust, Mariette M. Woestemeyer, as Trustee of the Mariette M. Woestemeyer 2007 Annuity Trust and Mrs. Woestemeyer.

(4)

Consists of (a) 30,000 shares issuable upon the exercise of stock options granted to Mr. Gruner on June 27, 2007, which are immediately exercisable and which vest in equal monthly installments over a three year period and (b) 1,923,369 shares of our common stock held by JMI Equity Fund, III, L.P. as disclosed in footnote 11 of this table. Mr. Gruner is a managing member of the general partner of JMI Equity Fund, III, L.P. Mr. Gruner disclaims beneficial ownership of these shares, except to the extent of his pecuniary interest therein.

(5)

Consists of (a) 30,000 shares issuable upon the exercise of stock options granted to Mr. Jaggers on June 27, 2007, which are immediately exercisable and which vest in equal monthly installments over a three year period and (b) 6,090,671 shares held by entities affiliated with TA Associated as disclosed in footnote 10 of this table. Mr. Jaggers is the managing director and a limited partner of such entities. Mr. Jaggers disclaims beneficial ownership of these shares, except to the extent of his pecuniary interest therein and 25,908 shares.

(6)

Consists of (a) 1,795,543 shares held of record by Ronald F. Woestemeyer and Mariette Woestemeyer; (b) 1,500,000 shares held of record by Ronald F. Woestemeyer, as Trustee of the Ronald F. Woestemeyer 2007 Annuity Trust; (c) 1,000,000 shares held of record by Mariette M. Woestemeyer, as Trustee of the Mariette M. Woestemeyer 2007 Annuity Trust; (d) 1,000,000 shares held of record by Joetta W. Moulden, Trustee of the Woestemeyer 1999 Gift Trust; (e) 30,000 shares issuable upon the exercise of stock options granted to Mrs. Woestemeyer on June 27, 2007, which are immediately exercisable and which vest in equal monthly installments over a three year period. Mrs. Woestemeyer disclaims beneficial ownership of the shares held of record by Joetta W. Moulden, Trustee of the Woestemeyer 1999 Gift Trust, and Ronald F. Woestemeyer, as Trustee of the Ronald F. Woestemeyer 2007 Annuity Trust.

(7)

Includes 30,000 shares issuable upon the exercise of stock options granted to Mr. Petersen on June 27, 2007, which are immediately exercisable and which vest in equal monthly installments over a three year period.

(8)

Consists of 30,000 shares issuable upon the exercise of stock options granted to Mr. Williams on June 27, 2007, which are immediately exercisable and which vest in equal monthly installments over a three year period.

(9)

Consists of 16,299,583 shares held of record by our current directors and executive officers, 29,168 of which are subject to repurchase rights we hold as of November 1, 2007.

(10)

Consists of (a) 4,967,603 shares held of record by TA/Advent VIII, L.P.; (b) 932,360 shares held of record by Advent Atlantic and Pacific III, L.P.; (c) 91,358 shares held of record by TA Executives Fund LLC; and (d) 99,350 shares held of record by TA Investors LLC (such entities, collectively, the "TA Funds"). Investment and voting control of each of the TA Funds is held by TA Associates, Inc. No stockholder, director or officer of TA Associates, Inc. has voting or investment power with respect to our shares of common stock held by the TA Associates Funds. Voting and investment power with respect to such shares is vested in a three-person investment committee consisting of the following employees of TA Associates, Inc.: Kevin Landry, Jacqui Morby and Kurt Jaggers. Mr. Jaggers is a Managing Director of TA Associates, Inc. TA Associates, Inc. is the general partner of TA Associates AAP III Partners, which is the general partner of our stockholder, Advent Atlantic and Pacific III, L.P. TA Associates, Inc. is also the manager of TA Associates VIII LLC, which is the general partner of our stockholders, TA/Advent VIII L.P. TA Associates, Inc. is the manager of our stockholders, TA Executives Fund LLC and TA Investors LLC. Mr. Jaggers disclaims beneficial ownership held by the TA Funds. The address for each of the TA Funds is John Hancock Tower, 56th floor, 200 Clarendon Street, Boston, MA 02116.

(11) Consists of 1,923,369 shares held of record by JMI Equity Fund III, L.P. Investment and voting control of JMI Equity Fund III, L.P. is held by JMI Associates III, LLC, its general partner. Mr. Gruner, Charles E. Noell III and Paul V. Barber are managing members of JMI Associates III, LLC and may be deemed the beneficial owners of any shares beneficially owned by JMI Associates III, LLC. Mr. Gruner disclaims beneficial ownership held by JMI Equity Fund III, L.P. except to the extent of his pecuniary interest therein. The address for JMI Equity Fund III, L.P. is 2 Hamill Road, Suite 272, Baltimore, Maryland 21210.

(12) Mr. Yuen is an employee of ours.

(13) Includes 6,250 shares issuable upon the exercise of stock options which will be exercisable within 60 days of November 1, 2007. Mr. Boyd is an employee of ours.

(14) Consists of (a) 87,615 shares held of record by Roy J. Vickery and Peter P. Kiernan, as joint tenants with right of survivorship and (b) 6,250 shares issuable upon the exercise of stock options which will be exercisable within 60 days of November 1, 2007. Mr. Kiernan is an employee of ours.

Description of capital stock

General

Our authorized capital stock consists of 75,000,000 shares of common stock, $0.001 par value per share, and 5,000,000 shares of undesignated preferred stock, $0.001 par value per share. As of November 1, 2007, we had outstanding 26,004,063 shares of our common stock and 162 common stockholders of record.

Common stock

Dividend rights

Subject to preferences that may apply to shares of preferred stock outstanding at the time, the holders of outstanding shares of our common stock are entitled to received dividends out of assets legally available at the times and in the amounts that our board of directors may determine from time to time.

Voting rights

Each holder of common stock is entitled to one vote for each share of common stock held on all matters submitted to a vote of stockholders. We have not provided for cumulative voting for the election of directors in our certificate of incorporation. This means that the holders of a majority of the shares voted can elect all of the directors then standing for election. In addition, our certificate of incorporation and bylaws provide that certain actions require the approval of two-thirds, rather than a majority, of the shares entitled to vote.

No preemptive, conversion or redemption rights

Our common stock is not entitled to preemptive rights and is not subject to conversion or redemption.

Right to receive liquidation distributions

Upon our liquidation, dissolution or winding-up, the holders of our common stock are entitled to share in all assets remaining after payment of all liabilities and the liquidation preferences of any outstanding preferred stock. Each outstanding share of common stock is, and all shares of common stock to be issued in this offering when they are paid for will be, fully paid and nonassessable.

Preferred stock

Our board of directors is authorized, subject to limitations imposed by Delaware law, to issue up to a total of 5,000,000 shares of preferred stock in one or more series, without stockholder approval. Our board is authorized to establish from time to time the number of shares to be included in each series of preferred stock, and to fix the rights, preferences and privileges of the shares of each wholly unissued series of preferred stock and any of its qualifications, limitations or restrictions. Our board can also increase or decrease the number of shares of any series of preferred stock, but not below the number of shares of that series of preferred stock then outstanding, without any further vote or action by the stockholders.

Registration rights

According to the terms of our Stock Purchase and Stockholders Agreement, TA Associates, JMI Equity and certain other stockholders are entitled to demand, piggyback and Form S-3 registration rights. These rights expire on the earlier of June 27, 2012 and the time when such holders can sell all of the shares of our common stock that they hold in compliance with securities laws without the use of a registration statement.

We have entered into registration rights agreements with Mr. and Mrs. Woestemeyer and two of our former officers which provide for piggyback registration rights for the shares held by these individuals other than in connection with our initial public offering. These piggyback registration rights expire when the holders cease to hold a minimum number of shares of our common stock or at the time when such holders can sell all of the shares of our common stock that they hold in compliance with securities laws without the use of a registration statement. Mr. and Mrs. Woestemeyer are not subject to the minimum holding requirement.

Demand registration rights

At any time following June 27, 2008, our stockholders with demand registration rights under our Stock Purchase and Stockholders Agreement have the right to require that we register all or a portion of their shares of common stock. The underwriters of any underwritten offering have the right to limit the number of shares to be included in a registration statement filed in response to the exercise of these demand registration rights. We must pay all expenses, except for underwriters' discounts and commissions, incurred in connection with these demand registration rights, except that we are not required to pay for expenses incurred if the holders of these rights subsequently withdraw their request for registration.

Piggyback registration rights

If we register any securities for public sale, our stockholders with piggyback registration rights under our registration rights agreements and our Stock Purchase and Stockholders Agreement have the right to include their shares in the registration, subject to specified exceptions. The underwriters of any underwritten offering have the right to limit the number of shares registered by these holders. We must pay all expenses, except for underwriters' discounts and commissions, incurred in connection with these piggyback registration rights.

Form S-3 registration rights

Our stockholders who are party to our Stock Purchase and Stockholders Agreement can request that we register such holders' shares of common stock on Form S-3 if we are eligible to file a registration statement on that form. We must pay all expenses, except for underwriters' discounts and commissions, for all registrations on Form S-3.

Anti-takeover effects of Delaware law and our certificate of incorporation and bylaws

The provisions of Delaware law, our amended and restated certificate of incorporation and our bylaws described below may have the effect of delaying, deferring or discouraging another party from acquiring control of us.

Delaware law

We are subject to the provisions of Section 203 of the Delaware General Corporation Law regulating corporate takeovers. In general, these provisions prohibit a Delaware corporation from engaging in any business combination with any interested stockholder for a period of three years following the date that the stockholder became an interested stockholder, unless:

- the transaction is approved by the board before the date the interested stockholder attained that status;
- upon consummation of the transaction that resulted in the stockholder becoming an interested stockholder, the interested stockholder owned at least 85% of the voting stock of the corporation outstanding at the time the transaction commenced; or
- the business combination is approved by the board and authorized at a meeting of stockholders by at least two-thirds of the outstanding shares of voting stock that are not owned by the interested stockholder.

Section 203 defines "business combination" to include the following:

- any merger or consolidation involving the corporation and the interested stockholder;
- any sale, transfer, pledge or other disposition of 10% or more of the assets of the corporation involving the interested stockholder;
- subject to certain exceptions, any transaction that results in the issuance or transfer by the corporation of any stock of the corporation to the interested stockholder;
- any transaction involving the corporation that has the effect of increasing the proportionate share of the stock of any class or series of the corporation beneficially owned by the interested stockholder; or
- the receipt by the interested stockholder of the benefit of any loans, advances, guarantees, pledges or other financial benefits provided by or through the corporation.

