UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2012

OR

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

For the transition period from to

Commission file number 001-35108

SERVICESOURCE INTERNATIONAL, INC.

(Exact name of registrant as specified in our charter)

Delaware	**No. 81-0578975**
(State or Other Jurisdiction of	**(I.R.S. Employer**
Incorporation or Organization)	**Identification No.)**
634 Second Street	
San Francisco, California	**94107**
(Address of Principal Executive Offices)	**(Zip Code)**

(415) 901-6030

(Registrant s Telephone Number, Including Area Code)

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

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

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

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

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

Indicate number of shares outstanding of each of the issuer s classes of common stock, as of the latest practical date:

Class	**Outstanding as of July 23, 2012**
Common Stock	74,906,424

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PART I FINANCIAL INFORMATION

Item 1. ***Financial Statements***

SERVICESOURCE INTERNATIONAL, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands)

(Unaudited)

	June 30, 2012	December 31, 2011
Assets		
Current assets:		
Cash and cash equivalents	$ 65,586	$ 65,983
Short-term investments	48,611	42,882
Accounts receivable, net	51,391	54,095
Current portion of deferred income taxes	203	3,526
Prepaid expenses and other	8,404	7,945
Total current assets	174,195	174,431
Property and equipment, net	33,661	26,840
Deferred income taxes, net of current portion	1,341	30,238
Other assets, net	1,167	1,118
Goodwill	6,334	6,334
Total assets	$ 216,698	$ 238,961
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	$ 7,525	$ 8,617
Accrued taxes	3,368	4,008
Accrued compensation and benefits	14,751	18,665
Other accrued liabilities	8,180	7,639
Obligations under capital leases	725	706
Total current liabilities	34,549	39,635
Obligations under capital leases, net of current portion	787	958
Other long-term liabilities	5,307	1,352
Total liabilities	40,643	41,945
Commitments and contingencies (Note 8)		
Stockholders equity:		
Common stock; $0.0001 par value; 1,000,000 shares authorized; 74,966 shares issued and 74,845 shares outstanding as of June 30, 2012; 72,688 shares issued and 72,567 shares outstanding as of December 31, 2011	7	7
Treasury stock	(441)	(441)
Additional paid-in capital	194,925	177,796
Retained earnings (accumulated deficit)	(18,627)	19,416
Accumulated other comprehensive income	191	238

Total stockholders equity	176,055	197,016
Total liabilities and stockholders equity	$ 216,698	$ 238,961

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

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SERVICESOURCE INTERNATIONAL, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share amounts)

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	**2011**	**2012**	**2011**
Net revenue	$ 59,694	$ 48,512	$ 117,268	$ 94,634
Cost of revenue	33,882	28,229	66,458	54,365
Gross profit	25,812	20,283	50,810	40,269
Operating expenses:				
Sales and marketing	14,169	11,415	27,646	22,520
Research and development	4,298	3,390	8,879	6,103
General and administrative	10,564	7,870	20,639	15,723
Total operating expenses	29,031	22,675	57,164	44,346
Loss from operations	(3,219)	(2,392)	(6,354)	(4,077)
Interest expense	(70)	(51)	(117)	(384)
Other expense, net	(263)	(384)	(307)	(909)
Loss before income taxes	(3,552)	(2,827)	(6,778)	(5,370)
Income tax (benefit) provision	33,217	(1,694)	31,267	(21,653)
Net income (loss)	$ (36,769)	$ (1,133)	$ (38,045)	$ 16,283
Net income (loss) per common share:				
Basic	$ (0.50)	$ (0.02)	$ (0.52)	$ 0.26
Diluted	$ (0.50)	$ (0.02)	$ (0.52)	$ 0.24
Weighted-average shares used in computing net income (loss) per common share:				
Basic	74,172	67,607	73,654	62,714
Diluted	74,172	67,607	73,654	69,205

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

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SERVICESOURCE INTERNATIONAL, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(In thousands)

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Net income (loss)	$ (36,769)	$ (1,133)	$ (38,045)	$ 16,283
Other comprehensive income, net of tax:				
Foreign currency translation adjustments	(56)	275	(73)	628
Unrealized gain (loss) on investments	(14)	(7)	26	(7)
Other comprehensive income (loss), net of tax	(70)	268	(47)	621
Total comprehensive income (loss), net of tax	$ (36,389)	$ (865)	$ (38,092)	$ 16,904

