

PROS Holdings, Inc.  
Form 10-Q  
August 02, 2012  
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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington D.C. 20549

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FORM 10-Q

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ý 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: 001-33554

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PROS HOLDINGS, INC.

(Exact name of registrant as specified in its charter)

|   |   |
|---|---|
| Delaware  | 76-0168604                              |
| (State or Other Jurisdiction of<br>Incorporation or Organization) | (I.R.S. Employer<br>Identification No.) |

|  |            |
|--|------------|
| 3100 Main Street, Suite 900 Houston TX   | 77002      |
| (Address of Principal Executive Offices) | (Zip Code) |

(713)-335-5151  
Registrant's telephone number, including area code

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(Former Name, Former Address and Former Fiscal Year, if changed Since Last Report)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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



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Large Accelerated Filer  Accelerated Filer

Non-Accelerated Filer  (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

The number of shares outstanding of the Registrant's Common Stock, \$0.001 par value, was 27,409,320 as of July 30, 2012.

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| <br><b>CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS</b>  |           |
| <p>This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Forward-looking statements relate to future events or our future financial performance. These forward-looking statements regarding future events and our future results are based on current expectations, estimates, forecasts and projections, and the beliefs and assumptions of our management including, without limitation, our expectations regarding the following: the sales of our software products and services; the impact of our revenue recognition policies; our belief that our current assets, including cash, cash equivalents, and expected cash flows from operating activities, will be sufficient to fund our operations; our anticipated additions to property, plant and equipment; our belief that our facilities are suitable and adequate to meet our current operating needs; our belief that we do not have any material exposure to changes in the fair value of our investment portfolio as a result of changes in interest rates. Words such as “we expect,” “anticipate,” “target,” “project,” “believe,” “goals,” “estimate,” “potential,” “predict,” “may,” “might,” “could,” “intend,” and variations of these types of words similar expressions are intended to identify these forward-looking statements.</p> |           |

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## PART I. Financial Information

## ITEM 1. INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

## PROS Holdings, Inc.

## Condensed Consolidated Balance Sheets

(In thousands, except share amounts)

(Unaudited)

|  | June 30, 2012 | December 31,<br>2011 |
|--|---------------|----------------------|
| Assets:  |               |                      |
| Current assets:  |               |                      |
| Cash and cash equivalents  | \$71,162      | \$68,457             |
| Accounts and unbilled receivables, net of allowance of \$860 and \$1,130, respectively   | 36,528        | 33,864               |
| Prepaid and other current assets   | 3,922         | 8,353                |
| Total current assets   | 111,612       | 110,674              |
| Restricted cash  | 329           | 329                  |
| Property and equipment, net  | 7,995         | 4,703                |
| Other long term assets, net  | 5,826         | 5,553                |
| Total assets   | \$125,762     | \$121,259            |
| Liabilities and Stockholders' Equity:  |               |                      |
| Current liabilities:   |               |                      |
| Accounts payable   | \$2,600       | \$4,915              |
| Accrued liabilities  | 1,462         | 1,318                |
| Accrued payroll and other employee benefits  | 4,546         | 5,139                |
| Deferred revenue   | 33,663        | 33,094               |
| Total current liabilities  | 42,271        | 44,466               |
| Long-term deferred revenue   | 3,126         | 2,850                |
| Total liabilities  | 45,397        | 47,316               |
| Commitments and contingencies (Note 5)   |               |                      |
| Stockholders' equity:  |               |                      |
| Preferred stock, \$0.001 par value, 5,000,000 shares authorized none issued  | —             | —                    |
| Common stock, \$0.001 par value, 75,000,000 shares authorized; 31,825,187 and 31,432,430 shares issued, respectively; 27,407,602 and 27,014,845 shares outstanding, respectively | 32            | 31                   |
| Additional paid-in capital   | 82,169        | 77,934               |
| Treasury stock, 4,417,585 common shares, at cost   | (13,938)      | (13,938)             |
| Accumulated other comprehensive loss   | (11)          | (11)                 |
| Retained earnings  | 12,113        | 9,927                |
| Total stockholders' equity   | 80,365        | 73,943               |
| Total liabilities and stockholders' equity   | \$125,762     | \$121,259            |

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

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

|  | For the Three Months Ended |            | For the Six Months Ended |            |
|--|----------------------------|------------|--------------------------|------------|
|  | June 30,                   | 2011       | June 30,                 | 2011       |
|  | 2012                       |            | 2012                     |            |
| Revenue:                                       |                            |            |                          |            |
| License and implementation                     | \$18,176                   | \$15,082   | \$35,972                 | \$28,875   |
| Maintenance and support                        | 9,958                      | 8,703      | 19,183                   | 16,316     |
| Total revenue                                  | 28,134                     | 23,785     | 55,155                   | 45,191     |
| Cost of revenue:                               |                            |            |                          |            |
| License and implementation                     | 5,540                      | 4,765      | 11,543                   | 9,447      |
| Maintenance and support                        | 1,960                      | 1,643      | 3,895                    | 3,353      |
| Total cost of revenue                          | 7,500                      | 6,408      | 15,438                   | 12,800     |
| Gross profit                                   | 20,634                     | 17,377     | 39,717                   | 32,391     |
| Operating expenses:                            |                            |            |                          |            |
| Selling, marketing, general and administrative | 11,883                     | 9,115      | 22,140                   | 16,986     |
| Research and development                       | 6,772                      | 6,149      | 13,469                   | 12,109     |
| Income from operations                         | 1,979                      | 2,113      | 4,108                    | 3,296      |
| Other income (expense), net:                   |                            |            |                          |            |
| Other income(expense), net                     | (129                       | ) (21      | ) (106                   | ) 56       |
| Income before income tax provision             | 1,850                      | 2,092      | 4,002                    | 3,352      |
| Income tax provision                           | 855                        | 651        | 1,816                    | 1,055      |
| Net income                                     | \$995                      | \$1,441    | \$2,186                  | \$2,297    |
| Net earnings per share:                        |                            |            |                          |            |
| Basic  | \$0.04                     | \$0.05     | \$0.08                   | \$0.09     |
| Diluted  | \$0.04                     | \$0.05     | \$0.08                   | \$0.08     |
| Weighted average number of shares:             |                            |            |                          |            |
| Basic  | 27,375,429                 | 26,829,158 | 27,271,201               | 26,711,621 |
| Diluted  | 28,337,143                 | 27,828,209 | 28,303,760               | 27,615,189 |
| Other comprehensive income, net of tax:        |                            |            |                          |            |
| Other comprehensive income                     | —                          | —          | —                        | —          |
| Comprehensive income                           | \$995                      | \$1,441    | \$2,186                  | \$2,297    |

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

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

|   | For the Six Months Ended June 30, |          |
|---|-----------------------------------|----------|
|   | 2012                              | 2011     |
| Operating activities:   |                                   |          |
| Net income  | \$2,186                           | \$2,297  |
| Adjustments to reconcile net income to net cash provided by operating activities: |                                   |          |
| Depreciation  | 938                               | 782      |
| Share-based compensation  | 4,472                             | 3,361    |
| Excess tax benefits on share-based compensation                                   | (1,669)                           | ) (1,241 |
| Provision for doubtful accounts   | (257                              | ) —      |
| Other noncash   | —                                 | (2       |
| Changes in operating assets and liabilities:                                      |                                   |          |
| Accounts and unbilled receivables   | (2,407                            | ) 2,547  |
| Prepaid expenses and other assets   | 5,811                             | (378     |
| Accounts payable  | (2,465                            | ) 1,263  |
| Accrued liabilities   | 979                               | (416     |
| Accrued payroll and other employee benefits                                       | (1,464                            | ) 1,332  |
| Deferred revenue  | 845                               | (923     |
| Net cash provided by operating activities   | 6,969                             | 8,622    |
| Investing activities:   |                                   |          |
| Purchases of property and equipment   | (4,079                            | ) (1,310 |
| Increase in restricted cash   | —                                 | (36      |
| Increase in short-term investment   | —                                 | 73       |
| Net cash used in investing activities   | (4,079                            | ) (1,273 |
| Financing activities:   |                                   |          |
| Exercise of stock options   | 510                               | 1,563    |
| Excess tax benefits on share-based compensation                                   | 1,669                             | 1,241    |
| Tax withholding related to net share settlement of restricted stock units         | (2,364                            | ) (1,602 |
| Net cash (used in) provided by financing activities                               | (185                              | ) 1,202  |
| Net increase in cash and cash equivalents   | 2,705                             | 8,551    |
| Cash and cash equivalents:  |                                   |          |
| Beginning of period   | 68,457                            | 55,845   |
| End of period   | \$71,162                          | \$64,396 |

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

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PROS Holdings, Inc.