In general, Section 203 defines an interested stockholder as any entity or person beneficially owning 15% or more of the outstanding voting stock of the corporation and any entity or person affiliated with or controlling or controlled by any of these entities or persons. The statute could prohibit or delay mergers or other takeover or change in control attempts and, accordingly, may discourage attempts to acquire us.

Certificate of incorporation and bylaws

Our amended and restated certificate of incorporation and bylaws provide for:

- the division of our board of directors into three classes to be elected on a staggered basis, one class each year;
- a prohibition on actions by written consent of our stockholders;
- the elimination of the right of stockholders to call a special meeting of stockholders;
- a requirement that stockholders provide advance notice of any stockholder nominations of directors or any proposal of business to be considered at any meeting of stockholders;

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- a requirement that a supermajority vote be obtained to amend or repeal certain provisions of our certificate of incorporation; and
- the ability of our board of directors to issue preferred stock without stockholder approval.

Transfer agent and registrar

The transfer agent and registrar for our common stock is Computershare Trust Company, N.A. and its address is 250 Royall Street, Canton, MA 02021.

Listing

Our common stock is listed on the New York Stock Exchange under the trading symbol "PRO."

Material U.S. federal tax consequences to non-U.S. holders

The following is a summary of material United States federal income and estate tax consequences of the ownership and disposition of our common stock by a non-United States holder. For purposes of this discussion, a non-United States holder is any beneficial owner that for United States federal income tax purposes is not a United States person; the term United States person means:

- an individual citizen or resident of the United States;
- a corporation or other entity taxable as a corporation created or organized in the United States or under the laws of the United States or any political subdivision thereof;
- an estate whose income is subject to United States federal income tax regardless of its source; or
- a trust (x) whose administration is subject to the primary supervision of a United States court and which has one or more United States persons who have the authority to control all substantial decisions of the trust or (y) which has made an election to be treated as a United States person.

An individual may, in certain cases, be treated, for the taxable year of a disposition, as a resident of the United States, rather than as a nonresident, among other ways, by virtue of being present in the United States on at least 31 days in that taxable year and for an aggregate of at least 183 days during the three-year period ending in that taxable year (counting for such purposes all the days present in the current year, one-third of the days present in the immediately preceding year and one-sixth of the days present in the second preceding year). Residents are subject to United States federal income tax as if they were United States citizens. Such individuals are urged to consult their own tax advisors regarding the United States federal income tax consequences of the sale, exchange or other disposition of our common stock.

If a partnership or other pass-through entity holds common stock, the tax treatment of a partner or member in the partnership or other entity will generally depend on the status of the partner or member and upon the activities of the partnership or other entity. Accordingly, we urge partnerships or other pass-through entities which hold our common stock and partners or members in these partnerships or other entities to consult their tax advisors.

This discussion assumes that non-United States holders will acquire our common stock pursuant to this offering and will hold our common stock as a capital asset (generally, property held for investment). This discussion does not address all aspects of United States federal income taxation that may be relevant in light of a non-United States holder's special tax status or special tax situations. United States expatriates, controlled foreign corporations, passive foreign investment companies, corporations that accumulate earnings to avoid federal income tax, life insurance companies, tax-exempt organizations, dealers in securities or currencies, brokers, banks or other financial institutions, certain trusts, hybrid entities, pension funds and investors that hold common stock as part of a hedge, straddle or conversion transaction are among those categories of potential investors that are subject to special rules not covered in this discussion. This discussion does not consider the tax consequences for partnerships, entities classified as a partnership for United States federal income tax purposes, or persons who hold their interests through a partnership or other entity classified as a partnership for United States federal income tax purposes. This discussion does not address any United States federal gift tax consequences, or state or local or non-United States tax consequences. Furthermore, the following discussion is based on current provisions of the

Internal Revenue Code of 1986, as amended, and Treasury Regulations and administrative and judicial interpretations thereof, all as in effect on the date hereof, and all of which are subject to change, possibly with retroactive effect.

Dividends

We do not plan to pay any dividends on our common stock for the foreseeable future. However, if we do pay dividends on our common stock, those payments will constitute dividends to the extent paid from our current or accumulated earnings and profits, as determined under United States federal income tax principles. To the extent those dividends exceed our current and accumulated earnings and profits, the dividends will constitute a return of capital and will first reduce a holder's basis, but not below zero, and then will be treated as gain from the sale of stock.

The gross amount of any dividend (out of earnings and profits) paid to a non-United States holder of common stock generally will be subject to United States withholding tax at a rate of 30% unless the holder is entitled to an exemption from or reduced rate of withholding under an applicable income tax treaty. In order to receive a reduced treaty rate, prior to the payment of a dividend a non-United States holder must provide us with an IRS Form W-8BEN (or successor form) certifying qualification for the reduced rate.

Dividends received by a non-United States holder that are effectively connected with a United States trade or business conducted by the non-United States holder (and dividends attributable to a non- United States holder's permanent establishment in the United States if an income tax treaty applies) are exempt from this withholding tax. To obtain this exemption, prior to the payment of a dividend, a non-United States holder must provide us with an IRS Form W-8ECI (or successor form) properly certifying this exemption. Effectively connected dividends (or dividends attributable to a permanent establishment), although not subject to withholding tax, are taxed at the same graduated rates applicable to United States persons, net of certain deductions and credits. In addition, dividends received by a corporate non-United States holder that are effectively connected with a United States trade or business of the corporate non-United States holder (or dividends attributable to a corporate non-United States holder's permanent establishment in the United States if an income tax treaty applies) may also be subject to a branch profits tax at a rate of 30% (or such lower rate as may be specified in an income tax treaty).

A non-United States holder who provides us with an IRS Form W-8BEN or an IRS Form W-8ECI will be required to periodically update such form.

A non-United States holder of common stock that is eligible for a reduced rate of withholding tax pursuant to an income tax treaty may obtain a refund of any excess amounts currently withheld if an appropriate claim for refund is timely filed with the IRS.

Gain on disposition of common stock

A non-United States holder generally will not be subject to United States federal income tax on gain realized on the sale or other disposition of our common stock unless:

- the gain is effectively connected with a United States trade or business of the non-United States holder (or attributable to a permanent establishment in the United States if an income tax treaty applies), which gain, in the case of a corporate non-United States holder, must also be taken into account for branch profits tax purposes;

the non-United States holder is an individual who is present in the United States for a period or periods aggregating 183 days or more during the calendar year in which the sale or disposition occurs and certain other conditions are met; or

our common stock constitutes a United States real property interest by reason of our status as a "United States real property holding corporation" for United States federal income tax purposes at any time within the shorter of the five-year period preceding the disposition or the holder's holding period for our common stock. We believe that we are not currently, and we are not likely to become, a "United States real property holding corporation" for United States federal income tax purposes.

If we were to become a United States real property holding corporation, so long as our common stock is regularly traded on an established securities market and continues to be so traded, a non-United States holder would be subject to United States federal income tax on any gain from the sale, exchange or other disposition of shares of our common stock, by reason of such United States real property holding corporation status, only if such non-United States holder actually or constructively owned, more than 5% of our common stock at any time during the shorter of the five-year period preceding the disposition or the holder's holding period for our common stock. Any such non-United States holder that owns or has owned, actually or constructively, more than 5% of our common stock is urged to consult that holder's own tax advisor with respect to the particular tax consequences to such holder for the gain from the sale, exchange or other disposition of shares of our common stock if we were to be or to become a United States real property holding company.

Backup withholding and information reporting

Generally, we must report annually to the IRS the amount of dividends paid, the name and address of the recipient, and the amount, if any, of tax withheld. A similar report is sent to the holder. Pursuant to tax treaties or other agreements, the IRS may make its reports available to tax authorities in the non-United States holder's country of residence.

Payments of dividends or of proceeds on the disposition of stock made to a non-United States holder may be subject to additional information reporting and backup withholding. Backup withholding will not apply if the non-United States holder establishes an exemption, for example, by properly certifying its non-United States status on an IRS Form W-8BEN (or successor form). Notwithstanding the foregoing, backup withholding may apply if either we or our paying agent has actual knowledge, or reason to know, that the holder is a United States person.

Backup withholding is not an additional tax. Rather, the United States income tax liability of persons subject to backup withholding will be reduced by the amount of tax withheld. If withholding results in an overpayment of taxes, a credit or refund may be obtained, provided that the required information is furnished to the IRS in a timely manner.

Federal estate tax

An individual non-United States holder who is treated as the owner, or has made certain lifetime transfers, of an interest in our common stock will be required to include the value thereof in his or her gross estate for United States federal estate tax purposes, and may be subject to United States federal estate tax unless an applicable estate tax or other treaty provides otherwise.

This discussion is for general purposes only. Prospective investors are urged to consult their own tax advisors regarding the application of the United States federal income and estate tax laws to their particular situations and the consequences under United States federal gift tax laws, as well as foreign, state, and local laws and tax treaties.

Shares eligible for future sale

Future sales of substantial amounts of our common stock, including shares issued upon exercise of outstanding options, in the public market after the restrictions lapse, or the possibility of the sales, could cause the prevailing market price of our common stock to fall or impair our ability to raise equity capital in the future.

Upon completion of this offering, we will have outstanding 26,069,063 shares of our common stock, based on the number of shares outstanding as of November 1, 2007 and assuming that there are no exercises of outstanding options after November 1, 2007. Of these shares, all of the shares sold in this offering and our initial public offering, or a total of 12,848,750 shares, will be freely tradable in the public market without restriction or further registration under the Securities Act, unless these shares are held by "affiliates," as that term is defined in Rule 144 under the Securities Act. Shares purchased by an affiliate may not be resold except pursuant to an effective registration statement or an exemption from registration, including the exemption under Rule 144 of the Securities Act described below. After this offering, and assuming no exercise of the underwriters' over allotment option, 13,220,313 shares of our common stock held by existing stockholders will be "restricted securities," as that term is defined in Rule 144 under the Securities Act. These restricted securities may be sold in the public market only if they are registered or if they qualify for an exemption from registration under Rule 144 or 701 under the Securities Act. These rules are summarized below. Subject to the lock-up agreements described below and the provisions of Rule 144 and Rule 701, these restricted securities will be available for sale in the public market as follows:

Number of shares	Date of availability for sale
1,806,351	December 25, 2007 (unless otherwise extended pursuant to the terms of outstanding lock-up agreements)
11,413,962	90 days after the date of this prospectus

Lock-up agreements

In connection with our initial public offering, all of our officers, directors, employees and stockholders have agreed, subject to limited exceptions, not to directly or indirectly sell or dispose of any shares of common stock or any securities convertible into or exchangeable or exercisable for shares of common stock prior to December 25, 2007 without the prior written consent of J.P. Morgan Securities Inc. and Deutsche Bank Securities Inc.