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SERVICESOURCE INTERNATIONAL, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Six Months Ended June 30, 2012	Six Months Ended June 30, 2011
Cash flows from operating activities		
Net income (loss)	$ (38,045)	$ 16,283
Adjustments to reconcile net income (loss) to net cash (used in) provided by operating activities:		
Depreciation and amortization	4,577	4,488
Loss on disposal of fixed assets	(1)	46
Amortization of deferred financing costs	123	298
Amortization of premium on short-term investments	445	14
Deferred income taxes	32,220	(22,715)
Stock-based compensation	9,607	5,136
Income tax deficiency from stock-based compensation	362	
Changes in operating assets and liabilities:		
Accounts receivable	2,586	4,122
Prepaid expenses and other	(811)	(1,940)
Accounts payable	(877)	1,107
Accrued taxes	(618)	1,321
Accrued compensation and benefits	(3,904)	3,404
Accrued payables to customers		(30,644)
Other accrued liabilities	4,145	1,128
Net cash provided by (used in) operating activities	9,809	(17,952)
Cash flows from investing activities		
Acquisition of property and equipment	(11,244)	(6,288)
Purchases of short-term investments, net	(24,186)	(42,273)
Sales of marketable securities	6,210	
Maturities of marketable securities	11,820	
Net cash used in investing activities	(17,400)	(48,561)
Cash flows from financing activities		
Net proceeds from issuance of common stock in initial public offering		88,015
Proceeds from revolving credit facility		23,424
Repayment of revolving credit facility		(23,424)
Repayment on long-term debt	(155)	(15,582)
Payment of deferred debt issuance costs		(200)
Proceeds from common stock issuances	7,818	2,247
Income tax deficiency from stock-based compensation	(362)	
Net cash provided by financing activities	7,301	74,480
Net increase (decrease) in cash and cash equivalents	(290)	7,967
Effect of exchange rate changes on cash and cash equivalents	(107)	752
Cash and cash equivalents at beginning of period	65,983	22,652

Cash and cash equivalents at end of period	$ 65,586	$ 31,371

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

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SERVICESOURCE INTERNATIONAL, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Note 1 Description of Business and Basis of Presentation

ServiceSource manages the service contract renewals process of maintenance, support and subscription agreements on behalf of its customers. The Company s integrated solution consists of a suite of cloud applications, dedicated service sales teams working under its customers brands and a proprietary Service Revenue Intelligence Platform. By integrating software, managed services and data, the Company provides end-to-end management and optimization of the service contract renewals process, including data management, quoting, selling and service revenue business intelligence. The Company s business is built on a pay-for-performance model, whereby customers pay the Company based on renewal sales that the Company generates on the customers behalf. The Company s corporate headquarters is located in San Francisco, California. The Company has additional offices in Colorado, Tennessee, the United Kingdom, Ireland, Malaysia and Singapore.

The accompanying unaudited interim condensed consolidated financial statements (condensed consolidated financial statements) include the accounts of ServiceSource International Inc. and its subsidiaries (SSI or Company). Intercompany accounts and transactions have been eliminated in consolidation.

These condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States (U.S. GAAP or GAAP) for interim financial information, rules and regulations of the Securities and Exchange Commission (SEC) for interim financial statements, and accounting policies, consistent in all material respects with those applied in preparing our audited annual consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2011. These condensed consolidated financial statements and accompanying notes should be read in conjunction with our annual consolidated financial statements and the notes thereto for the year ended December 31, 2011, included in our Annual Report on Form 10-K. In the opinion of management, these condensed consolidated financial statements reflect all adjustments, including normal recurring adjustments, management considers necessary for a fair statement of our financial position, operating results, and cash flows for the interim periods presented. The results for the interim periods are not necessarily indicative of results for the entire year.

The December 31, 2011 condensed consolidated balance sheet data was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America. These unaudited interim condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes for the year ended December 31, 2011 included in the Company s Annual Report on Form 10-K.

Recently Adopted Accounting Pronouncements

Effective January 1, 2012, the Company adopted revised guidance related to the presentation of comprehensive income that increases comparability between U.S. GAAP and International Financial Reporting Standards. This guidance eliminates the current option to report other comprehensive income (OCI) and its components in the statement of changes in stockholders equity. The Company adopted this guidance during the first quarter of 2012 and elected to disclose OCI as a separate statement.