Notes to Condensed Consolidated Financial Statements

(Unaudited)

1. Organization and Nature of Operations

PROS Holdings, Inc., a Delaware corporation, through its operating subsidiaries (the “Company”), is a leading global provider of pricing and revenue management software. This software is an emerging category of enterprise applications designed to allow business to make better sales decisions to significantly improve business agility in dynamic markets. The Company offers its large enterprise and mid-market customers secure and scalable software solutions which optimize pricing and product mix on a real-time basis by applying advanced forecasting and optimization technologies to their relevant enterprise and market data. The Company’s software solutions are engineered to work together with existing customer information technology, including private and public cloud environments, and support the real-time, high volume transaction processing and database requirements of some of the world’s largest and most sophisticated businesses. The Company also provides professional services to configure its software solutions to meet the specific integration and process needs of each customer. The Company provides its software solutions to enterprises across a range of industries, including manufacturing, distribution, services and travel.

2. Summary of Significant Accounting Policies

The accompanying unaudited condensed consolidated financial statements reflect the application of significant accounting policies as described below and elsewhere in these notes to the condensed consolidated financial statements.

Basis of presentation

The accompanying unaudited condensed consolidated financial statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) for interim financial reporting and applicable quarterly reporting regulations of the Securities and Exchange Commission (“SEC”). In management’s opinion, the accompanying interim unaudited condensed consolidated financial statements include all adjustments necessary for a fair statement of the financial position of the Company as of June 30, 2012, the results of operations for the three and six months ended June 30, 2012 and cash flows for the six months ended June 30, 2012. Prior period realized and unrealized foreign currency transaction gains and losses in the unaudited condensed consolidated statements of comprehensive income have been reclassified for all periods presented to conform to the current period presentation. Previously, these amounts were recorded in cost of license and implementation revenue. Such reclassifications did not affect total revenues or net income and were not material to the financial statements. Certain information and disclosures normally included in the notes to the annual financial statements prepared in accordance with GAAP have been omitted from these interim unaudited condensed consolidated financial statements pursuant to the rules and regulations of the SEC. Accordingly, these unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements in the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2011 (“Annual Report”) filed with the SEC. The condensed consolidated balance sheet as of December 31, 2011 was derived from the Company’s audited consolidated financial statements, but does not include all disclosures required by GAAP.

Basis of consolidation

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



Dollar amounts

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

Use of estimates

The Company's management prepares the unaudited condensed consolidated financial statements in accordance with GAAP. The Company makes estimates and assumptions in the preparation of its unaudited condensed consolidated financial statements, and its estimates and assumptions may affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the unaudited condensed consolidated financial statements, and the reported amounts of revenue and expenses during the reporting periods. Actual results could differ from those estimates. The complexity and judgment required in the Company's estimation process and issues related to the assumptions, risks and uncertainties inherent in the application of the percentage-of-completion method of accounting affect the amounts of revenue, expenses, unbilled receivables and deferred revenue. Estimates are also used for, but not limited to, receivables, allowance for doubtful accounts, useful lives of

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assets, depreciation, income taxes and deferred tax asset valuation, valuation of stock options, other current liabilities and accrued liabilities. Numerous internal and external factors can affect estimates. The critical accounting policies related to the estimates and judgments are discussed in the Company's Annual Report on Form 10-K for the year ended December 31, 2011 under management's discussion and analysis of financial condition and results of operations. There have been no significant changes to the Company's critical accounting policies as described in the Company's Annual Report.

### Revenue recognition

The Company derives its revenue from the licensing and implementation of software solutions and associated software maintenance and support. To a lesser extent, the Company's revenue includes non-software related hosting services. The Company's arrangements with customers typically include: (a) license fees paid for the use of our solutions either in perpetuity or over a specified term and implementation fees for configuration, implementation and training services and (b) maintenance and support fees related to technical support and software updates. If there is significant uncertainty about contract completion or collectability is not reasonable assured, revenue is deferred until the uncertainty is sufficiently resolved or collectability is reasonably assured. In addition, revenue is recognized when persuasive evidence of an arrangement exists and fees are fixed or determinable. For certain arrangements, we engage independent contractors to assist in the implementation of our software solutions. These arrangements are analyzed based on numerous factors to determine the amount of revenue to be recognized.

The Company's software license arrangements typically include implementation services that can be considered essential to the customer's usability of the licensed software solutions and therefore new perpetual software license revenue is generally recognized with the implementation services using 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 necessary for each contract for implementation of the software solutions. The Company measures performance under the percentage-of-completion method using total man-day method based on current estimates of man-days to complete the project. The Company believes that for each such project, man-days expended in proportion to total estimated man-days at completion represents the most reliable and meaningful measure for determining a project's progress toward completion. Under our fixed-fee arrangements, should a loss be anticipated on a contract, the full amount is recorded when the loss is determinable.

The Company also licenses software solutions under term license agreements that typically include maintenance during the license term. When maintenance is included for the entire term of the license, there is no renewal rate and the Company has not established vendor specific objective evidence ("VSOE") of fair value for the maintenance. For term license agreements, revenue and the associated costs are deferred until the delivery of the solution and recognized ratably over the remaining license term.

For arrangements that include hosting services we allocate the arrangement consideration between the hosting service and other elements and recognize the hosting fee ratably beginning on the date the customer commences use of our services and continuing through the end of the customer term.

The Company's customer arrangements typically contain multiple elements that include software license, implementation services and post-implementation maintenance and support. In October 2009, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2009-13, Multiple-Deliverable Revenue Arrangements, (amendments to FASB Accounting Standards Codification ("ASC")) Topic 605, Revenue Recognition), which amended the accounting standards for certain multiple deliverable revenue arrangements that contain non-software related elements to:

-

provide updated guidance on whether multiple deliverables exist, how the deliverables in an arrangement should be separated, and how the consideration should be allocated;

- require an entity to allocate revenue in an arrangement using best estimated selling price, (“BESP”) of deliverables if a vendor does not have VSOE of selling price; and
- eliminate the use of the residual method and require an entity to allocate revenue using the relative selling price method.

For multiple element arrangements containing our non-software services, the Company must (1) determine whether and when each element has been delivered; (2) determine fair value of each element using the selling price hierarchy of VSOE of fair value, third party evidence (“TPE”), or BESP, as applicable, and (3) allocate the total price among the various elements based on the relative selling price method.

For multiple-element arrangements that contain software and non-software elements such as the Company's hosting service offerings, we allocate revenue between the software and software related elements as a group and any non-software elements based on a relative fair value allocation. We determine fair value for each deliverable using this hierarchy and utilize VSOE of fair value if it exists.

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In certain instances, the Company may not be able to establish VSOE for all deliverables in an arrangement with multiple elements. This may be due to infrequently selling each element separately, not pricing solutions or services within a narrow range, or only having a limited sales history. In addition, third party evidence may not be available. When the Company is unable to establish selling prices using VSOE or TPE, it uses BESP in the allocation of arrangement consideration. The objective of BESP is to determine the price at which the Company would transact a sale if the product or service were sold on a stand-alone basis. For transactions that only include software and software-related elements the Company continues to account for such arrangements under the software revenue recognition standards which require it to establish VSOE of fair value to allocate arrangement consideration to multiple deliverables.