In connection with this offering, the selling stockholders and our directors and executive officers have agreed subject to limited exceptions, not to directly or indirectly sell or dispose of any shares of common stock or any securities convertible into or exchangeable or exercisable for shares of common stock for a period of 90 days after the date of this prospectus without the prior written consent of J.P. Morgan Securities Inc. and Deutsche Bank Securities Inc. For additional information, see "Underwriting."

Rule 144

In general, under Rule 144 as currently in effect, a person who has beneficially owned shares of our common stock for at least one year from the later of the date those shares of common stock were acquired from us or from an affiliate of ours, including the holding period of any prior owner other than an affiliate, would be entitled to sell, within any three-month period, a number of shares that is not more than the greater of:

- 1% of the number of shares of common stock then outstanding, which will equal approximately 260,690 shares immediately after this offering; or

- the average weekly trading volume of our common stock on the New York Stock Exchange during the four calendar weeks before a notice of the sale on Form 144 is filed.

Sales under Rule 144 are also subject to manner of sale provisions, notice requirements and the availability of current public information about us.

Rule 144(k)

In addition, under Rule 144(k), a person who is not one of our affiliates at any time during the three months preceding a sale, and who has beneficially owned the shares proposed to be sold for at least two years from the later of the date these shares of our common stock were acquired from us or from an affiliate of ours, including the holding period of any prior owner other than an affiliate, is entitled to sell those shares without complying with the manner of sale, public information, volume limitation or notice provisions of Rule 144. Therefore, unless otherwise restricted pursuant to the lock-up agreements, those shares may be freely sold.

Rule 701

Any employee, officer or director of, or consultant to us who purchased shares under a written compensatory plan or contract may be entitled to sell them in reliance on Rule 701. Rule 701 permits affiliates to sell their Rule 701 shares under Rule 144 without complying with the holding period requirements of Rule 144. Rule 701 further provides that non-affiliates may sell these shares in reliance on Rule 144 without complying with the holding period, public information, volume limitation or notice provisions of Rule 144. All holders of Rule 701 shares other than affiliates have satisfied the resale provisions of Rule 701 and may sell such shares at anytime. However, all shares issued under Rule 701 are subject to lock-up agreements and will only become eligible for sale when lock-up agreements expire on December 25, 2007 or 90 days after the date of this prospectus, as applicable, unless otherwise extended.

Stock plans

We have filed a registration statement on Form S-8 under the Securities Act covering 2,212,260 shares of our common stock issued upon exercise of outstanding options under our 1997 stock option plan, 1999 equity incentive plan and 2007 plan and shares of our common stock reserved for issuance under our 2007 plan. However, no resale of these registered shares shall occur until after the expiration of lock-up agreements on December 25, 2007 or 90 days after the date of this prospectus, as applicable, unless otherwise extended.

Registration rights

At any time following June 27, 2008, certain holders of common stock may demand that we register their shares under the Securities Act or, if we file another registration statement under the Securities Act, may elect to include their shares in such registration. If these shares are registered, they will be freely tradable without restriction under the Securities Act. For additional information, see "Description of capital stock Registration rights."

Underwriting

We and the selling stockholders are offering the shares of common stock described in this prospectus through a number of underwriters. J.P. Morgan Securities Inc. and Deutsche Bank Securities Inc. are acting as joint book-running managers and as representatives of the underwriters. We and the selling stockholders have entered into an underwriting agreement with the underwriters. Subject to the terms and conditions of the underwriting agreement, we and the selling stockholders have agreed to sell to the underwriters, and each underwriter has severally agreed to purchase, at the public offering price less the underwriting discounts and commissions set forth on the cover page of this prospectus, the number of shares of common stock listed next to its name in the following table:

Name	Number of shares
J.P. Morgan Securities Inc.	1,750,000
Deutsche Bank Securities Inc.	1,750,000
Jefferies & Company, Inc.	625,000
Thomas Weisel Partners LLC	625,000
Needham & Company, LLC	250,000
Total	5,000,000

The underwriters are committed to purchase all the shares of common stock offered by us and the selling stockholders if they purchase any shares. The underwriting agreement also provides that if an underwriter defaults, the purchase commitments of non-defaulting underwriters may also be increased or the offering may be terminated.

The underwriters propose to offer the shares of common stock directly to the public at the public offering price set forth on the cover page of this prospectus and to certain dealers at that price less a concession not in excess of $0.553 per share. Any such dealers may resell shares to certain other brokers or dealers at a discount of up to $0.100 per share from the public offering price. After the offering of the shares, the public offering price and other selling terms may be changed by the underwriters. Sales of shares made outside of the United States may be made by affiliates of the underwriters.

The underwriters have an option to purchase up to 750,000 additional shares of common stock from the selling stockholders to cover sales of shares by the underwriters which exceed the number of shares specified in the table above. The underwriters have 30 days from the date of this prospectus to exercise this over-allotment option. If any shares are purchased with this over-allotment option, the underwriters will purchase shares in approximately the same proportion as shown in the table above. If any additional shares of common stock are purchased, the underwriters will offer the additional shares on the same terms as those on which the shares are being offered.

The underwriting fee is equal to the public offering price per share of common stock less the amount paid by the underwriters to us and the selling stockholders per share of common stock. The underwriting fee is $0.921 per share. The following table shows the per share and total underwriting discounts and commissions to be paid to the underwriters assuming both no exercise and full exercise of the underwriters' option to purchase additional shares.

Underwriting discounts and commissions

	Paid by the Company		Paid by the Selling Stockholders	
	Without over-allotment exercise	With full over-allotment exercise	Without over-allotment exercise	With full over-allotment exercise
Per Share	$ 0.92	$ 0.92	$ 0.92	$ 0.92
Total	$ 59,865	$ 59,865	$ 4,545,135	$ 5,235,885

We estimate that the total expenses of this offering, including registration, filing and listing fees, printing fees and legal and accounting expenses, but excluding the underwriting discounts and commissions, will be approximately $550,000.

A prospectus in electronic format may be made available on the websites maintained by one or more underwriters, or selling group members, if any, participating in the offering. The underwriters may agree to allocate a number of shares to underwriters and selling group members for sale to their online brokerage account holders. Internet distributions will be allocated by the representatives to underwriters and selling group members that may make Internet distributions on the same basis as other allocations.

We have agreed that we will not offer, sell, contract to sell, pledge or otherwise dispose of, directly or indirectly, or file with the SEC a registration statement under the Securities Act relating to, any shares of our common stock or securities convertible into or exchangeable or exercisable for any shares of our common stock, or publicly disclose the intention to make any offer, sale, pledge, disposition or filing, without the prior written consent of J.P. Morgan Securities Inc. and Deutsche Bank Securities Inc. for a period of 90 days after the date of this prospectus. Notwithstanding the foregoing, if (1) during the last 17 days of the 90-day restricted period, we issue an earnings release or material news or a material event relating to us occurs; or (2) prior to the expiration of the 90-day restricted period, we announce that we will release earnings results during the 16-day period beginning on the last day of the 90-day period, the restrictions described above shall continue to apply until the expiration of the 18-day period beginning on the issuance of the earnings release or the occurrence of the material news or material event.

Our directors and executive officers, and the selling stockholders have entered into lock-up agreements with the underwriters prior to the commencement of this offering pursuant to which each of these persons or entities, with limited exceptions, for a period of 90 days after the date of the final prospectus, may not, without the prior written consent of J.P. Morgan Securities Inc. and Deutsche Bank Securities Inc., (1) offer, pledge, announce the intention to sell, grant any option, right or warrant to purchase, or otherwise transfer or dispose of, directly or indirectly, any shares of our common stock (including, without limitation, common stock that may be deemed to be beneficially owned by such persons in accordance with the rules and regulations of the SEC and securities that may be issued upon exercise of a stock option or warrant) or (2) enter into any swap or other agreement that transfers, in whole or in part, any of the economic consequences of ownership of the common stock, whether any such transaction described in clause (1) or (2) above is to be settled by delivery of common stock or such other securities, in cash or otherwise. Notwithstanding the foregoing, if (1) during the last 17 days of the 90-day restricted period, we issue an earnings release or material news or a material event relating to our company occurs; or (2) prior to the expiration of the 90-day restricted period, we announce that we will release earnings results during the 16-day period beginning on the last day of the 90-day period, the restrictions described above shall continue to apply until the expiration of the 18-day period beginning on the issuance of the earnings release or the occurrence of the material news or material event.

We and the selling stockholders have agreed to indemnify the underwriters against certain liabilities, including liabilities under the Securities Act.

Our common stock is listed on the New York Stock Exchange under the symbol "PRO."

In connection with this offering, the underwriters may engage in stabilizing transactions, which involves making bids for, purchasing and selling shares of common stock in the open market for the purpose of preventing or retarding a decline in the market price of the common stock while this offering is in progress. These stabilizing transactions may include making short sales of the common stock, which involves the sale by the underwriters of a greater number of shares of common stock than they are required to purchase in this offering, and purchasing shares of common stock on the open market to cover positions created by short sales. Short sales may be "covered" shorts, which are short positions in an amount not greater than the underwriters' option to purchase additional shares referred to above, or may be "naked" shorts, which are short positions in excess of that amount. The underwriters may close out any covered short position either by exercising their option to purchase additional shares, in whole or in part, or by purchasing shares in the open market. In making this determination, the underwriters will consider, among other things, the price of shares available for purchase in the open market compared to the price at which the underwriters may purchase shares through the option to purchase additional shares. A naked short position is more likely to be created if the underwriters are concerned that there may be downward pressure on the price of the common stock in the open market that could adversely affect investors who purchase in this offering. To the extent that the underwriters create a naked short position, they will purchase shares in the open market to cover the position.

The underwriters have advised us that, pursuant to Regulation M of the Securities Act, they may also engage in other activities that stabilize, maintain or otherwise affect the price of the common stock, including the imposition of penalty bids. This means that if the representative of the underwriters purchase common stock in the open market in stabilizing transactions or to cover short sales, the representative can require the underwriters that sold those shares as part of this offering to repay the underwriting discount received by them.

These activities may have the effect of raising or maintaining the market price of the common stock or preventing or retarding a decline in the market price of the common stock, and, as a result, the price of the common stock may be higher than the price that otherwise might exist in the open market. If the underwriters commence these activities, they may discontinue them at any time. The underwriters may carry out these transactions on New York Stock Exchange, in the over-the-counter market or otherwise.