Note 2 Related Party Transactions

In the first quarter of 2012, the Company purchased a software license and related services from Jive Software, Inc. Anthony Zingale, who is Chief Executive Officer and Chairman of the Board of Jive Software, is a member of the Company s board of directors and serves on the Company s nominating and governance committee. The aggregate value of the purchase slightly exceeds, per annum, the $120,000 related party disclosure threshold over the 15-month term of the license and was made in the ordinary course of business. Also in the second quarter of 2012, Jive Software signed an agreement with the Company to use the Company s service. The fees for this agreement are variable based upon sales commissions, but the estimated annual fees from this agreement are not expected to exceed one million dollars. Both transactions were pre-approved by the Company s audit committee and have been negotiated at arm s length, on normal commercial terms and reflect normal market prices. Mr. Zingale is not a member of the Company s audit committee and did not participate in the audit committee s approval process.

Note 3 Cash, Cash Equivalents and Short-term Investments

Cash equivalents consist of highly liquid fixed-income investments with original maturities of three months or less at the time of purchase, including money market funds. Short-term investments consist of readily marketable securities with a remaining maturity of more than three months from time of purchase. The Company classifies all of its cash equivalents and short-term investments as available for sale, as these investments are free of trading restrictions. These marketable securities are carried at fair value, with the unrealized gains and losses, net of tax, reported as accumulated other comprehensive income and included as a separate component of

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stockholders equity. Gains and losses are recognized when realized. When the Company determines that an other-than-temporary decline in fair value has occurred, the amount of the decline that is related to a credit loss is recognized in earnings. Gains and losses are determined using the specific identification method. The Company s realized gains and losses in the three and six months ended June 30, 2012 and 2011 were insignificant.

Cash and cash equivalents and short-term investments consisted of the following as of June 30, 2012 and December 31, 2011 (in thousands):

June 30, 2012

	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Cash	$ 64,193	$	$	$ 64,193
Cash equivalents:				
Money market mutual funds	693			693
Commercial paper	700			700
Total cash equivalents	1,393			1,393
Total cash and cash equivalents	65,586			65,586
Short-term investments:				
Certificate of deposit	750		(1)	749
Asset-backed securities	1,000	3		1,003
Municipal securities	28,390	32	(9)	28,413
Commercial paper	7,609	3		7,612
Corporate bonds	10,827	12	(5)	10,834
Total short-term investments	48,576	50	(15)	48,611
Cash, cash equivalents and short-term investments	$ 114,162	$ 50	$ (15)	$ 114,197

December 31, 2011

	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Cash	$ 59,033	$	$	$ 59,033
Cash equivalents:				
Money market mutual funds	4,201			4,201
Commercial paper	2,749			2,749
Total cash equivalents	6,950			6,950
Total cash and cash equivalents	65,983			65,983
Short-term investments:				
Certificate of deposit	750		(4)	746
Municipal securities	33,568	30	(6)	33,592
Commercial paper	3,645	1	(1)	3,645

Corporate bonds	4,910	3	(14)	4,899
Total short-term investments	42,873	34	(25)	42,882
Cash, cash equivalents and short-term investments	$ 108,856	$ 34	$ (25)	$ 108,865

The following table summarizes the cost and estimated fair value of short-term fixed income securities classified as short-term investments based on stated maturities as of June 30, 2012:

	Amortized Cost	Estimated Fair Value
Less than 1 year	$ 37,395	$ 37,428
Due in 1 to 3 years	11,181	11,183
Total	$ 48,576	$ 48,611

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As of June 30, 2012, the Company did not consider any of its investments to be other-than-temporarily impaired.

Note 4 Fair Value of Financial Instruments

The Company measures certain financial instruments at fair value on a recurring basis. The Company uses a three-tier fair value hierarchy, which prioritizes the inputs used in the valuation methodologies in measuring fair value:

Level 1 valuations are based on quoted prices in active markets for identical assets or liabilities.

Level 2 valuations are based on inputs that are observable, either directly or indirectly, other than quoted prices included within Level 1. Such inputs used in determining fair value for Level 2 valuations include quoted prices in active markets for similar assets or liabilities, quoted prices for identical or similar assets or liabilities in markets that are not active, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 valuations are based on information that is unobservable and significant to the overall fair value measurement.