Maintenance and support revenue includes post-implementation customer support and the right to unspecified software updates and enhancements on a when and if available basis. The Company generally invoices for maintenance and support services on a monthly, quarterly or on an annual basis through the maintenance and support period. The Company recognizes revenue from maintenance arrangements ratably over the period in which the services are provided.

Software license and implementation revenue that has been recognized, but for which the Company has not invoiced the customer, is recorded as unbilled receivables. Invoices that have been issued before software license, implementation and maintenance and support revenue has been recognized are recorded as deferred revenue in the accompanying unaudited condensed consolidated balance sheets.

## Internal-use software

Costs incurred to date to develop internal-use software during the application development stage are capitalized, stated at cost, and depreciated using the straight-line method over the estimated useful lives of the assets. Application development stage costs generally include costs associated with internal-use software configuration, coding, installation and testing. During the three and six months ended June 30, 2012, the Company capitalized internal-use software development costs of \$0.5 million and \$0.8 million, respectively, related to its cloud-based product offerings and \$0.1 million and \$0.6 million, respectively, related to the implementation of a new enterprise resource planning system. Prior to 2012, the Company did not have any costs to capitalize related to internal-use software. Capitalized software for internal use is included in property and equipment, net in the condensed consolidated balance sheets.

## Noncash share-based compensation

The Company measures all share-based payments to its employees based on the grant date fair value of the awards and recognizes expense in the Company's unaudited consolidated statement of comprehensive income on a straight-line basis over the period during which the recipient is required to perform service (generally over the vesting period of the awards). To date, the Company has granted Stock Options, Stock Appreciation Rights ("SARs"), Restricted Stock Units ("RSUs") and Market Stock Units ("MSUs"). The MSUs are performance-based awards that vest based upon the Company's relative shareholder return.

The following table presents the number of awards outstanding for each award type as of June 30, 2012 and December 31, 2011, respectively (in thousands).

| Award type             | June 30, 2012 | December 31, 2011 |
|------------------------|---------------|-------------------|
| Stock options          | 1,537         | 1,581             |
| Restricted stock units | 1,251         | 1,153             |

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|                           |     |     |
|---------------------------|-----|-----|
| Stock appreciation rights | 808 | 836 |
| Market share units        | 205 | —   |

Stock options, SARs and RSUs vest ratably between three and four years. The actual number of MSUs that will be eligible to vest is based on the total shareholder return of the Company relative to the total shareholder return of the Russell 2000 Index (“Index”) over a two year period ending December 31, 2013 (“performance period”). The MSUs vest on January 1, 2014, and the maximum number of shares issuable upon vesting is 200% of the MSUs initially granted.

The fair value of the restricted stock units is based on the closing price of the Company’s stock on the date of grant.

The Company estimates the fair value of MSUs on the date of grant using a Monte Carlo simulation model. The determination of fair value of the MSUs is affected by the Company’s stock price and a number of assumptions including the expected volatilities of the Company’s stock and the Index, its risk-free interest rate and expected dividends. The Company’s

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expected volatility at the date of grant was based on the historical volatilities of the Company and the Index over the performance period. The Company did not estimate a forfeiture rate for the MSUs due to the limited size, the vesting period and nature of the grantee population and the lack of history of granting this type of award.

The Company did not grant any MSUs in 2011 or in the three months ended June 30, 2012.

The assumptions used to value the MSUs granted during the six months ended June 30, 2012 were as follows:

|                               | For the Six Months<br>Ended June 30, 2012 |
|-------------------------------|---|
| Volatility                    | 61%                                       |
| Risk-free interest rate       | 0.28%                                     |
| Expected option life in years | 1.88                                      |
| Dividend yield                | —   |

Earnings per share

The Company computes basic earnings per share by dividing net income by the weighted average number of common shares outstanding. Diluted earnings per share is computed by dividing net income by the weighted average number of common shares and dilutive potential common shares then outstanding. Potential common shares consist of shares issuable upon the exercise of stock options and SARs or the vesting of share-based awards. Diluted earnings per share reflects the assumed conversion of all dilutive share-based awards using the treasury stock method.

Fair value measurement

The Company's financial assets that are measured at fair value on a recurring basis consisted of \$58.0 million invested in treasury money market funds at both June 30, 2012 and December 31, 2011, respectively. The fair value of these accounts is determined based on quoted market prices, which represents level 1 in the fair value hierarchy as defined by Accounting Standard Codification, ("ASC"), 820, "Fair Value Measurement and Disclosure."

Deferred revenue and unbilled receivables

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

Income taxes

At the end of each interim reporting period, the Company estimates its annual effective tax rate to calculate its income tax provision. The estimated effective tax rate includes U.S. federal, state and foreign income taxes and is based on the application of an estimated annual income tax rate applied to the current quarter's year-to-date pre-tax income. This estimated effective tax rate is used in providing for income taxes on a year-to-date basis and may change in subsequent interim reporting periods. The effective tax rate for the three and six months ended June 30, 2012 was 46% and 45%, respectively. The effective tax rate for the three and six months ended June 30, 2011 was 31%. The increase in the effective tax rate in the three and six months ended June 30, 2012 compared to the three and six months ended June 30, 2011 is due primarily to nondeductible share-based compensation expense and the effect of the nonrenewal to date of the R&E tax credit effective in 2012. The difference between the effective tax rate and the federal statutory

rate of 34% for the three and six months ended June 30, 2012 was due primarily to nondeductible share-based compensation expense.

Recent accounting pronouncements

In December 2011, the FASB issued ASU 2011-12, Comprehensive Income (Topic 220): Deferral of the Effective Date for Amendments to the Presentation of Reclassification of Items Out of Accumulated Other Comprehensive Income in ASU 2011-5. ASU 2011-12 defers the effective date pertaining to reclassification adjustments out of accumulated other comprehensive income in ASU 2011-5, Comprehensive Income (Topic 220): Presentation of Comprehensive Income. The Company adopted the standard

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on January 1, 2012, reporting comprehensive income in a single continuous financial statement in its unaudited condensed statements of comprehensive income. For the three and six months ended June 30, 2012 and 2011, the Company did not report other comprehensive income in its unaudited consolidated statements of comprehensive income. In previous periods, the Company has reported cumulative foreign currency translation adjustments in other comprehensive income related to a wholly-owned foreign subsidiary. Since this standard affects disclosure requirements only, its adoption did not have a material impact on the Company's consolidated financial statements.

## 3. Earnings per Share

The following table sets forth the computation of basic and diluted earnings per share for the three and six months ended June 30, 2012 and 2011:

|  | For the Three Months<br>Ended June 30, |         | For the Six Months Ended<br>June 30, |         |
|--|--|---------|--------------------------------------|---------|
|  | 2012                                   | 2011    | 2012                                 | 2011    |
| Numerator:                                 |  |         |                                      |         |
| Net income                                 | \$995                                  | \$1,441 | \$2,186                              | \$2,297 |
| Denominator:                               |  |         |                                      |         |
| Weighted average shares (basic)            | 27,375                                 | 26,829  | 27,271                               | 26,712  |
| Dilutive effect of potential common shares | 962                                    | 999     | 1,033                                | 903     |
| Weighted average shares (diluted)          | 28,337                                 | 27,828  | 28,304                               | 27,615  |
| Basic earnings per share                   | \$0.04                                 | \$0.05  | \$0.08                               | \$0.09  |
| Diluted earnings per share                 | \$0.04                                 | \$0.05  | \$0.08                               | \$0.08  |

Dilutive potential common shares consist of shares issuable upon the exercise of stock options, settlement of SARs, and vesting of RSUs. The MSUs are not included in dilutive potential common shares outstanding as they were determined to be antidilutive for the three and six months ended June 30, 2012. Potential common shares determined to be antidilutive and excluded from diluted weighted average shares outstanding were approximately 722,247 and 581,000 for the three months ended June 30, 2012 and 2011, respectively, and approximately 528,392 and 895,000 for the six months ended June 30, 2012 and 2011.