Each of J.P. Morgan Securities Inc., Deutsche Bank Securities Inc., Jefferies & Company, Inc. and Thomas Weisel Partners LLC acted as an underwriter in our initial public offering, and certain of the underwriters and their affiliates have in the past and may provide from time to time in the future certain commercial banking, financial advisory, investment banking and other services for us and such affiliates in the ordinary course of their business, for which they may receive customary fees and commissions. In addition, from time to time, certain of the underwriters and their affiliates may effect transactions for their own account or the account of customers, and hold on behalf of themselves or their customers, long or short positions in our debt or equity securities or loans.

Legal matters

DLA Piper US LLP, Austin, Texas, will pass upon the validity of the issuance of the shares of common stock offered by this prospectus. Davis Polk & Wardwell, Menlo Park, California, is representing the underwriters in this offering.

Experts

The consolidated financial statements as of December 31, 2005 and 2006 and for each of the three years in the period ended December 31, 2006 included in this prospectus have been so included in reliance on the report of PricewaterhouseCoopers LLP, an independent registered public accounting firm, given on the authority of said firm as experts in auditing and accounting.

Where you can find additional information

We have filed with the Securities and Exchange Commission a registration statement on Form S-1, including exhibits, under the Securities Act with respect to the common stock to be sold in this offering. This prospectus, which constitutes a part of the registration statement, does not contain all of the information in the registration statement or the exhibits. Statements made in this prospectus regarding the contents of any contract, agreement or other document are only summaries. With respect to each contract, agreement or other document filed as an exhibit to the registration statement, we refer you to the exhibit for a more complete description of the matter involved.

We are subject to the information and periodic reporting requirements of the Securities Exchange Act of 1934, as amended, or the Exchange Act, and, in accordance therewith, file periodic reports, proxy statements and other information with the SEC. You may read and copy all or any portion of the registration statement or any reports, statements or other information in the files at the public reference room of the Securities and Exchange Commission located at 100 F Street, N.E., Washington, D.C. 20549. You can request copies of these documents upon payment of a duplicating fee by writing to the Securities and Exchange Commission. You may call the Securities and Exchange Commission at 1-800-SEC-0330 for further information on the operation of its public reference room. Our filings, including our registration statement, will also be available to you on the web site maintained by the Securities and Exchange Commission at http://www.sec.gov.

PROS Holdings, Inc.

Index to consolidated financial statements

Report of independent registered public accounting firm

To the Board of Directors and Stockholders of
PROS Holdings, Inc.:

In our opinion, the consolidated financial statements listed in the accompanying index present fairly, in all material respects, the financial position of PROS Holdings, Inc., and its subsidiaries, at December 31, 2005 and 2006, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2006 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in the accompanying index presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

/s/ PricewaterhouseCoopers LLP
Houston, Texas
January 26, 2007, except for Note 3, as to which the date is April 3, 2007

PROS Holdings, Inc.

Consolidated balance sheets

	December 31 2005	December 31 2006	September 30 2007
			(unaudited)
Assets:			
Current assets:			
Cash and cash equivalents	$ 38,489,803	$ 42,540,180	$ 40,011,604
Accounts and unbilled receivables, net of allowance of $1,020,000, $1,190,000, and $1,220,000	7,429,022	13,788,989	14,921,151
Prepaid expenses and other current assets	1,349,355	2,199,997	3,850,691
Total current assets	47,268,180	58,529,166	58,783,446
Property and equipment, net	2,553,309	2,372,872	3,141,828
Other assets	468,154	2,144,371	2,492,477
Total assets	$ 50,289,643	$ 63,046,409	$ 64,417,751
Liabilities and stockholders' equity:			
Current liabilities:			
Accounts payable	$ 1,633,321	$ 584,372	$ 1,446,615
Accrued liabilities	2,833,776	3,965,817	3,390,989
Accrued contract labor	746,900	1,405,287	1,017,745
Accrued payroll	1,800,812	2,918,979	2,589,062
Deferred revenue	13,174,190	22,079,937	22,190,764
Total current liabilities	20,188,999	30,954,392	30,635,175
Long-term deferred revenue	787,500	4,131,757	5,264,086
Commitments and contingencies			
Redeemable preferred stock, $0.001 par value, 3,921,312 shares authorized, 3,921,312, 2,627,282 and 0 shares outstanding, respectively	25,268,841	17,283,168	
Stockholders' equity:			
Common stock, 28,000,000, 28,000,000 and 75,000,000 shares authorized, 23,431,174, 23,580,729 and 29,646,224 issued, 19,584,134, 19,733,689 and 25,799,184 shares outstanding, respectively	23,431	23,581	29,646
Additional paid-in capital	7,745,357	7,812,536	51,418,790
Common stock warrants	226,000	226,000	226,000
Treasury stock, 3,847,040 common shares at cost	(8,937,500)	(8,937,500)	(8,937,500)
Accumulated (deficit) earnings	4,987,015	11,552,475	(14,218,446)
Total stockholders' equity	4,044,303	10,677,092	28,518,490
Total liabilities and stockholders' equity	$ 50,289,643	$ 63,046,409	$ 64,417,751

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

PROS Holdings, Inc.

Consolidated statements of income

	Year ended December 31			Nine months ended September 30	
	2004	2005	2006	2006	2007
				(unaudited)	(unaudited)
Revenue:					
License and implementation	$ 20,015,056	$ 20,189,874	$ 29,604,257	$ 20,639,078	$ 30,577,733
Maintenance and support	12,430,746	14,939,887	16,423,252	12,178,920	13,718,877
Total revenue	32,445,802	35,129,761	46,027,509	32,817,998	44,296,610
Cost of revenue:					
License and implementation	10,638,232	10,070,868	12,079,683	8,548,802	9,682,794
Maintenance and support	2,750,280	3,310,048	3,525,721	2,712,512	3,459,189
Total cost of revenue	13,388,512	13,380,916	15,605,404	11,261,314	13,141,983
Gross profit	19,057,290	21,748,845	30,422,105	21,556,684	31,154,627
Operating expenses:					
Selling, general and administrative	8,968,822	12,010,371	13,260,623	10,046,647	11,530,223
Research and development	6,262,014	6,399,159	10,332,301	7,075,432	12,394,270
Income from operations	3,826,454	3,339,315	6,829,181	4,434,605	7,230,134
Other income (expense):					
Interest income	370,977	1,074,753	1,920,576	1,405,135	1,100,514
Interest and deferred finance costs	(5,328)				(868,982)
Income before income tax provision	4,192,103	4,414,068	8,749,757	5,839,740	7,461,666
Income tax provision	536,184	974,541	1,724,498	1,150,960	398,074
Net income	3,655,919	3,439,527	7,025,259	4,688,780	7,063,592
Accretion of preferred stock	(1,256,011)	(852,420)	(459,799)	(371,861)	(81,915)
Net earnings attributable to common stockholders	$ 2,399,908	$ 2,587,107	$ 6,565,460	$ 4,316,919	$ 6,981,677
Net earnings attributable to common stockholders per share:					
Basic	$ 0.24	$ 0.19	$ 0.33	$ 0.22	$ 0.32
Diluted	$ 0.19	$ 0.16	$ 0.32	$ 0.21	$ 0.31

Weighted average number of shares:					
Basic	9,822,094	13,891,415	19,649,372	19,622,655	22,038,459
Diluted	19,617,672	20,012,010	20,604,202	20,756,902	22,509,178

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

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PROS Holdings, Inc.
Consolidated statements of redeemable preferred stock and stockholders' equity (deficit)
Years ended December 31, 2004, 2005 and 2006 and nine months ended September 30, 2007 (unaudited)

	Preferred Stock												
	Series A Convertible Redeemable		Redeemable		Common stock					Treasury stock			
	Shares	Amount	Shares	Amount	Shares	Amount	Additional paid-in capital	Common stock warrants	Deferred compensation	Shares	Amount	Accumulated (deficit) earnings	stockh (
Balances at December 31, 2003	3,921,312	$ 30,656,489		$	9,820,761	$ 13,668	$ 237,389	$ 226,000	$ (2,129)	3,847,040	$ (8,937,500)	$	$ (8,4
Exercise of stock options					2,000	2	4,498						
Accretion of Series A convertible redeemable preferred stock		1,256,011										(1,256,011)	(1,2
Compensation expense related to options									2,129				
Net income												3,655,919	3,6
Balances at December 31, 2004	3,921,312	31,912,500			9,822,761	13,670	241,887	226,000		3,847,040	(8,937,500)	2,399,908	(6,0
Exercise of stock options					11,373	11	17,141						
Accretion of Series A convertible redeemable preferred stock		654,839										(654,839)	(6
Conversion of Series A convertible redeemable preferred stock	(3,921,312)	(32,567,339)	3,921,312	25,071,260	9,750,000	9,750	7,486,329						7,4
Accretion of redeemable preferred stock				197,581								(197,581)	(1
Net income												3,439,527	3,4
Balances at December 31, 2005			3,921,312	25,268,841	19,584,134	23,431	7,745,357	226,000		3,847,040	(8,937,500)	4,987,015	4,0

Exercise of stock options			149,555	150	67,179					
Accretion of redeemable preferred stock		459,799							(459,799)	(4
Redemption of redeemable preferred stock	(1,294,030)	(8,445,472)								
Net income									7,025,259	7,0
Balances at December 31, 2006	2,627,282	17,283,168	19,733,689	23,581	7,812,536	226,000	3,847,040	(8,937,500)	11,552,475	10,6
Exercise of stock options (unaudited)			946,745	946	683,759					6
Accretion of redeemable preferred stock (unaudited)		81,915							(81,915)	
Redemption of redeemable preferred stock (unaudited)	(2,627,282)	(17,365,083)								
Stock based compensation (unaudited)					931,744					9
Issuance of common stock in connection with the initial public offering, net of issuance costs incurred			5,118,750	5,119	50,566,447					50,5
Common stock dividend (unaudited)					(8,575,696)				(32,752,598)	(41,3
Net income (unaudited)									7,063,592	7,0
Balance at September 30, 2007 (unaudited)			25,799,184	$ 29,646	$ 51,418,790	$ 226,000	3,847,040	$ (8,937,500)	$ (14,218,446)	$ 28,5

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

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PROS Holdings, Inc.