All of the Company s cash equivalents and short-term investments are classified within Level 1 or Level 2.

The following table presents information about the Company s financial instruments that are measured at fair value as of June 30, 2012 and indicates the fair value hierarchy of the valuation (in thousands):

Description	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash equivalents:				
Money market mutual funds	$ 693	$ 693	$	$
Commercial paper	700		700	
Total cash equivalents	1,393	693	700	
Short-term investments:				
Certificate of deposit	749		749	
Asset backed securities	1,003		1,003	
Municipal securities	28,413		28,413	
Commercial paper	7,612		7,612	
Corporate bonds	10,834		10,834	
Total short-term investments	48,611		48,611	
Cash equivalents and short-term investments	$ 50,004	$ 693	$ 49,311	$

The following table presents information about the Company s financial instruments that are measured at fair value as of December 31, 2011 and indicates the fair value hierarchy of the valuation (in thousands):

Total

Description		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash equivalents:				
Money market mutual funds	$ 4,201	$ 4,201	$	$
Commercial paper	2,749		2,749	
Total cash equivalents	6,950	4,201	2,749	

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	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Short-term investments:				
Certificate of deposit	746		746	
Municipal securities	33,592		33,592	
Commercial paper	3,645		3,645	
Corporate bonds	4,899		4,899	
Total short-term investments	42,882		42,882	
Cash equivalents and short-term investments	$ 49,832	$ 4,201	$ 45,631	$

The Company did not have any financial liabilities measured at fair value on a recurring basis as of June 30, 2012 or December 31, 2011.

Note 5 Property and Equipment, Net

Property and equipment balances were comprised of the following (in thousands):

	June 30, 2012	December 31, 2011
Computers and equipment	$ 13,627	$ 11,562
Software	19,875	19,487
Furniture and fixtures	7,799	5,879
Leasehold improvements	8,734	4,957
	50,035	41,885
Less: accumulated depreciation and amortization	(27,092)	(23,187)
	22,943	18,698
Construction in progress	10,718	8,142
	$ 33,661	$ 26,840

Depreciation and amortization expense during the three and six months ended June 30, 2012 and the three and six months ended June 30, 2011, was $2.3 million, $4.6 million, $2.6 million and $4.5 million, respectively.

Total property and equipment assets under capital lease at June 30, 2012 and December 31, 2011, was $3.2 and 3.3 million, respectively. Accumulated depreciation related to assets under capital lease as of these dates were $2.0 million and $1.7 million, respectively.

The Company capitalized internal-use software development costs of $2.8 million and $0.6 million during the three months ended June 30, 2012 and 2011, respectively and $5.0 million and $2.0 million during the six months ended June 30, 2012 and 2011, respectively. As of June 30, 2012 and December, 31 2011, the carrying value of capitalized costs related to internal-use software was $14.1 million and $9.0 million, respectively. Amortization of capitalized costs related to internal-use software for the three months ended June 30, 2012 and 2011 was $0.6 million and $1.2 million, respectively, and for the six months ended June 30, 2012 and 2011 was $1.3 million and $1.9 million, respectively.

Note 6 Other Accrued Liabilities

Other accrued liabilities balances were comprised of the following (in thousands):

	June 30, 2012	December 31, 2011
Accrued professional fees	$ 1,181	$ 944
Amounts refundable to end customers	233	582
Deferred revenue	372	593

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	June 30, 2012	December 31, 2011
Deferred rent obligations	583	734
Employee related	121	379
Other (includes ESPP contributions of $1,053 and $1,106 at June 30, 2012 and December 31, 2011, respectively)	5,690	4,407
	$ 8,180	$ 7,639

Note 7 Credit Facility and Capital Leases

Revolving Credit Facility

On July 5, 2012, the Company, entered into a new three-year credit agreement which provides for a secured revolving line of credit in the amount of $25.0 million on and before July 5, 2013 and $30.0 million thereafter, in each case with a $2.0 million letter of credit sublimit. Proceeds available under the agreement may be used for working capital and other general corporate purposes. The Company may prepay borrowing under the agreement in whole or in part at any time without premium or penalty. The Company may terminate the commitments under the credit agreement in whole at any time, and may reduce the commitments by up to $10.0 million between July 1, 2013 and June 30, 2014.