## 4. Noncash Share-based Compensation

The Company has two non-cash share based compensation plans; the 1999 Equity Incentive Plan ("1999 Stock Plan") and the 2007 Equity Incentive Plan ("2007 Stock Plan").

**1999 Stock Plan.** Under the 1999 Stock Plan, the Company is authorized to grant options to purchase shares of common stock to its employees, directors and consultants at the Company's discretion. The Company's 1999 Stock Plan was terminated in March 2007 for purposes of granting any future equity awards. There were issued and outstanding stock options to purchase 48,497 shares of the Company's common stock under the 1999 Stock Plan on June 30, 2012.

**2007 Stock Plan.** Under the 2007 Stock Plan, the Company is authorized to grant awards to the Company's employees, officers, directors and other individuals providing services to the Company or any of its affiliates. The 2007 Stock Plan has an evergreen provision that allows for an annual increase equal to the lesser of (i) 3.5% of the Company's outstanding shares (ii) 900,000 shares or (iii) any lesser amount determined by the Compensation Committee of the Board of Directors.



During the three months ended June 30, 2012, the Company granted 31,500 shares of RSUs to certain non-executive employees. These units vest over four years, convert to shares of common stock upon certain triggering events, and carried a weighted average grant-date fair value of \$15.25. The Company did not grant any MSUs, stock options or SARs during the three months ended June 30, 2012.

During the six months ended June 30, 2012, the Company granted 583,800 shares of RSUs with a weighted average grant-date fair value of \$18.83. During the six months ended June 30, 2012, the Company granted 205,000 shares of MSUs to certain executive officers and non-executive employees. These units vest on January 1, 2014, convert to shares of common stock upon certain triggering events and carried a weighted average grant-date fair value of \$26.08 upon their issuance. The Company did not grant any stock options or SARs during the six months ended June 30, 2012.

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Share-based compensation expense is allocated to expense categories on the unaudited condensed consolidated statements of comprehensive income. The following table summarizes share-based compensation expense included in the Company's unaudited condensed consolidated statements of comprehensive income for the three and six months ended June 30, 2012 and 2011:

|  | For the Three Months<br>Ended June 30, |         | For the Six Months<br>Ended June 30, |         |
|--|--|---------|--------------------------------------|---------|
|  | 2012                                   | 2011    | 2012                                 | 2011    |
| Share-based compensation:                      |  |         |                                      |         |
| Cost of revenue:                               |  |         |                                      |         |
| License and implementation                     | \$301                                  | \$278   | \$630                                | \$612   |
| Total included in cost of revenue              | 301                                    | 278     | 630                                  | 612     |
| Operating expenses:                            |  |         |                                      |         |
| Selling, marketing, general and administrative | 1,636                                  | 932     | 2,904                                | 2,004   |
| Research and development                       | 503                                    | 395     | 938                                  | 745     |
| Total included in operating expenses           | 2,139                                  | 1,327   | 3,842                                | 2,749   |
| Total share-based compensation expense         | \$2,440                                | \$1,605 | \$4,472                              | \$3,361 |

In February 2012, the Company increased the number of shares available for issuance by 900,000 to 6,368,000 under the evergreen provision in the 2007 Stock Plan. As of June 30, 2012, 686,482 shares remained available for issuance under the 2007 Stock Plan. At June 30, 2012, there was an estimated \$23.5 million of total unrecognized compensation costs related to share-based compensation arrangements. These costs will be recognized over a weighted average period of 2.8 years.

## 5. Commitments and Contingencies

### Litigation:

In the ordinary course of the Company's business, the Company regularly becomes involved in contract and other negotiations and, in more limited circumstances, becomes involved in legal proceedings, claims and litigation. The outcomes of these matters are inherently unpredictable. The Company is not currently involved in any outstanding litigation that it believes, individually or in the aggregate, will have a material adverse effect on its business, results of operations or financial condition.

## 6. Subsequent Events

On July 2, 2012, the Company, through its wholly owned subsidiary PROS, Inc., entered into a \$50.0 million secured Credit Agreement (the "Revolver") with Wells Fargo Bank, N.A. ("Wells Fargo").

The Revolver is for a five year term, with interest paid at the end of the applicable one month, three month or six month interest period at a rate per annum equal to LIBOR plus an applicable margin of 1.5% to 2.25% or the Federal Funds Rate plus an applicable margin of 1.5% to 2.25%. Borrowings under the Revolver are collateralized by a first priority interest in and lien on all of the Company's material assets.

The Revolver contains affirmative and negative covenants, including covenants which restrict the ability of the Company to, among other things, create liens, incur additional indebtedness and engage in certain other transactions, in each case subject to certain exclusions. In addition, the Revolver contains certain financial covenants which become effective in the event the Company's availability under the revolver plus cash and cash equivalents falls below \$20.0 million or upon the occurrence of an event of default.

Debt issuance costs of \$0.3 million incurred related to the Revolver will be carried in other long term assets and amortized to interest expense over the life of the Revolver.

As of August 2, 2012, the Company had no outstanding borrowings under the Revolver.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

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

This management’s discussion and analysis of financial condition and results of operations should be read along with the unaudited condensed consolidated financial statements and unaudited notes to condensed consolidated financial statements included in Item 1 of this Quarterly Report on Form 10-Q, as well as the audited consolidated financial statements and notes to consolidated financial statements and management’s discussion and analysis of financial condition and results of operations set forth in our Annual Report on Form 10-K for the year ended December 31, 2011.

### Overview

We are a leading provider of enterprise pricing and revenue management software to enterprises across a range of industries, including manufacturing, distribution, services and travel. These products are an emerging category of enterprise applications designed to allow companies to improve financial performance by implementing pricing excellence best practices. Enterprises use our software to 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 incorporates advanced pricing science, which includes operations research, forecasting and statistics. Our innovative science-based software products analyze, execute and optimize pricing strategies using data elements determined using pricing algorithms, including the pocket price, pocket margin, customer willingness-to-pay, customer cost-to-serve, win-loss ratios, market price, stretch price, as well as data from traditional enterprise applications—often augmenting it with real-time and historical data and external data sources. Our high performance software architecture supports real-time high volume transaction processing and allows us to handle the processing and database requirements of the most sophisticated and largest customers, including customers with hundreds of simultaneous users and sub-second electronic transactions. We provide professional services to configure, integrate and customize our solutions to meet the specific pricing needs of each customer.

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 improve pricing agility in dynamic markets, improve control of their pricing processes and optimally price each individual transaction. Since inception, we have implemented over 500 solutions across a range of industries in more than 50 countries.

### Opportunities, Trends and Uncertainties

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

Growth opportunities. We believe the market for pricing and revenue management software is underpenetrated. Market interest for our software has increased over the past several years providing us with a growth opportunity. We are investing in our businesses to more effectively address these opportunities through significant investment in research and development, sales, marketing and back office. In addition to organic growth, we may acquire companies or technologies that can contribute to the strategic, operational and financial growth of our business. We expect to continue to explore both organic and other strategic growth opportunities.

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Difficult economic conditions. The current global economic conditions continue to be challenging and have had and may continue to have a negative impact on the adoption of pricing and revenue management software and may increase the volatility in our business. Due to the difficult economic conditions, we continue to experience long sales cycles, increased scrutiny on purchasing decisions and overall cautiousness taken by customers. In addition, certain foreign countries are also facing significant economic crisis and it is possible that these crises could result in economic deterioration in the markets in which we operate. We believe our solutions provide value to our customers during periods of growth as well as in recessions, but it is uncertain the extent to which the difficult economic conditions will further affect our business.