Consolidated statements of cash flows

	Year ended December 31			Nine months ended September 30	
	2004	2005	2006	2006	2007
				(unaudited)	(unaudited)
Operating activities:					
Net income	$ 3,655,919	$ 3,439,527	$ 7,025,259	$ 4,688,780	$ 7,063,592
Adjustments to reconcile net income to net cash provided by operating activities:					
Depreciation and amortization	1,582,982	1,515,303	1,270,441	994,627	886,956
Noncash stock based compensation	2,129				931,744
Deferred taxes, net	(211,953)	(98,269)	(1,161,450)		(1,183,405)
Deferred financing costs					417,810
Maturities (purchase) of marketable securities classified as trading securities	(28,023,749)	28,023,749			
Changes in operating assets and liabilities:					
Accounts receivable, net	(5,961,301)	1,420,289	(5,273,768)	(3,619,394)	(409,457)
Unbilled receivable	812,397	(477,585)	(1,086,199)	(957,362)	(722,705)
Prepaid expenses and other	(721,392)	(335,705)	(1,365,409)	(1,274,750)	(815,395)
Accounts payable, accrued liabilities, accrued contract labor and accrued payroll	2,043,620	764,354	1,859,646	(494,611)	(654,363)
Deferred revenue	5,734,529	697,021	12,250,004	7,092,776	1,243,156
Net cash provided by operating activities	(21,086,819)	34,948,684	13,518,524	6,430,066	6,757,933
Investing activities:					
Purchases of property and equipment	(1,292,655)	(766,359)	(1,090,004)	(748,644)	(1,655,912)
Net cash used in investing activities	(1,292,655)	(766,359)	(1,090,004)	(748,644)	(1,655,912)
Financing activities:					
Proceeds from long-term debt					20,000,000
Proceeds from initial public offering					52,364,813
Payments on obligations under capital lease	(180,966)				
Payment on long-term debt					(20,000,000)
Dividend on common stock					(41,328,294)
Redemption of redeemable preferred stock			(8,445,472)	(8,445,471)	(17,365,083)
Exercise of stock options	4,500	17,152	67,329	60,528	684,705
Offering costs					(1,568,928)
Deferred financing costs					(417,810)
Net cash provided by (used in) financing activities	(176,466)	17,152	(8,378,143)	(8,384,943)	(7,630,597)
Net increase (decrease) in cash and cash equivalents	(22,555,940)	34,199,477	4,050,377	(2,703,521)	(2,528,576)
Cash and cash equivalents:					
Beginning of period	26,846,266	4,290,326	38,489,803	38,489,803	42,540,180
End of period	$ 4,290,326	$ 38,489,803	$ 42,540,180	$ 35,786,282	$ 40,011,604

Supplemental disclosure of cash flow

information:					
Cash paid during period for:					
Taxes	$ 791,000	$ 749,203	$ 1,825,500	$ 1,262,500	$ 2,632,000
Interest	5,328				451,173
Non-cash item:					
Financed loan costs					331,810

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

PROS Holdings, Inc.
Notes to consolidated financial statements

1. Organization and summary of significant accounting policies

Nature of operations

PROS Holdings, Inc., a Delaware corporation and subsidiaries (the "Company"), is a provider of pricing and revenue optimization software products, an emerging category of enterprise applications designed to allow companies to improve financial performance by enabling better pricing. Customers use the Company's software products to gain insight into their pricing strategies, identify detrimental pricing activities, optimize their pricing decision-making and improve their business processes and financial performance. The Company's software products incorporate advanced pricing science, which includes operations research, forecasting and statistics. These innovative science-based software products analyze, execute and optimize pricing strategies using data from traditional enterprise applications, often augmenting it with real-time and historical data. The Company also provides a range of services that include analyzing a company's current pricing processes and implementing the Company's software products to improve pricing performance. The Company provides its software products to enterprises across a range of industries, including manufacturing, distribution, services, hotel and cruise, and airline.

Principles of consolidation

The consolidated financial statements include the accounts of PROS Holdings, Inc., and its wholly-owned subsidiaries. All significant intercompany transactions and balances have been eliminated in consolidation. The consolidated financial statements presented reflect entries necessary for the fair presentation of the consolidated statement of income for the nine months ended September 30, 2006 and 2007, consolidated balance sheet as of September 30, 2007, consolidated statements of cash flows for the nine months ended September 30, 2006 and 2007 and consolidated statements of redeemable preferred stock and stockholders' equity (deficit) for the nine months ended September 30, 2007. All entries required for the fair presentation of the financial statements are of a normal recurring nature. The results of operations for the nine months ended September 30, 2006 and 2007 are not necessarily indicative of the results expected for the full fiscal year or for any other fiscal period.

Earnings per share

Basic earnings per share is computed by dividing net earnings attributable to common stockholders by the weighted average number of common shares outstanding for the period. Diluted earnings per share is computed using the weighted average number of common shares outstanding and, when dilutive, potential common shares from options and warrants (using the treasury-stock method) and potential common shares from convertible securities (using the if-converted method).

Use of estimates

The Company's management makes estimates and assumptions in the preparation of its consolidated financial statements in conformity with accounting principles generally accepted in the United States ("GAAP"). These estimates and assumptions may affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting periods. Actual results could differ from those estimates. The complexity of the estimation process and issues related to the assumptions, risks and uncertainties inherent in the application of the percentage-of-completion method of revenue recognition affect the amounts of revenue, expenses, unbilled receivables and deferred revenue. Numerous internal and external factors can affect estimates. Estimates are also used for, but not limited to, receivables, allowance for doubtful accounts, useful lives of assets, depreciation, income taxes and deferred tax asset valuation, valuation of stock options and accrued liabilities.

Financial instruments

The carrying amount of the Company's financial instruments, which include cash equivalents, marketable securities, receivables and accounts payable approximates their fair values at December 31, 2005 and 2006.

Cash and cash equivalents

The Company considers all highly liquid investments with an original or remaining maturity of three months or less at the time of purchase to be cash equivalents. The Company has a cash management program that provides for the investment of excess cash balances, primarily in short-term money market instruments.

Marketable securities

Management determines the appropriate classification of investments in debt and equity securities at the time of purchase and re-evaluates such designation as of each subsequent balance sheet date. Securities for which the Company has the ability and intent to hold to maturity are classified as "held to maturity." Securities classified as "trading securities" are recorded at fair value. Gains and losses on trading securities, realized and unrealized, are included in earnings and are calculated using the specific identification method. Any other securities are classified as "available for sale." There were no marketable securities as of December 31, 2005 and 2006.

Prepaid expenses and other assets

Prepaid expenses and other assets consist primarily of short-term deferred tax assets, deferred project costs and prepaid third-party license fees.

Property and equipment

Property and equipment are recorded at cost, less accumulated depreciation and amortization. Maintenance, repairs and minor replacements are charged to expense as incurred. Significant renewals and betterments are capitalized. The Company computes depreciation and amortization using the straight-line method over the assets' estimated useful life. When property is retired or disposed of, the cost and related accumulated depreciation are removed from the accounts and any resulting gains or losses are reflected in the consolidated statements of income.

Impairment of long-lived assets

Property and equipment are reviewed for impairment whenever an event or change in circumstances indicates that the carrying amount of an asset or group of assets may not be recoverable. The impairment review includes comparison of future cash flows expected to be generated by the asset or group of assets with the associated assets' carrying value. If the carrying value of the asset or group of assets exceeds its expected future cash flows (undiscounted and without interest charges), an impairment loss is recognized to the extent that the carrying amount of the asset exceeds its fair value. The Company has not recorded any impairment charges in any of the years ended December 31, 2004, 2005 and 2006.

Revenue recognition

The Company's revenue is recognized in accordance with the provisions of the American Institute of Certified Public Accountants Statement of Position ("SOP") 97-2, *Software Revenue Recognition* and related interpretations. The Company generates revenue from the licensing of the right to use its software products directly to end-users, implementation, training services, sales of post-contract support and maintenance and support.

Revenue from software licenses and implementation services is recognized as the services are performed using the percentage-of-completion method in accordance with the provisions contained within SOP 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts*. Our software license arrangements typically include implementation services that are considered essential to the customers' usability of the licensed software products and therefore new software license revenue is generally recognized together with the implementation services based on the percentage-of-completion method. The percentage-of-completion computation is measured by the percentage of man-days incurred during the reporting period as compared to the estimated total man-days for each contract estimated necessary for implementation of the software products. If at the commencement of a contract, the contract fee is not fixed and determinable, revenue is deferred until the contract fee becomes fixed and determinable. If there is significant uncertainty about contract completion or receipt of payment, revenue is deferred until the uncertainty is sufficiently resolved. Under fixed-fee contracts, should a loss be anticipated on a contract, the full amount thereof is recorded when the loss is determined.

The Company also licenses software products for fixed terms. Fixed-term licenses include maintenance during the license period. Because products are not delivered at the inception of the term, revenue and costs for fixed-term licenses are deferred until the delivery of the product and then recognized ratably over the term of the license. Revenue from fixed term licenses, which is included in license and implementation revenue in the statement of income, represented approximately 2.2%, 6.2% and 7.2% of total revenue for the years ended December 31, 2004, 2005 and 2006, respectively.

Maintenance and support revenue includes post-contract customer support and the right to unspecified software updates and enhancements on a when and if available basis. For arrangements containing both license and implementation and post-contract customer support, maintenance and support revenue is generally attributed to those contracts based on specific renewal pricing contained therein, which provides vendor-specific fair value of the maintenance and support services, and is recognized ratably over the period in which the services are provided.

Reimbursable travel and expense billings to customers are recognized as revenue as the expenses are incurred.

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

Software development costs

Software development costs associated with new products and enhancements to existing software products are expensed as incurred until technological feasibility, in the form of a working model, has been established. To date, the time period between the establishment of technological feasibility and the completion of software development has been short, and no significant development costs have been incurred during this period. Accordingly, the Company has not capitalized any software development costs to date.

Stock options

In December 2004, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Account Standard 123(R), *Share-Based Payment*, or SFAS 123(R). Under this standard, the fair value of each employee stock option is estimated on the date of grant using an options pricing model. The Company adopted SFAS 123(R) effective January 1, 2006 using the prospective transition method. Under this transition method, no compensation expense is recorded for employee stock options issued prior to the adoption of SFAS 123(R).

The Company currently uses the Black-Scholes valuation model to estimate the fair value of its share-based payments. Share-based compensation expense recognized in the Company's financial statements starting on January 1, 2006 and thereafter is based on awards that are expected to vest. These amounts are reduced using an estimated forfeiture rate. Forfeitures are required to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

Prior to the adoption of SFAS 123(R), and as permitted by SFAS 123, *Accounting for Stock-Based Compensation* and SFAS 148, *Accounting for Stock-Based Compensation Transition and Disclosure,* the Company elected to follow Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employee*, or APB 25, in accounting for employee stock options and implemented the disclosure-only provisions of SFAS 123 and SFAS 148. Under APB 25, stock compensation expense was recorded when the exercise price of employee stock options was less than the fair value of the underlying stock on the date of grant.