The loans bear interest, at the Company s option, at a base rate determined in accordance with the credit agreement, minus 0.50%, or at a LIBOR rate plus 2.00%. Principal, together with all accrued and unpaid interest, is due and payable on the maturity date. The Company is also obligated to pay a quarterly commitment fee, payable in arrears, based on the available commitments at a rate of 0.45%.

The credit agreement contains customary affirmative and negative covenants, as well as financial covenants. Affirmative covenants include, among others, delivery of financial statements, compliance certificates and notices of specified events, maintenance of properties and insurance, preservation of existence, and compliance with applicable laws and regulations. Negative covenants include, among others, limitations on the ability of the Company and its subsidiaries to grant liens, incur indebtedness, engage in mergers, consolidations and sales of assets and engage in affiliate transactions. The agreement requires the Company to maintain a maximum leverage ratio and a minimum liquidity amount, each as defined in the agreement.

The credit agreement also contains customary events of default including, among other things, payment defaults, breaches of covenants or representations and warranties, cross-defaults with certain other indebtedness, bankruptcy and insolvency events and change in control of the Company, subject to grace periods in certain instances. Upon an event of default, the lender may declare the outstanding obligations of the Company under the agreement to be immediately due and payable and exercise other rights and remedies provided for under the credit agreement.

The Company s obligations under the credit agreement are guaranteed by its subsidiary, ServiceSource Delaware, Inc. and are secured by substantially all of the assets of the Company and the Guarantor.

Effective June 29, 2012, the Company terminated a $20 million credit facility. At the time of the termination, no borrowings and a letter of credit in the face amount of $850,000 were outstanding under this facility.

Capital Leases

The Company has capital lease agreements that are collateralized by the underlying property and equipment and expire through September 2019. The weighted-average imputed interest rates for the capital lease agreements were 3.75% and 5.6 % at June 30, 2012 and 2011, respectively.

Future minimum annual payments under capital lease obligations as of June 30, 2012 were as follows (in thousands):

Years Ending December 31,	
2012 (remaining six months)	$ 569
2013	323

2014	264
2015	71
2016	73
Thereafter	212
	$ 1,512

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Note 8 Commitments and Contingencies

Operating Leases

The Company leases its office space and certain equipment under non-cancelable operating lease agreements with various expiration dates through September 30, 2022. Rent expense for the three and six months ended June 30, 2012 and the three and six months ended June 30, 2011, was $2.0 million, $4.4 million, $1.6 million, and $3.2 million, respectively. The Company recognizes rent expense on a straight-line basis over the lease period and accrues for rent expense incurred but not paid.

Future annual minimum lease payments under all noncancelable operating leases as of June 30, 2012 were as follows (in thousands):

Years Ending December 31,	
2012 (remaining six months)	$ 4,324
2013	7,711
2014	6,655
2015	5,041
2016	3,647
Thereafter	16,174
	$ 43,552

Other Matters

The Company may be subject to litigation or other claims in the normal course of business. In the opinion of management, the Company s ultimate liability, if any, related to any currently pending or threatened litigation or claims would not materially affect its consolidated financial position, results of operations or cash flows.

Note 9 Stockholders Equity

Stock Option Plans

The Company maintained the following stock plans: the 2011 Equity Incentive Plan (the 2011 Plan), and the 2011 Employee Stock Purchase Plan. The Company s board of directors and, as delegated to its compensation committee, administers the 2011 Plan and has authority to determine the directors, officers, employees and consultants to whom options or restricted stock may be granted, the option price or restricted stock purchase price, the timing of when each share is exercisable and the duration of the exercise period and the nature of any restrictions or vesting periods applicable to an option or restricted stock grant

Under the 2011 Plan, options granted are generally subject to a four-year vesting period whereby options become 25% vested after a one-year period and the remainder then vests monthly through the end of the vesting period. Vested options may be exercised up to ten years from the vesting commencement date, as defined in the 2011 Plan. Vested but unexercised options expire three months after termination of employment with the Company. The restricted stock units typically vest over four years with a yearly cliff contingent upon employment with the Company on the dates of vest.

The Company has elected to recognize the compensation cost of all stock-based awards on a straight-line basis over the vesting period of the award. Further, the Company applied an estimated forfeiture rate to unvested awards when computing the share compensation expenses. The Company estimated the forfeiture rate for unvested awards based on its historical experience on employee turnover behavior and other factors.