Variability in revenue. Our revenue recognition policy provides visibility into a significant portion of our revenue in the near-term quarters, although the actual timing of revenue recognition varies based on the nature and requirements of our contracts. For the substantial majority of our arrangements, we have not historically recognized license revenue upon customer contract signature and software delivery. We evaluate our contract terms and conditions as well as our

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implementation performance obligations in making our revenue recognition determination for each contract. Our revenue could also vary based on our customer mix and customer geographic location. We sell our solutions to customers in the manufacturing, distribution, services and travel industries. From a geographical standpoint, approximately 61% and 66% of our consolidated revenues were derived from customers outside the United States for each of the three months ended June 30, 2012 and 2011, respectively, and approximately 61% and 63% of our consolidated revenues were derived from customers outside the United States for each of the six months ended June 30, 2012 and 2011, respectively. Our contracts with customers outside the United States are predominately denominated in U.S. dollars. The economic and political environments around the world could change our concentration of revenue within industries and across geographies.

Income taxes. During the three and six months ended June 30, 2012, the effective income tax rate was 46% and 45% as compared to the federal rate of 34%. The increase in the effective tax rate is due primarily to nondeductible share-based compensation expense. We expect our effective tax rate to be higher than the federal rate in 2012 and 2013. The research and experimentation ("R&E") tax credit has not been reinstated for 2012 and, accordingly, our federal income tax provision for the three and six months ended June 30, 2012 excludes the effect of the R&E tax credit. If the R&E tax credit is reinstated during 2012, our annual effective tax rate will be favorably impacted, resulting in a reduction to our 2012 tax provision on a cumulative basis.

## Results of Operations

Comparison of three months ended June 30, 2012 with three months ended June 30, 2011

## Revenue:

| (Dollars in thousands)     | For the Three Months Ended June 30, |       |                                  |                                  | Variance \$ | Variance % |
|----------------------------|-------------------------------------|-------|----------------------------------|----------------------------------|-------------|------------|
|                            | 2012                                | 2011  | As a percentage of total revenue | As a percentage of total revenue |             |            |
| License and implementation | \$18,176                            | 65 %  | \$15,082                         | 63 %                             | \$3,094     | 21 %       |
| Maintenance and support    | 9,958                               | 35 %  | 8,703                            | 37 %                             | 1,255       | 14 %       |
| Total                      | \$28,134                            | 100 % | \$23,785                         | 100 %                            | \$4,349     | 18 %       |

License and implementation. License and implementation revenue increased \$3.1 million to \$18.2 million for the three months ended June 30, 2012 from \$15.1 million for the three months ended June 30, 2011, representing a 21% increase. The increase in license and implementation revenue in the three months ended June 30, 2012 was principally due to a 6% increase in the number of implementations from 80 to 85, and a 33% increase in the average revenue recognized per man-day as compared to the corresponding period of 2011. These increases were offset by a 10% decrease in the number of man-days expended that generated license and implementation revenue.

License and implementation revenue includes revenue from both term licenses and hosting services. Revenue from term licenses represented approximately 4.6% and 7.1% of total revenue for the three months ended June 30, 2012 and 2011, respectively. Revenue from hosting services represented approximately 2.9% and 2.6% of total revenue for the three months ended June 30, 2012 and 2011, respectively.

Maintenance and support. Maintenance and support revenue increased \$1.3 million to \$10.0 million for the three months ended June 30, 2012 from \$8.7 million for the three months ended June 30, 2011, representing a 14% increase. The increase in maintenance and support revenue is principally a result of an increase in the number of customers for which we are providing maintenance and support services.

Cost of revenue and gross profit:

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| (Dollars in thousands)             | For the Three Months Ended June 30,<br>2012 |                                       | 2011     |                                       | Variance \$ | Variance % |
|------------------------------------|---|---------------------------------------|----------|---------------------------------------|-------------|------------|
|                                    | Amount                                      | As a Percentage<br>of Related Revenue | Amount   | As a Percentage<br>of Related Revenue |             |            |
| Cost of license and implementation | \$5,540                                     | 30 %                                  | \$4,765  | 32 %                                  | \$775       | 16 %       |
| Cost of maintenance and support    | 1,960                                       | 20 %                                  | 1,643    | 19 %                                  | 317         | 19 %       |
| Total cost of revenue              | \$7,500                                     | 27 %                                  | \$6,408  | 27 %                                  | \$1,092     | 17 %       |
| Gross profit                       | \$20,634                                    | 73 %                                  | \$17,377 | 73 %                                  | \$3,257     | 19 %       |

Cost of license and implementation. Cost of license and implementation increased \$0.8 million to \$5.5 million for the three months ended June 30, 2012 from \$4.8 million for the three months ended June 30, 2011, representing a 16% increase. The increase in cost of license and implementation is principally attributable to an increase of \$0.4 million of human resource costs. Human resources costs, which include our personnel and contractors, increased as a result of an increase in headcount needed to support the increased number of active implementations and salary merit increases. In addition, there was an increase of \$0.2 million of hosting expenses and an increase of \$0.2 million of travel expense.

License and implementation gross profit percentages were 70% for the three months ended June 30, 2012 as compared to 68% for the three months ended June 30, 2011. The increase in license and implementation gross profit percentages was principally the result of a 21% increase in license and implementation revenue. License and implementation gross profit percentages can vary from period to period depending on different factors, including the amount of implementation services required to deploy our products relative to the total contract price.

Cost of maintenance and support. Cost of maintenance and support increased \$0.3 million to \$2.0 million for the three months ended June 30, 2012 from \$1.6 million for the three months ended June 30, 2011, representing a 19% increase. The increase in cost of maintenance and support in the three months ended June 30, 2012 when compared to the corresponding period in 2011 is attributable to an increase of \$0.3 million of human resources costs associated with the continued growth in our customer maintenance and support function commensurate with maintenance and support revenue growth. Maintenance and support gross profit percentages were 80% for the three months ended June 30, 2012 as compared to 81% for the three months ended June 30, 2011.

Gross profit. Gross profit increased \$3.3 million to \$20.6 million for the three months ended June 30, 2012 from \$17.4 million for the three months ended June 30, 2011, representing a 19% increase. The increase in overall gross profit was attributable to an 18% increase in total revenue.

## Operating expenses:

| (Dollars in thousands)                         | For the Three Months Ended June 30,<br>2012 |  | 2011     |  | Variance \$ | Variance % |
|--|---|--|----------|--|-------------|------------|
|  | Amount                                      | As a Percentage<br>of Total<br>Revenue | Amount   | As a Percentage<br>of Total<br>Revenue |             |            |
| Selling, marketing, general and administrative | \$11,883                                    | 42 %                                   | \$9,115  | 38 %                                   | \$2,768     | 30 %       |
| Research and development                       | 6,772                                       | 24 %                                   | 6,149    | 26 %                                   | 623         | 10 %       |
| Total operating expenses                       | \$18,655                                    | 66 %                                   | \$15,264 | 64 %                                   | \$3,391     | 22 %       |



Selling, marketing, general and administrative expenses. Selling, marketing, general and administrative expenses increased \$2.8 million to \$11.9 million for the three months ended June 30, 2012 from \$9.1 million for the three months ended June 30, 2011, representing a 30% increase. The increase was principally due to an increase of \$2.2 million in sales, marketing, general and administrative human resources costs, which includes third party contractor expenses, as a result of an increase in headcount to support our planned growth objectives and salary merit increases. Included in the increase in human resources costs is an increase of \$0.7 million of non-cash share based compensation as a result of equity awards being granted. In addition, there was an increase of \$0.3 million of overhead and other expenses, an increase of \$0.1 million of consultants fees related to the implementation of a new enterprise resource planning system, an increase of \$0.1 million of third party recruiting fees, and an increase of \$0.1 million of travel expenses.

