PROS Holdings, Inc.
Form 10-Q
November 06, 2014
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2014

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

PROS HOLDINGS, INC.
(Exact name of registrant as specified in its charter)

Delaware	76-0168604
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer 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)

(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 x No o

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 x No o

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.

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Large Accelerated Filer	x	Accelerated Filer	o
Non-Accelerated Filer	o (do not check if a smaller reporting company)	Smaller Reporting Company	o

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

The number of shares outstanding of the Registrant's Common Stock, $0.001 par value, was 29,018,286 as of November 4, 2014.

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Form 10-Q
For the Quarterly Period Ended September 30, 2014

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CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

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 belief that we will successfully integrate our acquisitions; our anticipated additions to property, plant and equipment; our belief that our facilities are suitable and adequate to meet our current operating needs; and 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, but not limited to, "we expect," "anticipate," "target," "project," "believe," "goals," "estimate," "potential," "pr "may," "might," "could," "would," "intend," and variations of these types of words and similar expressions are intended to identify these forward-looking statements.

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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) September 30, 2014	December 31, 2013
Assets:		
Current assets:		
Cash and cash equivalents	$40,413	$44,688
Accounts and unbilled receivables, net of allowance of $770 and $1,060, respectively	52,111	46,566
Prepaid and other current assets	13,090	6,157
Restricted cash - current	2,322	39,718
Total current assets	107,936	137,129
Restricted cash - noncurrent	100	100
Property and equipment, net	17,446	15,587
Intangibles, net	21,919	8,232
Goodwill	22,097	7,024
Deferred tax assets - noncurrent, net of valuation allowance	10,744	10,505
Other long term assets	1,710	1,251
Total assets	$181,952	$179,828
Liabilities and Stockholders' Equity:		
Current liabilities:		
Accounts payable and other liabilities	$10,061	$7,839
Accrued liabilities	8,928	5,210
Accrued payroll and other employee benefits	10,913	9,679
Deferred revenue	50,111	42,274
Total current liabilities	80,013	65,002
Long-term deferred revenue	2,639	2,977
Other long-term liabilities	1,445	546
Total liabilities	84,097	68,525
Commitments and contingencies (Note 7)		
PROS 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; 33,434,825 and 32,606,228 shares issued, respectively; 29,017,240 and 28,188,643 shares outstanding, respectively	34	33
Additional paid-in capital	112,332	106,880
Treasury stock, 4,417,585 common shares, at cost	(13,938)	(13,938)
Retained earnings (accumulated deficit)	(1,076)	18,328
Accumulated other comprehensive loss	(1,421)	—
Non-controlling interest	1,924	—
Total stockholders' equity	97,855	111,303
Total liabilities and stockholders' equity	$181,952	$179,828

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

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

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2014	2013	2014	2013
Revenue:				
License	$11,844	$10,930	$36,039	$30,044
Services	13,764	12,195	38,959	35,939
Subscription	6,775	1,960	16,901	5,864
Total license, services and subscription	32,383	25,085	91,899	71,847
Maintenance and support	14,336	11,728	40,101	34,119
Total revenue	46,719	36,813	132,000	105,966
Cost of revenue:				
License	48	37	154	270
Services	10,556	8,696	31,604	24,857
Subscription	773	275	2,862	1,160
Total license, services and subscription	11,377	9,008	34,620	26,287
Maintenance and support	2,350	2,018	7,287	6,079
Total cost of revenue	13,727	11,026	41,907	32,366
Gross profit	32,992	25,787	90,093	73,600
Operating expenses:				
Selling, marketing, general and administrative	24,422	15,714	71,144	45,936
Research and development	11,665	8,001	34,316	24,122
Acquisition-related	625	677	2,594	677
Impairment charge	—	—	2,130	—
(Loss) income from operations	(3,720)	1,395	(20,091)	2,865
Other (expense) income, net	(466)	83	(2,009)	(150)
(Loss) income before income tax provision	(4,186)	1,478	(22,100)	2,715
Income tax (benefit) provision	(257)	485	(2,057)	(592)
Net (loss) income	(3,929)	993	(20,043)	3,307
Net loss attributable to non-controlling interest	(195)	—	(858)	—
Net (loss) income attributable to PROS Holdings, Inc.	(3,734)	993	(19,185)	3,307
Net (loss) earnings per share attributable to PROS Holdings, Inc.:				
Basic	$(0.13)	$0.04	$(0.66)	$0.12
Diluted	$(0.13)	$0.03	$(0.66)	$0.11
Weighted average number of shares:				
Basic	29,000,481	28,096,333	28,875,499	27,953,416
Diluted	29,000,481	30,315,499	28,875,499	29,935,756
Other comprehensive (loss) income, net of tax:				
Foreign currency translation adjustment	(1,613)	—	(1,436)	—
Other comprehensive (loss) income, net of tax	(1,613)	—	(1,436)	3,307
Comprehensive (loss) income	(5,542)	993	(21,479)	3,307
Comprehensive loss attributable to non-controlling interest	(230)	—	(873)	—
Comprehensive (loss) income attributable to	$(5,312)	$993	$(20,606)	$3,307