The Company granted options to purchase 747,954, 442,500 and zero shares of the Company's common stock to employees during the years ended December 31, 2004, 2005 and 2006, respectively. The fair value of options granted during the years ended December 31, 2004 and 2005 was estimated using the minimum value method with the following assumptions: a risk-free interest rate of 4.35%; no expected dividend yield; and an expected life of five years. No volatility was used for the calculation of fair value of options pursuant to the minimum value method.

Upon exercise of stock options, shares of common stock will be issued from previously unissued shares but could be issued from treasury shares.

The following table presents the pro forma effect of net income and earnings per share as if we had applied the fair-value recognition to stock-based compensation prior to the adoption of SFAS No. 123(R):

	Year ended December 31	
	2004	**2005**
Net earnings attributable to common stockholders	$ 2,399,908	$ 2,587,107
Less: Total stock-based employee compensation expense determined under the fair value method for all awards net of related tax effects	(82,515)	(28,076)
Pro forma net earnings attributable to common stock holders (basic)	2,317,393	2,559,031
Add: accretion of preferred stock	1,256,011	654,839
Pro forma net income (diluted)	$ 3,573,404	$ 3,213,870
Basic earnings per share:		
As reported	$ 0.24	$ 0.19
Pro forma	$ 0.24	$ 0.18
Diluted earnings per share:		
As reported	$ 0.19	$ 0.16
Pro forma	$ 0.18	$ 0.16

The Company accounts for equity instruments issued to non-employees in accordance with provisions of Emerging Issues Task Force No. 96-18, *Accounting for Equity Instruments that are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services* ("EITF 96-18"). Under EITF 96-18, stock option awards issued to non-employees are accounted for at the fair value using the Black-Scholes option-pricing model and are recorded using the straight-line method over the vesting period, which approximates the service period. Historically, these stock options vested immediately upon grant and the Company therefore recorded compensation expense in the same period in which the options were granted.

For further discussion of the Company's stock-based employee compensation plan, see Note 6 to the consolidated financial statements.

2007 stock option grants (unaudited)

In the nine months ended September 30, 2007, the Company issued options to purchase 1,357,500 shares of common stock to employees and options to purchase 25,000 shares of common stock to consultants and advisors. In connection with the grant of these options, the Company will record stock-based compensation expense of approximately $7.0 million (unaudited), which is the estimated fair value of the options calculated using the Black-Scholes option pricing model. The Company recorded compensation expense of $931,000 related to these stock options in the nine months ended September 30, 2007. The approximately $6.1 million in unrecognized compensation expense as of September 30, 2007 will be expensed over the remaining vesting period. Assumptions used to value the common stock are as follows (unaudited):

Dividend Yield:	0%
Volatility:	54.75%
Risk free interest rate:	4.48%
Weighted average expected life:	4.9 years
Forfeitures:	2.6%

Dividend yield. The Company does not anticipate paying any dividends to its stockholders in the foreseeable future and, as such, has assumed a dividend yield of 0%.

Volatility. As a private company, the Company estimates volatility in accordance with Staff Accounting Bulletin No. 107, *Share-Based Payment*, using historical volatilities of similar public entities.

Risk free interest rate. The Company assumed the risk free interest rate to be equal to observed interest rates appropriate for the weighted average expected life of the options.

Weighted average expected life. The expected life of the options is a historical weighted average of the expected lives of similar securities of comparable public entities.

Forfeitures. The forfeiture rate on unvested stock option awards is based on historical experience since January 1, 2004.

Product warranties

The Company generally issues warranties for 90 days from the completion of implementation, depending on the contract, for software licenses and implementation services. In the Company's experience, warranty costs have been insignificant.

Income taxes

The Company uses the asset and liability method to account for income taxes, including recognition of deferred tax assets and liabilities for the anticipated future tax consequences attributable to differences between financial statement amounts and their respective tax basis. The Company reviews its deferred tax assets for recovery. A valuation allowance is established when the Company believes that it is more likely than not that some portion of its deferred tax assets will not be realized. Changes in the valuation allowance from period to period are included in the Company's tax provision in the period of change.

In 2007, we recognized a tax benefit of $1.1 million (unaudited) upon the reversal of a valuation allowance previously recorded against our deferred tax assets. This reversal was the result of our determination during the third quarter that it was more likely than not that the associated deferred tax assets would be realized. Without this reversal, our effective tax rate would have been 20%. As of September 30, 2007, we have a valuation allowance of $149,000 (unaudited) for deferred tax assets related to foreign tax credit carryforwards.

Segment reporting

SFAS No. 131, *Disclosure about Segments of an Enterprise and Related Information*, establishes standards for reporting information about operating segments in annual financial statement and in interim financial reports issued to stockholders. Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated on a regular basis by the chief operating decision-maker, or decision making group, in deciding how to allocate resources to an individual segment and in assessing performance of the segment. In light of the Company's offering of one solution suite, which is pricing and revenue optimization software, management has determined that the primary form of internal reporting is aligned with the offering of this suite. In addition, the company's assets are primarily located in its corporate office in the United States. Although the Company sells its pricing and revenue optimization software to customers in several industries and geographies, the company does not produce reports for, assess the performance of, or allocate resources to these industries or regions based upon any asset-based metrics, or based upon income or expenses operating income or net income. Therefore, the Company believes that it operates in one segment.

Reclassifications and revisions

Certain reclassifications have been made to the consolidated balance sheet as of December 31, 2005 to conform with the 2006 presentation, which had no effect on total assets, total liabilities, stockholders' equity, net income or cash flows.

Recent accounting pronouncements

In June 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109*, or FIN 48. FIN 48 clarifies the accounting for uncertainties in income taxes recognized in an enterprise's financial statements. FIN 48 requires that the Company determine whether it is more likely than not that a tax position will be sustained upon examination by the appropriate taxing authority. If a tax position meets the "more likely than not" recognition criteria, FIN 48 requires the tax position be measured at the largest amount of benefit greater than 50% likely of being realized upon ultimate settlement. This accounting standard is effective for fiscal years beginning January 1, 2007. The Company adopted the provisions of FIN 48 on January 1, 2007. As a result of the adoption of FIN 48, the Company did not incur a tax liability. Any interest and penalties accrued related to uncertain tax positions will be recognized in the Company's income tax provision.

In September 2006, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Current Year Misstatements*, or SAB 108. SAB 108 provides guidance on the approach that companies must follow in quantifying misstatements of their financial statements. SAB 108 requires analysis of misstatements using both an income statement (rollover) approach and a balance sheet (iron curtain) approach in assessing materiality and provides for a one-time cumulative effect transition adjustment. SAB 108 did not have a material effect on the Company's consolidated financial position, results of operations or cash flows.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements,* which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS No. 157 does not require any new fair value measurements, but provides guidance on how to measure fair value by providing a fair value hierarchy used to classify the source of the information. SFAS No. 157 is effective for the Company fiscal year beginning January 1, 2008. The Company is currently evaluating the impact of adopting SFAS No. 157.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115*. This pronouncement permits entities to use the fair value method to measure certain financial assets and liabilities by electing an irrevocable option to use the fair value method at specified election dates. After election of the option, subsequent changes in fair value would result in the recognition of unrealized gains or losses as period costs during the period the change occurred. SFAS No. 159 becomes effective as of the beginning of the first fiscal year that begins after November 15, 2007, with early adoption permitted. However, entities may not retroactively apply the provisions of SFAS No. 159 to fiscal years preceding the date of adoption. The Company is currently evaluating the effect that SFAS No. 159 may have on its financial position, results of operations and cash flows.

2. Accounts receivable and contracts in progress

Accounts receivable at December 31, 2005 and 2006, consist of the following:

	December 31	
	2005	2006
Accounts receivable	$ 7,728,005	$ 13,171,773
Unbilled receivables	721,017	1,807,216
	8,449,022	14,978,989
Less: Allowance for doubtful accounts	(1,020,000)	(1,190,000)
Accounts receivable, net	$ 7,429,022	$ 13,788,989

The bad debt expense reflected in selling, general and administrative expenses in the accompanying consolidated statements of income for the years ended December 31, 2004, 2005 and 2006, totaled approximately $182,000, $0 and $27,000, respectively.

Activity related to contracts in progress at December 31, 2005 and 2006, is summarized as follows:

	Year ended December 31	
	2005	2006
Costs & estimated earnings recognized to date	$ 26,791,096	$ 49,072,064
Progress billings to date	(40,031,769)	(73,476,542)
	$ (13,240,673)	$ (24,404,478)

The foregoing table reflects the aggregate invoiced amount of all contracts in progress as of the respective dates, including amounts that have already been collected.

These amounts are included in the accompanying consolidated balance sheets at December 31, 2005 and 2006, as follows:

	December 31	
	2005	2006
Unbilled receivables	$ 721,017	$ 1,807,216
Deferred revenue	(13,961,690)	(26,211,694)
	$ (13,240,673)	$ (24,404,478)

During the years ended December 31, 2005 and 2006, the Company had approximately $1,139,000 and $1,780,000, respectively, in deferred maintenance and support revenue, which is reflected within the above table.

3. Earnings per share

The following table sets forth the computation of basic and diluted earnings per share:

	Year ended December 31			Nine months ended September 30	
	2004	2005	2006	2006	2007
				(unaudited)	(unaudited)
Numerator:					
Net earnings attributable to common stockholders (basic)	$ 2,399,908	$ 2,587,107	$ 6,565,460	$ 4,316,919	$ 6,981,677
Add: accretion of Series A convertible redeemable preferred stock	1,256,011	654,839			
Net income (diluted)	$ 3,655,919	$ 3,241,946	$ 6,565,460	$ 4,316,919	$ 6,981,677
Denominator:					
Weighted average shares (basic)	9,822,094	13,891,415	19,649,372	19,622,655	22,038,459
Dilutive effect of stock options and warrants	45,578	433,095	954,830	1,134,247	470,719
Dilutive effect of Series A convertible redeemable preferred stock	9,750,000	5,687,500			
Weighted average shares with assumed conversion of Series A convertible redeemable preferred stock (diluted)	19,617,672	20,012,010	20,604,202	20,756,902	22,509,178
Basic earnings per share	$ 0.24	$ 0.19	$ 0.33	$ 0.22	$ 0.32
Diluted earnings per share	$ 0.19	$ 0.16	$ 0.32	$ 0.21	$ 0.31

The Company has excluded 1,179,194, 654,400, 108,150, 449,400, 0 (unaudited) and 1,352,500 (unaudited) potential common shares from the computation of full year 2004, 2005 and 2006 and the nine months ended September 30, 2006 and 2007 dilutive earnings per share, respectively, because the effect would have been antidilutive.