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Research and development expenses. Research and development expenses increased \$0.6 million to \$6.8 million for the three months ended June 30, 2012 from \$6.1 million for the three months ended June 30, 2011, representing a 10% increase. The increase was principally attributed to an increase of \$0.7 million in human resources costs, which includes third party contractor expenses, as a result of increased headcount to support work on new projects and initiatives, and salary merit increases. These amounts were partially offset by a decrease of \$0.2 million in other expenses.

## Other income (expense), net:

| (Dollars in thousands)           | For the Three Months Ended June 30, |        | 2011                             |        | Variance \$ | Variance % |                                  |      |   |
|----------------------------------|-------------------------------------|--------|----------------------------------|--------|-------------|------------|----------------------------------|------|---|
|                                  | 2012                                | Amount | As a Percentage of Total Revenue | Amount |             |            | As a Percentage of Total Revenue |      |   |
| Interest income                  | \$1                                 | —      | %                                | \$12   | —           | %          | \$(11)                           | (92) | % |
| Foreign currency exchange losses | (130)                               | ) —    | %                                | (33)   | ) —         | %          | (97)                             | ) nm |   |
| Other income (expense), net      | \$(129)                             | ) —    | %                                | \$(21) | ) —         | %          | \$(108)                          | ) nm |   |

Other income (expense), net. Other income (expense), net consists of interest income on our cash and cash equivalents and foreign currency exchange losses on transactions denominated in currencies other than the functional currency. Foreign currency exchange losses increased by \$0.1 million during the three months ended June 30, 2012 primarily due to unrealized foreign currency exchange losses from the revaluation of accounts receivable balances denominated in foreign currencies that weakened relative to the U.S. dollar during the second quarter of 2012.

## Income tax provision:

| (Dollars in thousands) | For the Three Months Ended |      | June 30, |      | Variance \$ | Variance % |   |
|------------------------|----------------------------|------|----------|------|-------------|------------|---|
|                        | 2012                       | 2011 | 2012     | 2011 |             |            |   |
| Effective tax rate     | 46                         | %    | 31       | %    | n/a         | 15         | % |
| Income tax provision   | \$855                      |      | \$651    |      | \$204       | 31         | % |

Income tax provision. Our income tax provision increased \$0.2 million to \$0.9 million for the three months ended June 30, 2012 from \$0.7 million for the three months ended June 30, 2011. Our effective tax rates were 46% and 31% for the three months ended June 30, 2012 and 2011, respectively. The increase in our effective tax rate in the three months ended June 30, 2012 is due primarily to nondeductible share-based compensation expense and the impact of the nonrenewal of the R&E tax credit in 2012.

## Comparison of six months ended June 30, 2012 with six months ended June 30, 2011

## Revenue:

| (Dollars in thousands)     | For the Six Months Ended June 30, |        | 2011                             |          | Variance \$ | Variance % |                                  |    |   |
|----------------------------|-----------------------------------|--------|----------------------------------|----------|-------------|------------|----------------------------------|----|---|
|                            | 2012                              | Amount | As a Percentage of Total Revenue | Amount   |             |            | As a Percentage of Total Revenue |    |   |
| License and implementation | \$35,972                          | 65     | %                                | \$28,875 | 64          | %          | \$7,097                          | 25 | % |

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|                         |          |     |            |     |           |    |   |
|-------------------------|----------|-----|------------|-----|-----------|----|---|
| Maintenance and support | 19,183   | 35  | % 16,316   | 36  | % 2,867   | 18 | % |
| Total                   | \$55,155 | 100 | % \$45,191 | 100 | % \$9,964 | 22 | % |

License and implementation. License and implementation revenue increased \$7.1 million to \$36.0 million for the six months ended June 30, 2012 from \$28.9 million for the six months ended June 30, 2011, representing a 25% increase. The increase in license and implementation revenue in the six months ended June 30, 2012 was principally due to a 6% increase in the number of implementations from 89 to 94, and a 34% increase in the average revenue recognized per man-day as compared to the corresponding period of 2011. These increases were offset by an 8% decrease in the number of man-days expended that generated license and implementation revenue.

License and implementation revenue includes revenue from both term licenses and hosting services. Revenue from term

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licenses represented approximately 5.0% and 6.8% of total revenue for the six months ended June 30, 2012 and 2011, respectively. Revenue from hosting services represented approximately 2.7% and 2.0% of total revenue for the six months ended June 30, 2012 and 2011, respectively.

Maintenance and support. Maintenance and support revenue increased \$2.9 million to \$19.2 million for the six months ended June 30, 2012 from \$16.3 million for the six months ended June 30, 2011, representing an 18% increase. The increase in maintenance and support revenue is principally a result of an increase in the number of customers for which we are providing maintenance and support services.

## Cost of revenue and gross profit:

| (Dollars in thousands)             | For the Six Months Ended June 30, |      |                                    |                                    | Variance \$ | Variance % |   |
|------------------------------------|-----------------------------------|------|------------------------------------|------------------------------------|-------------|------------|---|
|                                    | 2012                              | 2011 | As a percentage of related revenue | As a percentage of related revenue |             |            |   |
| Cost of license and implementation | \$11,543                          | 32   | % \$9,447                          | 33                                 | % \$2,096   | 22         | % |
| Cost of maintenance and support    | 3,895                             | 20   | % 3,353                            | 21                                 | % 542       | 16         | % |
| Total cost of revenue              | \$15,438                          | 28   | % \$12,800                         | 28                                 | % \$2,638   | 21         | % |
| Gross profit                       | \$39,717                          | 72   | % \$32,391                         | 72                                 | % \$7,326   | 23         | % |

Cost of license and implementation. Cost of license and implementation increased \$2.1 million to \$11.5 million for the six months ended June 30, 2012 from \$9.4 million for the six months ended June 30, 2011, representing a 22% increase. The increase in cost of license and implementation is principally attributable to an increase of \$1.5 million of human resource costs. Human resources costs, which include our personnel and contractors, increased as a result of an increase in headcount to support the increased number of active implementations and salary merit increases. In addition, there was an increase of \$0.3 million of travel expense and an increase of \$0.2 million of hosting expenses.

License and implementation gross profit percentages were 68% for the six months ended June 30, 2012 and 67% for the six months ended June 30, 2011. License and implementation gross profit percentages may vary from period to period depending on different factors, including the amount of implementation services required to deploy our products relative to the total contract price.

Cost of maintenance and support. Cost of maintenance and support increased \$0.5 million to \$3.9 million for the six months ended June 30, 2012 from \$3.4 million for the six months ended June 30, 2011, representing a 16% increase. The increase in cost of maintenance in the first six months of 2012 when compared to the corresponding period in 2011 is attributable to an increase of \$0.4 million of human resources costs associated with the continued growth in our customer maintenance and support function commensurate with maintenance and support revenue growth. Maintenance and support gross profit percentages were 80% for the six months ended June 30, 2012 as compared to 79% for the six months ended June 30, 2011.

Gross profit. Gross profit increased \$7.3 million to \$39.7 million for the six months ended June 30, 2012 from \$32.4 million for the six months ended June 30, 2011, representing a 23% increase. The increase in overall gross profit was attributable to a 22% increase in total revenue.