PROS Holdings, Inc.
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 Nine Months Ended September 30,	
	2014	2013
Operating activities:		
Net (loss) income	$(20,043)	$3,307
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	7,967	3,080
Share-based compensation	16,530	11,822
Tax shortfall from share-based compensation	—	(9)
Deferred income tax, net	(238)	654
Provision for doubtful accounts	(290)	(40)
Impairment charge	2,130	—
Changes in operating assets and liabilities:		
Accounts and unbilled receivables	5,024	(5,787)
Prepaid expenses and other assets	(6,375)	(1,413)
Accounts payable and other liabilities	(3,222)	2,191
Accrued liabilities	448	1,371
Accrued payroll and other employee benefits	(932)	(811)
Deferred revenue	2,108	(3,206)
Net cash provided by operating activities	3,107	11,159
Investing activities:		
Purchases of property and equipment	(6,290)	(2,636)
Acquisition of Cameleon Software, net of cash acquired	(22,048)	—
Capitalized internal-use software development costs	(2,166)	(2,265)
Decrease in restricted cash	37,396	329
Net cash provided by (used) in investing activities	6,892	(4,572)
Financing activities:		
Exercise of stock options	1,055	3,079
Proceeds from employee stock plans	335	—
Tax withholding related to net share settlement of restricted stock units	(12,462)	(2,450)
Increase in Parent's ownership in Cameleon Software	(3,621)	—
Net cash (used in) provided by financing activities	(14,693)	629
Effect of foreign currency rates on cash	419	—
Net change in cash and cash equivalents	(4,275)	7,216
Cash and cash equivalents:		
Beginning of period	44,688	83,558
End of period	$40,413	$90,774

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 ("PROS", the “Company”, "Parent", "we", "us", or "our"), provides big data software applications designed to help companies outperform in their markets by using big data to sell more effectively. The Company applies data science to unlock buying patterns and preferences within transaction data to reveal which opportunities are most likely to close, which offers are most likely to sell and which prices are most likely to win. The Company offers big data software applications to analyze, execute, and optimize sales, pricing, quoting, rebates and revenue management. The Company also provides professional services to implement its software applications as well as business consulting. In addition, the Company provides product maintenance and support to its customers, including unspecified upgrades, maintenance releases and bug fixes during the term of the support period on a when-and-if-available basis. The Company provides its big data software applications to enterprises across a range of industries, including manufacturing, distribution, services and travel.

In December 2013, the Company acquired SignalDemand, Inc. ("SignalDemand"), a software-as-a-service ("SaaS") optimization software company headquartered in San Francisco, California, for total cash consideration of $13.5 million. With products designed to help the Company's clients perform in volatile markets with greater confidence and agility, this acquisition broadened the Company's offerings to companies in resource-based and commodity-driven industries. Through SignalDemand's solutions and PROS' big data software applications, PROS processes thousands of variables to deliver real-time recommendations, helping companies make price and mix decisions across diverse products, customers and channels.