4. Property and equipment

Property and equipment as of December 31, 2005 and 2006, consist of the following:

	Estimated useful life	December 31 2005	December 31 2006
Furniture and fixtures	7-10 years	$ 2,002,102	$ 2,015,900
Computers and equipment	3-10 years	5,004,448	5,758,681
Software	2-5 years	1,333,134	1,235,617
Leasehold improvements	Shorter of lease term or useful life	847,052	855,359
Property and equipment, gross		9,186,736	9,865,557
Less: Accumulated depreciation and amortization		(6,633,427)	(7,492,685)
Property and equipment, net		$ 2,553,309	$ 2,372,872

Depreciation and leasehold amortization expense was $1,582,982, $1,515,303 and $1,270,441 for the years ended December 31, 2004, 2005 and 2006, respectively. During the years ended December 31, 2005 and 2006, the Company disposed of approximately $1,918,000 and $411,000, respectively, of fully depreciated assets. As of December 31, 2005 and 2006, the Company had approximately $2,473,000 and $4,815,000, respectively, of fully depreciated assets in use.

5. Debt (unaudited)

On March 23, 2007, the Company entered into a $28.0 million credit facility with a commercial bank, consisting of a $20.0 million term loan and a $8.0 million line of credit. Interest was payable at a Eurodollar rate plus 2.75% or a base rate plus 1.5%, at the Company's option (8.09% at June 30, 2007). The term loan required repayment of principal of $50,000 plus interest every three months for five years, with all unpaid principal due on March 23, 2012. On July 3, 2007, the Company used $20,066,000 of proceeds from its initial public offering to retire the remaining $19,950,000 principle balance of the credit facility and related accrued interest totaling $116,000. In connection with the payoff and termination of the credit facility on July 3, 2007, financing fees in the amount of $397,000, which were included in other assets in the Company's consolidated balance sheet, were expensed in the third quarter of 2007.

6. Stockholders' equity

Preferred stock financing

On June 8, 1998 the Company entered into a stock purchase and stockholders agreement (the "Purchase Agreement") with certain investment partnerships and individuals. The Company sold 3,921,312 shares of its authorized Series A convertible redeemable preferred stock, par value $0.001 per share ("Series A Preferred Stock") for $25,000,000. The Company incurred approximately $1,500,000 in transaction fees in connection with the financing. The Company also designated another 3,921,312 shares of its preferred stock to be issued as redeemable preferred stock ("Redeemable Preferred Stock") with a par value of $0.001 per share, upon the conversion of the Series A Preferred Stock.

Series A preferred stock

On August 15, 2005 ("Conversion Date"), the holders of the Series A Preferred Stock elected to convert the Series A Preferred Stock into 9,750,000 shares of common stock at a defined conversion rate of 2.486 per share plus 3,921,312 shares of Redeemable Preferred Stock. There were no shares of Series A Preferred Stock outstanding after this transaction, as all shares were cancelled upon the conversion.

Redeemable preferred stock

Holders of Redeemable Preferred Stock do not have general voting rights, except for the right to elect, as a separate class, two members to the board of directors and the right to consent or withhold consent to certain actions by the Company. The Redeemable Preferred Stock has cumulative, noncompounding dividend rights of $0.13388 per share per year. The cumulative dividends become due and payable upon liquidation or redemption of the Redeemable Preferred Stock.

As of December 31, 2006, the redemption amount for the Redeemable Preferred Stock was $17,283,168. The Redeemable Preferred Stock has a liquidation value of $4.463 per share plus accrued and unpaid dividends on the Redeemable Preferred Stock, plus accrued and unpaid dividends on the Series A Preferred Stock as of the Conversion Date. Included in the Redeemable Preferred Stock are cumulative unpaid dividends on the Series A Preferred Stock in the amount of $5,070,117, cumulative unpaid dividends on the Redeemable Preferred Stock in the amount of $484,130, and the liquidation value of remaining outstanding Redeemable Preferred Stock, in the amount of $11,728,921.

The Redeemable Preferred Stock is redeemable by the holders following a Qualified Public Offering, an Extraordinary Transaction as defined in the Certificate of Incorporation or if the holders elect to redeem by giving the Company not less than 10 days written notice according to the following schedule: up to 33% after one year from the Conversion Date, up to 66% of the then-outstanding shares after two years from the Conversion Date and up to 100% of the then outstanding shares after three years from the Conversion Date. Additionally, the Company can elect to redeem the Redeemable Preferred Stock upon a Qualified Public Offering or according to the following schedule: exactly 33% after one year from the Conversion Date, exactly 66% of the then outstanding shares after two years from the Conversion Date and exactly 100% of the then outstanding shares after three years from the Conversion Date.

In August 2006, the holders of the Redeemable Preferred Stock elected to redeem 33% of the Redeemable Preferred Stock and on August 15, 2006 a redemption payment of $8,445,472 was made, consisting of $5,775,000 representing the liquidation value of the surrendered shares, $173,250 of accreted dividends on the Redeemable Preferred Stock and $2,497,222 of accreted dividends on the Series A Preferred Stock.

The Company is accreting the Redeemable Preferred Stock to the redemption price as a deduction from retained earnings, to the extent available, and any remaining to additional paid-in-capital.

Redeemable preferred stock redemption and common stock dividend (unaudited)

On March 27, 2007, by mutual consent of the Company and the holders of Redeemable Preferred Stock, the Company redeemed its remaining outstanding Redeemable Preferred Stock for approximately $17.4 million.

On March 29, 2007, the Company paid a one-time cash dividend on its common stock of $2.00 per share, totaling $41.3 million.

Common stock warrants

In December 1998, the Company granted warrants to purchase 100,000 shares of common stock (the "Warrants") to each of the Company's two founders. The Warrants have an 11-year term, vesting on January 21, 2009, and expiring on January 20, 2010. The Warrants fully vest upon a qualified public offering and have an exercise price of $2.05 per share. The Company has recorded the Warrants as a component of equity pursuant to Emerging Issues Task Force issue No. 00-19, *Accounting for derivative financial instruments indexed to, and potentially settled in, a company's own stock,* at their estimated fair value at the date of issuance, which is $226,000, in the accompanying financial statements.

Registration rights

Certain of the Company's stockholders are entitled to require registration for the sale of their shares if the Company becomes publicly traded. The Company would be required to bear all registration expenses if these rights are exercised, other than underwriting discounts and selling commissions.

Stock options

The Company maintains incentive stock option plans to provide long-term incentives to its key employees, officers, directors and consultants under which 2,387,688 shares of common stock were reserved for issuance. As of December 31, 2006, 431,742 shares remained available for grant. Options have a ten-year term and vest over terms of two, four, five or ten years.

The following is a summary of the Company's option activity for the years ended December 31, 2004, 2005 and 2006:

	Number of shares under option	Weighted average exercise price	Aggregate intrinsic value(1)
Outstanding, December 31, 2003	675,630	$ 2.11	
Granted	747,594	0.25	
Forfeited	(159,200)	1.42	
Exercised	(2,000)	2.25	
Outstanding, December 31, 2004	1,262,024	1.09	
Exercisable, December 31, 2004	801,244	1.55	
Granted	442,500	0.53	
Forfeited	(63,327)	1.89	
Exercised	(11,373)	1.55	
Outstanding, December 31, 2005	1,629,824	0.91	
Exercisable, December 31, 2005	983,474	1.22	
Granted			
Forfeited	(31,164)	1.47	
Exercised	(149,555)	0.45	
Outstanding, December 31, 2006	1,449,105	0.94	
Granted (unaudited)	1,382,500	6.82	
Forfeited (unaudited)	(176,800)	2.29	
Exercised (unaudited)	(946,745)	0.72	$ 7,168,143
Outstanding, September 30, 2007 (unaudited)	1,708,060	5.68	10,914,503
Exercisable, September, 30, 2007 (unaudited)	148,270	3.24	1,309,224

(1) The aggregate intrinsic value was calculated based on the positive difference between the estimated fair value of the Company's common stock on September 30, 2007 of $12.07 and the exercise price of the underlying options.

The following table summarizes information about stock options outstanding at December 31, 2006:

		Options outstanding		Options exercisable	
Range of exercise prices:	Outstanding as of December 31, 2006	Weighted average remaining contractual life (in years)	Weighted average exercise price	Exercisable as of December 31, 2006	Weighted average exercise price
$0.00-$0.25	687,355	6.8	$ 0.24	607,587	$ 0.24
$0.26-$1.00	328,750	8.6	0.56	112,500	0.52
$1.01-$3.00	433,000	3.1	2.35	433,000	2.35
	1,449,105	6.1	0.94	1,153,087	1.06

No stock options were granted to non-employees in 2005 or 2006. During 2004, compensation expense for the fair value of stock options granted to non-employees totaled $2,129. The total intrinsic value of options exercised in 2004, 2005 and 2006 was $0, $1,495 and $445,023, respectively.

The following table summarizes information about stock options outstanding at September 30, 2007 (unaudited):

		Options outstanding		Options exercisable	
Range of exercise prices	Outstanding as of September 30, 2007	Weighted average remaining contractual life (in years)	Weighted average exercise price	Exercisable as of September 30, 2007	Weighted average exercise price
$0.00-$0.25	52,750	6.7	$ 0.25	8,750	$ 0.25
$0.26-$1.00	212,760	8.0	$ 0.58	36,960	$ 0.64
$1.01-$3.00	65,050	2.7	$ 2.56	65,050	$ 2.56
$3.01-$6.00	1,150,000	9.5	$ 6.00	25,000	$ 6.00
$6.01-$11.00	227,500	9.7	$ 11.00	12,510	$ 11.00
	1,708,060	9.0	$ 5.68	148,270	$ 3.24

For the nine months ended September 30, 2007, 25,000 (unaudited) fully vested stock options were granted to non-employees and compensation expense related to the fair value of these stock options was approximately $124,000 (unaudited).

Initial public offering (unaudited)

In July 2007, the Company completed its initial public offering of common stock (the "IPO") in which the Company sold and issued 5,118,750 shares of common stock and selling stockholders sold an additional 1,706,250 shares of common stock. The Company's Certificate of Incorporation, as restated on June 22, 2007, authorizes the issuance of 75,000,000 shares of common stock and 5,000,000 shares of preferred stock, each with $0.001 par value per share.

As a result of the IPO, the Company raised a total of $56.3 million in gross proceeds, and $52.4 million in net proceeds after deducting underwriting discounts and commissions of $3.9 million. In addition, the Company incurred $1.8 million of offering costs associated with the IPO that were recorded to additional paid-in capital and netted against the IPO proceeds. The Company did not receive any proceeds from the sale of shares in the IPO by the selling stockholders. In addition, the underwriters of its initial public offering have exercised in full their over-allotment option to purchase an additional 1,023,750 shares of common stock from selling stockholders at the initial public offering price of $11.00 per share. The over-allotment option was granted to the underwriters by the selling stockholders and the Company did not issue any new shares of common stock or receive any proceeds from the sale of these shares.