## Operating expenses:

|  | For the Six Months Ended June 30, |      |
|--|-----------------------------------|------|
|  | 2012                              | 2011 |

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| (Dollars in thousands)                            | Amount   | As a Percentage<br>of Total<br>Revenue | Amount     | As a Percentage<br>of Total<br>Revenue | Variance \$ | Variance % |
|---|----------|--|------------|--|-------------|------------|
| Selling, marketing,<br>general and administrative | \$22,140 | 40                                     | % \$16,986 | 38                                     | % \$5,154   | 30         |
| Research and<br>development                       | 13,469   | 24                                     | % 12,109   | 27                                     | % 1,360     | 11         |
| Total operating expenses                          | \$35,609 | 65                                     | % \$29,095 | 64                                     | % \$6,514   | 22         |

Selling, marketing, general and administrative expenses. Selling, marketing, general and administrative expenses

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increased \$5.2 million to \$22.1 million for the six months ended June 30, 2012 from \$17.0 million for the six months ended June 30, 2011, representing a 30% increase. The increase was principally due to an increase of \$3.4 million in sales, marketing, general and administrative human resources costs, which includes third party contractor expenses, as a result of an increase in headcount to support our planned growth objectives and salary merit increases for existing personnel. Included in the increase in human resources costs is an increase of \$0.9 million of non-cash share based compensation as a result of equity awards being granted. In addition, there was an increase of \$0.4 million of marketing expenses resulting from increases in marketing initiatives, an increase of \$0.4 million of travel expenses, an increase of \$0.4 million in third party recruiting expenses, an increase of \$0.3 million of consultants fees related to the implementation of a new enterprise resources planning system and an increase of \$0.3 million of overhead and other expenses. These increases were partially offset by a \$0.2 million decrease in bad debt expense.

Research and development expenses. Research and development expenses increased \$1.4 million to \$13.5 million for the six months ended June 30, 2012 from \$12.1 million for the six months ended June 30, 2011, representing a 11% increase. The increase was principally attributed to an increase of \$1.2 million in human resources costs, which includes third party contractor expenses, as a result of an increase headcount to support the work on new projects and initiatives and salary merit increases for existing personnel. Included in the human resources costs is an increase of \$0.2 million of non-cash share based compensation as a result of equity awards being granted. In addition, there was an increase of \$0.2 million of other expenses.

## Other income (expense), net:

| (Dollars in thousands)                | For the Six Months Ended June 30, |        | As a Percentage |          | As a Percentage |            |
|---------------------------------------|-----------------------------------|--------|-----------------|----------|-----------------|------------|
|                                       | 2012                              | 2011   | of Total        | of Total | Variance \$     | Variance % |
|                                       | Amount                            | Amount | Revenue         | Revenue  |                 |            |
| Interest income                       | \$3                               | \$30   | —               | —        | \$(27)          | (90)%      |
| Foreign currency exchange (loss)/gain | (109)                             | 26     | —               | —        | (135)           | nm         |
| Other income (expense), net           | \$(106)                           | \$56   | —               | —        | \$(162)         | nm         |

Other income (expense), net. Other income (expense) consists of interest income on our cash and cash equivalents and foreign currency exchange losses on transactions denominated in currencies other than the functional currency. Foreign currency exchange losses increased by \$0.1 million during the six months ended June 30, 2012 primarily due to unrealized foreign currency exchange losses from the revaluation of accounts receivable balances denominated in foreign currencies that weakened relative to the U.S. dollar predominately during the second quarter of 2012.

## Income tax provision:

| (Dollars in thousands) | For the Six Months |         | Variance \$ | Variance % |
|------------------------|--------------------|---------|-------------|------------|
|                        | 2012               | 2011    |             |            |
| Effective tax rate     | 45                 | 31      | n/a         | 14         |
| Income tax provision   | \$1,816            | \$1,055 | \$761       | 72         |

Income tax provision. Our income tax provision increased \$0.8 million to \$1.8 million for the six months ended June 30, 2012 from \$1.1 million for the six months ended June 30, 2011. Our effective tax rates were 45% and 31% for the six months ended June 30, 2012 and 2011, respectively. The increase in our effective tax rate in the six months ended June 30, 2012 is due primarily to nondeductible share-based compensation expense and the impact of the nonrenewal of the R&E tax credit in 2012.

## Liquidity and Capital Resources

## Liquidity

At June 30, 2012, we had \$71.2 million of cash and cash equivalents and \$69.3 million of working capital as compared to \$68.5 million of cash and cash equivalents and \$66.2 million of working capital at December 31, 2011. Our principal sources of liquidity are our cash and cash equivalents, cash flows generated from operations and potential borrowings under our credit facility. Our material drivers or variants of operating cash flow are net income, non-cash expenses (principally share-based compensation) and the timing of periodic billings and collections related to the sale of our software and related services. The primary source of operating cash flows is the collection of accounts receivable from our customers. Our operating cash flows are also impacted by the timing of payments to our vendors for accounts payable and other liabilities. We generally pay our vendors

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and service providers in accordance with the invoice terms and conditions.

Based on existing cash and cash equivalents balances, availability under our revolving line of credit and our current estimates of revenues and expenses, we believe that we will have adequate liquidity and capital resources to meet our operational requirements and anticipated capital expenditures for the next twelve months. Our future working capital requirements will depend on many factors, including the operations of our existing business, our potential strategic expansion, future acquisitions we might undertake, and the expansion into complementary businesses. If such need arises, we may need to raise additional funds through equity or debt financings. At June 30, 2012, we had restricted cash of \$0.3 million related to letters of credit.

The following table presents key components of our unaudited condensed consolidated statements of cash flows for the six months ended June 30, 2012 and 2011.

| (Dollars in thousands)                              | For the Six Months Ended June 30, |          |
|---|-----------------------------------|----------|
|   | 2012                              | 2011     |
| Net cash provided by operating activities           | \$6,969                           | \$8,622  |
| Net cash used in investing activities               | (4,079                            | ) (1,273 |
| Net cash (used in) provided by financing activities | (185                              | ) 1,202  |
| Cash and cash equivalents (beginning of period)     | 68,457                            | 55,845   |
| Cash and cash equivalents (end of period)           | \$71,162                          | \$64,396 |

Net cash provided by operating activities. Net cash provided by operating activities for the six months ended June 30, 2012 was \$7.0 million, which represents a decrease of \$1.7 million when compared to the corresponding period in 2011. For the six months ended June 30, 2012, our cash flows from operations were derived principally from our earnings from on-going operations prior to non-cash expenses such as depreciation, excess tax benefits on share-based compensation and share-based compensation and changes in our working capital. The decrease in net cash provided by operating activities for the six months ended June 30, 2012 as compared to the corresponding period in 2011 was due to a decrease of \$2.1 million attributed to changes in operating assets and liabilities, which are comprised of accounts receivable, unbilled receivables, prepaid and other assets, accounts payable, accrued liabilities, accrued payroll and other employee benefits and deferred revenue. This decrease was partially offset by an increase of \$0.6 million of non-cash expense and an increase of \$0.1 million of net income. Included in our changes in operating assets and liabilities in 2012 was \$5.1 million of cash provided from a tax refund received in second quarter.

Net cash used in investing activities. Net cash flow used in investing activities was \$4.1 million for six months ended June 30, 2012 compared to \$1.3 million for the six months ended June 30, 2011. The net cash used in investing activities is primarily the result of infrastructure investments and facility costs.

Net cash provided by financing activities. Net cash flow used in financing activities was \$0.2 million for the six months ended June 30, 2012 compared to net cash flow provided by financing activities of \$1.2 million for the six months ended June 30, 2011. The decrease is primarily the result of tax withholdings related to net share settlements of restricted stock units offset by the excess tax benefits on the vesting of restricted stock units and the exercise of stock options.

#### 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.



Contractual Obligations and Commitments

Revolving credit line

On July 2, 2012, we, through our wholly owned operating subsidiary, PROS, Inc., entered into a \$50.0 million Revolver with Wells Fargo.

The Revolver is for a five year term, with interest paid at the end of the applicable one month, three month or six month interest period at a rate per annum equal to LIBOR plus an applicable margin of 1.5% to 2.25% or the Federal Funds Rate plus an applicable margin of 1.50% to 2.25%. Borrowings under the Revolver are collateralized by a first priority interest in and lien

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on all of our material assets.