On February 8, 2012, the Company issued 200,000 performance-based equity awards to an executive which vest upon the achievement of certain financial performance goals, including revenue and an internal metric that is used for measuring customer contract commitments based on a net recurring revenue amount in which the Company measures customer revenue gains offset by losses during the measurement period. Determining the appropriate amount to expense based on the anticipated achievement of the stated goals requires judgment, including forecasting future financial results. The estimate of the timing of the expense recognition is revised periodically based on the probability of achieving the required performance targets and adjustments are made as appropriate. The cumulative impact of any revision is reflected in the period of the change. If the financial performance goals are not met, the award does not vest, no compensation cost is recognized and any previously stock-recognized stock-based compensation expense is reversed. No expense was recorded for the performance based equity award during the three or six months ended June 30, 2012.

At the end of each fiscal year, the share reserve under the 2011 Plan will increase automatically by an amount equal to 4% of the outstanding shares as of the end of that most recently completed fiscal year or 3,840,000 shares, whichever is less. On January 1, 2012, 2.9 million additional shares were reserved under the 2011 Plan pursuant to the automatic increase.

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Determining Fair Value of Stock Options

The Company estimates the fair value of stock option awards at the date of grant using the Black-Scholes option-pricing model. Options are granted with an exercise price equal to the fair value of the common stock as of the date of grant. Compensation expense is amortized net of estimated forfeitures on a straight-line basis over the requisite service period of the options, which is generally four years. Restricted stock, upon vesting entitles the holder to one share of common stock for each restricted stock and has an exercise price of $0.0001 per share, which is equal to the par value of the Company s common stock, and vests over four years. The fair value of the restricted stock is based on the Company s closing stock price on the date of grant, and compensation expense, net of estimated forfeitures, is recognized on a straight-line basis over the vesting period.

The weighted average Black-Scholes model assumptions for the three and six months ended June 30, 2012 and 2011 were as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Expected term (in years)	5.1	5.4	5.1	5.4
Expected volatility	45.5%	54.0%	45.5%	54.0%
Risk-free interest rate	0.83%	1.95%	0.82%	2.13%
Expected dividend yield				

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Option and restricted stock activity under the Company s Plans for the six months ended June 30, 2012 were as follows: (shares in thousands):

	Shares and Units Available for Grant	Options Outstanding Number of Shares	Options Outstanding Weighted-Average Exercise Price	Restricted Stock Outstanding Number of Shares
Outstanding December 31, 2011	6,409	15,335	$ 5.70	802
Additional shares reserved under the 2012 equity incentive plan	2,903			
Granted	(3,386)	1,575	17.21	1,811
Options exercised/ Restricted stock released		(1,643)	3.97	(34)
Forfeited	671	(585)	7.55	(86)
Outstanding June 30, 2012	6,597	14,682	$ 7.05	2,493

The weighted average grant-date fair value of employee stock options granted during the three months ended June 30, 2012 and 2011 was $6.68 and $7.03 per share, respectively and for the six months ended June 30, 2012 and 2011 was $6.98 and $6.32 per share, respectively.

The following table summarizes the consolidated stock-based compensation expense by line item in the Condensed Consolidated Statements of Operations (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Cost of revenue	$ 715	$ 447	$ 1,287	$ 816
Sales and marketing	1,982	949	3,656	1,870
Research and development	530	269	893	537
General and administrative	2,133	1,023	3,771	1,913
Total stock-based compensation	$ 5,360	$ 2,688	$ 9,607	$ 5,136

Employee Stock Purchase Plan

The Company s 2011 Employee Stock Purchase Plan (the ESPP) is intended to qualify under Section 423 of the Internal Revenue Code of 1986. Under the ESPP, employees are eligible to purchase common stock through payroll deductions of up to 10% of their eligible compensation, subject to any plan limitations. The purchase price of the shares on each purchase date is equal to 85% of the lower of the fair market value of the Company s common stock on the first and last trading days of each six-month offering period.