7. Income taxes

As of December 31, 2006, the Company had approximately $675,000 of general business tax credit ("GBC") carryforwards arising from research and development activities. These GBC credits may be carried forward for a period of 20 years and are available as an offset against any future regular tax liability. The GBC carryforwards begin to expire in 2022.

As of December 31, 2006, the Company had approximately $185,000 of foreign tax credit ("FTC") carryforwards arising from foreign taxes paid. These FTC carryforwards may be carried forward for a period of five years and are available as an offset against any future regular tax liability if there is sufficient foreign source income in the year of use. The foreign tax credits begin to expire in 2012.

The Company has recorded net deferred tax assets for the expected future consequences of temporary differences, including tax credit carryforwards. The level of future taxable income generation that would be required in order to realize the benefit of certain of the Company's tax credit carryforwards is substantially higher than its historical profitability. Therefore, a valuation allowance has been provided for certain of the Company's tax credit carryforwards that are not expected to be realized and the resulting effect on the rate at which the deferred tax items will be realized.

As of December 31, 2005 and 2006, the Company had income taxes payable of approximately $165,000 and $1,100,000, respectively, which are included in accrued liabilities in the accompanying consolidated balance sheets.

The provision for income taxes consisted of the following for the years ended December 31, 2004, 2005 and 2006:

	Year ended December 31		
	2004	**2005**	**2006**
Current			
Federal	$ 672,778	$ 985,344	$ 2,804,479
State and Foreign	75,359	87,466	81,469
	748,137	1,072,810	2,885,948
Deferred			
Federal	(211,953)	(98,269)	(1,161,450)
Income tax provision	$ 536,184	$ 974,541	$ 1,724,498

The differences between the effective tax rate reflected in the total provision for income taxes and the U.S. federal statutory rate of 34% for the years ended December 31, 2004, 2005 and 2006, were as follows:

	Year ended December 31		
	2004	2005	2006
Provision at the U.S. federal statutory rate	$ 1,425,315	$ 1,500,783	$ 2,974,917
Increase (decrease) resulting from			
State income taxes, net of federal taxes	(12,116)	31,776	17,510
Foreign income taxes, net of federal taxes		36,755	36,260
Nondeductible expenses	52,070	58,586	80,882
Extraterritorial income		(18,506)	(47,845)
Domestic production activities			(39,935)
Incremental benefits for tax credits	(601,315)	(567,327)	(730,768)
Change in tax rate/income subject			
to lower tax rates and other	(39,400)	(23,821)	(43,601)
Increase (decrease) in valuation allowance	(288,370)	(43,705)	(522,922)
	$ 536,184	$ 974,541	$ 1,724,498

Our effective tax rate historically has been lower than the statutory rate of 34% largely due to the application of general business tax credits. Our effective tax rate for the nine months ended September 30, 2007 was 5% (unaudited). In the third quarter of 2007, we recognized a tax benefit of $1.1 million (unaudited) upon the reversal of a valuation allowance previously recorded against our deferred tax assets. This reversal was the result of our determination during the third quarter that it was more likely than not that the associated deferred tax assets would be realized.

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and liabilities as of December 31, 2005 and 2006, are as follows:

	Year ended December 31	
	2005	**2006**
Current deferred tax asset:		
Accruals not currently deductible	$ 624,923	$ 1,348,797
Less: Valuation allowance	(257,321)	(555,387)
Total current net deferred tax asset	367,602	793,410
Noncurrent deferred tax liability:		
Property and equipment	(97,546)	
Total noncurrent deferred tax liability	(97,546)	
Noncurrent deferred tax asset:		
GBC carryforwards	1,945,487	675,067
Property and equipment		24,045
Deferred revenue		1,129,000
FTC carryforwards	250,969	185,452
Total noncurrent deferred tax assets	2,196,456	2,013,564
Less: Valuation allowance	(2,156,290)	(1,335,302)
Total noncurrent deferred tax asset (liability)	(57,380)	678,262
Total net deferred tax asset	$ 310,222	$ 1,471,672

The current net deferred tax asset and noncurrent net deferred tax asset are included in prepaids and other, and other assets, respectively, in the accompanying consolidated balance sheets.

8. Commitments and contingencies

Litigation

The Company may be subject to various legal proceedings arising in the ordinary course of business. Management does not believe the outcome of current legal actions will have a material adverse effect on the Company's financial position or results of operations.

Insurance

The Company is self-insured for a certain portion of annual healthcare costs. Management believes the Company's accrual for estimated potential claim costs to satisfy the self-insurance provisions of the insurance policies for claims occurring through December 31, 2006 is adequate. As of December 31, 2005 and 2006, the Company had recorded a self-insurance liability totaling approximately $285,000 and $391,000, respectively, which is included in accrued liabilities within the consolidated balance sheets.

Indemnification

The Company's software license agreements generally include certain provisions for indemnifying customers against liabilities if the Company's software products infringe a third party's intellectual property rights. To date, the Company has not incurred any losses as a result of such indemnifications and have not accrued any liabilities related to such obligations in the Company's consolidated financial statements.

Lease Agreements

The Company leases office space and office equipment under non-cancelable operating leases that expire at various dates through 2011. Total rent expense incurred during the years ended December 31, 2004, 2005 and 2006, was approximately $1,281,000, $1,281,000 and $1,080,000, respectively. Future minimum payments relating to non-cancelable operating lease agreements at December 31, 2006, are as follows:

Year ending December 31		Operating leases
2007	$	1,004,161
2008		1,126,588
2009		1,184,925
2010		1,207,800
2011		704,550
	$	5,228,024

The Company had no capital leases at December 31, 2006. In 2006 the company renegotiated its office lease which expired in May 2006. The new lease expires on July 31, 2011.

9. Geographic information

The Company evaluates the performance of its geographic regions based on revenue only. The Company does not assess the performance of its geographic regions based upon income or expenses, such as depreciation and amortization, operating income or net income. In addition, as the Company's assets are primarily located in its corporate office in the United States and not allocated to any specific region, the Company does not produce reports for, or measure the performance of, its geographic regions based on any asset-based metrics. Therefore, geographic information is presented only for revenue. International sales for the years ended December 31, 2004, 2005 and 2006, amounted to approximately $17,017,651, $20,960,261 and $28,830,603, respectively, representing 52%, 60% and 63%, respectively, of annual revenue. International sales for the nine months ended September 30, 2006 and 2007 amounted to $20,736,744 (unaudited) and $28,779,391 (unaudited), respectively, representing 63% (unaudited) and 65% (unaudited), respectively of revenue in the period.

The following geographic information is presented for the years ended December 31, 2004, 2005 and 2006 and the nine months ended Spetmber 30, 2006 and 2007.

	Year ended December 31						For the nine months ended September 30			
	2004		2005		2006		2006		2007	
	Revenue	Percent	Revenue	Percent	Revenue	Percent	Revenue (unaudited)	Percent	Revenue (unaudited)	Percent
The Americas										
United States of America	$ 15,428,151	48%	$ 14,169,500	40%	$ 17,196,906	37%	$ 12,081,254	37%	$ 15,517,219	35%
Other	2,273,915	7%	2,677,190	8%	4,182,045	9%	2,699,531	8%	4,401,643	10%
Subtotal	17,702,066	55%	16,846,690	48%	21,378,951	46%	14,780,785	45%	19,918,862	45%
Europe, the Middle East and Africa										
United Kingdom	1,291,785	4%	1,496,642	4%	5,223,140	11%	3,329,248	10%	5,482,048	13%
Germany	2,168,359	7%	4,296,647	12%	3,513,916	8%	2,605,623	8%	1,853,398	4%
Other	4,614,634	14%	5,858,794	17%	8,866,331	19%	6,505,968	20%	9,380,618	21%
Subtotal	8,074,778	25%	11,652,083	33%	17,603,387	38%	12,440,839	38%	16,716,064	38%
Asia Pacific	6,668,958	20%	6,630,988	19%	7,045,171	16%	5,596,374	17%	7,661,684	17%
Total revenue	$ 32,445,802	100%	$ 35,129,761	100%	$ 46,027,509	100%	$ 32,817,998	100%	$ 44,296,610	100%

10. Concentrations of credit risk

For the year ended December 31, 2006, no customer accounted for 10% or more of revenue. For the year ended December 31, 2005, the Company had one customer that accounted for 10.1% of revenue.

The Company's operations could be affected, either positively or negatively, due to the level of revenue derived from the airline industry. A significant portion of the Company's airline revenue is derived from maintenance and support revenue from over 40 different airlines.

The Company's short-term investments on deposit with any one party and at any point in time may exceed federally insured limits. To date, the Company has not incurred any losses in connection with short term investments.

11. Related-party transactions

The Company currently has employment agreements with its executive officers and three other members of management. The employment agreements provide for six months to one year of salary upon termination without cause or, in some cases, for good reason.

12. Employee retirement savings plan

The Company sponsors the PROS Holdings, Inc. 401(k) Plan. The 401(k) Plan is designed to provide eligible employees with an opportunity to make regular contributions to a long-term investment and savings program. All employees are eligible to participate in the 401(k) Plan following the completion of six consecutive months of service. The Company's matching contribution is defined as 50% of the first 6% of employee contributions. The Company may also make discretionary contributions. Matching and discretionary contributions by the Company in 2004, 2005 and 2006 totaled $375,537, $413,569 and $504,363, respectively.

13. Subsequent Event (unaudited)

On October 16, 2007, the Company's two founders, Mr. and Mrs. Woestemeyer, exercised warrants to purchase an aggregate of 200,000 shares of our common stock at a price of $2.05 per share.

Schedule II
Valuation and qualifying accounts

(Dollars in thousands)	Balance at beginning of period	Additions charged to costs and expenses	Deductions	Balance at end of period
Allowance for doubtful accounts deducted from accounts receivable in the balance sheet				
2006	$ 1,020	$ 205	$ (35)(1)	$ 1,190
2005	1,200		(180)(1)	1,020
2004	1,450	59	(309)(1)	1,200
Allowance for deferred tax assets not expected to be realized				
2006	$ 2,414	$ 1,562	$ (2,085)(2)	$ 1,891
2005	2,801	836	(1,223)(2)	2,414
2004	3,089	762	(1,050)(2)	2,801

(1) Uncollectible accounts written off, net of recoveries

(2) Reflects utilization of tax assets that previously had a valuation allowance

5,000,000 shares

Common stock

Prospectus

JPMorgan **Deutsche Bank Securities**

Jefferies & Company **Thomas Weisel Partners LLC**

Needham & Company, LLC