The Revolver contains affirmative and negative covenants, including covenants which restrict our ability to, among other things, create liens, incur additional indebtedness and engage in certain other transactions, in each case subject to certain exclusions. In addition, the Revolver contains certain financial covenants which become effective in the event our availability under the revolver plus cash and cash equivalents falls below \$20.0 million or upon the occurrence of an event of default.

Debt issuance costs of \$0.3 million incurred related to the Revolver will be carried in other long term assets and amortized to interest expense over the life of the Revolver.

There were no outstanding borrowings under the Revolver as of July 31, 2012.

Other than as described above, there have been no material changes to our contractual obligations and commitments as disclosed in our Annual Report on SEC Form 10-K for the year ended December 31, 2011.

### Recent Accounting Pronouncements

In December 2011, the FASB issued ASU 2011-12, Comprehensive Income (Topic 220): Deferral of the Effective Date for Amendments to the Presentation of Reclassification of Items Out of Accumulated Other Comprehensive Income in ASU 2011-5. ASU 2011-12 defers the effective date pertaining to reclassification adjustments out of accumulated other comprehensive income in ASU 2011-5, Comprehensive Income (Topic 220): Presentation of Comprehensive Income. We adopted the standard on January 1, 2012, reporting comprehensive income in a single continuous financial statement in its unaudited condensed statements of comprehensive income. For the three and six months ending June 30, 2012 and 2011, we did not report other comprehensive income in our unaudited consolidated statements of comprehensive income. In previous periods, we have reported foreign currency translation adjustments in other comprehensive income related to a wholly owned foreign subsidiary. Since this standard affects disclosure requirements only, its adoption did not have a material impact on our consolidated financial statements.

## ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

### Foreign Currency Exchange Risk

Our contracts are predominately denominated in U.S. dollars; however, we have contracts denominated in foreign currencies and therefore a portion of our revenue is subject to foreign currency risks. The primary market risk we face is from foreign currency exchange rate fluctuations. Our cash flows are subject to 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 June 30, 2012 would have resulted in a \$0.3 million loss. In addition, the Company has operating subsidiaries in the United Kingdom and Germany. However, due to the relative low volume of payments made by the Company through these foreign subsidiaries, the Company does not believe that it has significant exposure to foreign currency exchange risks. Fluctuations in currency exchange rates could harm our results of operations in the future.

We currently do not use derivative financial instruments to mitigate foreign currency exchange risks. We continue to review this issue and may consider hedging certain foreign exchange risks through the use of currency futures or options in future years.

### Exposure to Interest Rates

The Company's exposure to market risk for changes in interest rates relates to the variable interest rate on borrowings under the Company's Revolver. As of July 31, 2012, the Company had no borrowings under the Revolver.

#### ITEM 4. CONTROLS AND PROCEDURES

##### Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our chief executive officer and chief financial officer, evaluated the effectiveness of our disclosure controls and procedures as defined in Rules 13a-15(e) or 15d-15(e) under the Exchange Act of 1934, as amended (the Exchange Act) as of June 30, 2012. Based on our evaluation of our disclosure controls and procedures as of June 30, 2012, our chief executive officer and chief financial officer concluded that our disclosure controls and procedures were effective to ensure that information we are required to disclose in reports that we file or submit under the Exchange Act (i) is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules

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and forms, and (ii) is accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate to allow timely decisions regarding required disclosure.

### Changes in Internal Control over Financial Reporting

We are in the process of implementing the financial management and reporting modules of a new enterprise resource planning (“ERP”) system on a company-wide basis. During the three months ended June 30, 2012, we implemented the revenue recognition module. The implementation of this ERP module represents a change in internal control over financial reporting. Once the implementation is completed, we believe our internal control over financial reporting will be enhanced. We have taken steps to implement appropriate internal control over financial reporting during this period of change and will continue to evaluate the design and operating effectiveness of our internal controls during subsequent periods. We believe during the periods of implementation we have maintained effective internal control over financial reporting.

Other than the internal controls affected by the implementation of the ERP components, there have been no changes in, our internal control over financial reporting during the three months ended June 30, 2012 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## PART II. OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS

From time to time, we are a party to legal proceedings and claims arising in the ordinary course of business. We are not currently aware of any such proceedings or claims that we believe will have, individually or in the aggregate, a material adverse effect on our business, financial condition or results of operations.

### ITEM 1A. RISK FACTORS

Other than the risk factors listed below, there have been no material changes from the risk factors previously described under Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2011.

Our debt level may limit our future financial and operating flexibility.

The amount of our future debt could have significant effects on our operations, including, among other things:

- a substantial portion of our cash flow could be dedicated to the payment of principal and interest on our future debt and may not be available for other general corporate purposes;

- covenants contained in our Revolver require us to meet financial tests in the event that our availability under the revolver plus cash and cash equivalents falls below \$20.0 million or upon the occurrence of an event of default, that may adversely affect our flexibility in planning for and reacting to changes in our business;

- we may be at a competitive disadvantage relative to similar companies that have less debt; and

- increase our vulnerability to adverse economic and industry conditions.

In addition, the Revolver include covenants that, among other things, restrict our ability to incur additional indebtedness, make certain payments, sell assets, enter into certain transactions with affiliates and create liens. These and other covenants in our current agreement may restrict our ability to fully pursue our business strategies and adversely affect our growth prospects. Our ability to comply with such covenants may be affected by changes in our

operating and financial performance, changes in general business and economic conditions, adverse regulatory developments or other events beyond our control. The breach of any of these covenants could result in a default under our indebtedness, which could cause those and other obligations to become due and payable.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS.

We have an ongoing authorization from our Board of Directors to repurchase up to \$15.0 million in shares of our common stock in the open market or through privately negotiated transactions. As of June 30, 2012, \$10.0 million remained available for repurchase under the existing repurchase authorization.

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We did not make any purchases of our common stock under this program for the three months ended June 30, 2012.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

None.

ITEM 4. MINE SAFETY DISCLOSURE

None.

Item 5. Other information.

None.

ITEM 6. EXHIBITS.

| Number   | Description   |
|----------|---|
| 10.14(1) | Credit Agreement between PROS, Inc. and Wells Fargo Bank, National Association dated July 2, 2012         |
| 31.1     | Certification of Chief Executive Officer Pursuant to Exchange Act Rule 13a-14(a)/15d-14(a).               |
| 31.2     | Certification of Chief Financial Officer Pursuant to Exchange Act Rule 13a-14(a)/ 15d-14(a).              |
| 32.1*    | Certifications of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350. |
| 101.INS  | XBRL Instance Document.   |
| 101.SCH  | XBRL Taxonomy Extension Schema Document.  |
| 101.CAL  | XBRL Taxonomy Extension Calculation Linkbase Document.  |
| 101.DEF  | XBRL Taxonomy Extension Definition Linkbase Document.   |
| 101.LAB  | XBRL Taxonomy Extension Label Linkbase Document.  |
| 101.PRE  | XBRL Taxonomy Extension Presentation Linkbase Document.   |

\* This certification shall not be deemed “filed” for purposes of Section 18 of the Securities Act of 1934, or otherwise subject to the liability of that Section, nor shall it be deemed to be incorporated by reference into any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934  
(1) Incorporated by reference to our Current Report on Form 8-K dated July 9, 2012

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

|                      |                        |  |
|----------------------|------------------------|--|
|                      | PROS HOLDINGS,<br>INC. |  |
| Date: August 2, 2012 | By:                    | /s/ Andres Reiner<br>Andres Reiner<br>President and Chief Executive Officer<br>(Principal Executive Officer)                                       |
| Date: August 2, 2012 | By:                    | /s/ Charles H. Murphy<br>Charles H. Murphy<br>Executive Vice President and Chief Financial Officer<br>(Principal Financial and Accounting Officer) |