The Company estimates the fair value of purchase rights under the ESPP using the Black-Scholes valuation model. The fair value of each purchase right under the ESPP was estimated on the date of grant using the Black-Scholes option valuation model and the straight-line attribution approach with the following weighted-average assumptions:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Expected term (in years)	0.50	0.39	0.50	0.39
Expected volatility	45%	36%	45%	36%
Risk-free interest rate	0.13%	0.18%	0.13%	0.18%

Expected dividend yield

The ESPP provides that additional shares are reserved under the plan annually on the first day of each fiscal year in an amount equal to the lesser of (i) 1.5 million shares, (ii) one percent of the outstanding shares of common stock on the last day of the immediately preceding fiscal year, or (iii) an amount determined by the board of directors and/or the compensation committee of the board of directors. As of June 30, 2012, 190,292 shares had been issued under the ESPP and 1,435,382 shares were available for future issuance.

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Note 10 Income Taxes

The Company files U.S. federal and state and foreign income tax returns in jurisdictions with varying statutes of limitations. In the normal course of business the Company is subject to examination by taxing authorities throughout the world. These audits include questioning the timing and amount of deductions, the allocation of income among various tax jurisdictions and compliance with federal, state, local and foreign tax laws. The Company is not currently undergoing any examination of its income tax returns. Tax returns for the years 2007 through 2011 generally remain subject to examination by federal, state and foreign tax authorities. The Company s gross amount of unrecognized tax benefits increased from zero as of December 31, 2011 to $0.4 million as of June 30, 2012, all of which, if recognized, would affect the company s effective tax rate. It is difficult to predict the final timing and resolution of any particular uncertain tax position. Based on the Company s assessment of many factors, the Company does not expect that changes in the liability for unrecognized tax benefits for the next twelve months will have a significant impact on the Company s consolidated financial position or results of operations.

In evaluating its ability to recover its deferred tax assets, the Company considers all available positive and negative evidence including its past operating results, the existence of cumulative losses and its forecast of future taxable income. In determining future taxable income, the Company is responsible for assumptions utilized including the amount of state, federal and international pre-tax operating income, the reversal of temporary differences and the implementation of feasible and prudent tax planning strategies. These assumptions require significant judgment about the forecasts of future taxable income and are consistent with the plans and estimates the Company is using to manage the underlying businesses. As a result of the Company s assessment of the available evidence, the Company has provided a valuation allowance of $31.8 million on the deferred tax assets as of December 31, 2011. The tax benefits relating to any subsequent reversal of all or part of the valuation allowance will be accounted for as a reduction of income tax expense. No valuation allowance has been provided for deferred tax assets arising from jurisdictions where the Company reports taxable profits.

Note 11 Reportable Segments

The Company s operations are principally managed on a geographic basis and are comprised of three reportable and operating segments: NALA, EMEA, and APJ, as defined below.

The Company reports segment information based on the management approach. The management approach designates the internal reporting used by the Company s Chief Operating Decision Maker (CODM), for making decisions and assessing performance as the source of the Company s reportable segments. The CODM is the Company s Chief Executive Officer. The CODM allocates resources to and assesses the performance of each of the operating segment using information about its revenue and direct profit contribution, which is management s measure of segment profitability. Management has determined that the Company s reportable and operating segments are as follows, based on the information used by the CODM:

NALA Includes operations from offices in San Francisco, California; Denver, Colorado and Nashville, Tennessee related primarily to end customers in North America.

EMEA Includes operations from offices in Liverpool, United Kingdom and Dublin, Ireland related primarily to end customers in Europe.

APJ Includes operations from offices in Kuala Lumpur, Malaysia and Singapore related primarily to end customers in Asia Pacific and Japan.

The Company does not allocate sales and marketing, research and development, or general and administrative expenses to its geographic regions because management does not include the information in its measurement of the performance of the operating segments. The Company excludes certain items such as stock-based compensation, overhead allocations and other items from direct profit contribution. Revenue for a particular geography reflects fees the Company earns from its customers for sales and renewals of maintenance, support and subscription contracts on their behalf and managed from the Company s sales center in that geography.

Summarized financial information by geographic location based on the Company s internal management reporting and as utilized by the Company s CODM, is as follows (in thousands):

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	Three Months Ended June 30, 2012	Three Months Ended June 30, 2011	Six Months Ended June 30, 2012	Six Months Ended June 30, 2011
Net revenue				
NALA	$ 36,961	$ 28,686	$ 73,073	$ 56,431
EMEA	15,518	14,254	31,266	29,247
APJ	7,215	5,572	12,929	8,956
Total net revenue	$ 59,694	$ 48,512	$ 117,268	$ 94,634
Direct profit contribution				
NALA	$ 19,918	$ 15,699	$ 39,173	$