In January 2014, the Company acquired approximately 81.7% of the common stock of Cameleon Software SA ("Cameleon"), a publicly traded French société anonyme headquartered in Toulouse, France, in an all-cash tender offer for approximately $29.1 million. The Company continued to purchase shares of Cameleon in the open market through which the Company acquired an additional 11.6% of Cameleon's common stock for approximately $3.6 million. As of September 30, 2014, the Company owned 93.3% of the common stock of Cameleon.

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 generally accepted accounting principles 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 September 30, 2014, the results of operations for the three and nine months ended September 30, 2014 and cash flows for the nine months ended September 30, 2014.

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, 2013 (“Annual Report”) filed with the SEC. The condensed consolidated balance sheet as of December 31, 2013 was derived from the Company’s audited consolidated financial statements but does not include all disclosures required under GAAP.

Certain reclassifications of previously recorded amounts have been made to conform to the current period presentation, such reclassifications impacted the classification of components of cost of revenue, but did not have an impact on our results of operations, cash flows, or financial position.

Basis of consolidation

The unaudited condensed consolidated financial statements include the accounts of the Company and its subsidiaries. All intercompany transactions and balances have been eliminated in consolidation. The functional currency of Cameleon is its local currency. The financial statements of this subsidiary are translated into U.S. dollars using period-end rates of exchange for assets and liabilities, historical rates of exchange for equity, and average rates of exchange for the period for revenue and expenses. Translation gains (losses) are recorded in accumulated other comprehensive income (loss) as a component of stockholders' equity.

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, as well as 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 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 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 nonsoftware related SaaS and cloud-based services. The Company's arrangements with customers typically include some but not all of the following: (a) license fees for the use of our solutions either in perpetuity or over a specified term, (b) professional services fees for configuration, implementation and training services, (c) maintenance and support fees related to technical support and software updates, and (d) subscription fees for our SaaS and cloud-based offerings. If there is significant uncertainty about contract completion or collectability is not reasonably 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, delivery has occurred and fees are fixed or determinable.

License revenue includes perpetual license revenue recognized upon software delivery and an allocation of revenue from solution sales that are recognized using the percentage of completion method. The allocation represents management's estimate of the relative fair value of the perpetual licenses included in the solution sale arrangement.

Subscription revenues include revenue from our SaaS, cloud-based and term license offerings.

Professional services revenues consist of fees associated with the implementation and configuration of our software and subscription contracts, on-site support, training and other consulting services.

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 during the maintenance and support period. The Company recognizes revenue from maintenance arrangements ratably over the period in which the services are provided.

In determining whether professional services revenue should be accounted for separately from license revenue, the Company evaluates whether the professional services are considered essential to the functionality of the software using factors such as: the nature of the software products; whether they are ready for use by the customer upon receipt; the nature of professional services required; the availability of services from other vendors; whether the timing of payments for license revenue coincides with performance of services; and whether milestones or acceptance criteria exist that affect the realizability of the software license fee.

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If the Company determines that professional services revenue should not be accounted for separately from license revenue, the license revenue is recognized together with the professional services revenue using the percentage-of-completion method or completed contract method. The completed contract method is also used for contracts where there is a risk over final acceptance by the customer or for contracts that are short-term in nature.

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 the 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 on term licenses. 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.

The Company's cloud-based services allow customers to choose to deploy PROS solutions without any significant investment in hardware. With this option, PROS software is integrated in cloud-based IT environments which PROS deploys, supports and manages on the customers' behalf.

For arrangements that include cloud-based services, the Company allocates the arrangement consideration between the service and other elements and recognizes the cloud-based services fee ratably beginning on the date the customer commences use of the Company's services and continuing through the end of the contract term.

The Company's customer arrangements typically contain multiple elements that include software license, implementation services, and post-implementation maintenance and support. For multiple element arrangements involving the Company's nonsoftware services, the Company (1) determines whether and when each element has been delivered; (2) determines the fair value of each element using the selling price hierarchy of VSOE of fair value, third party evidence ("TPE"), or best estimated selling price ("BESP"), as applicable, and (3) allocates the total price among the various elements based on the selling price method.

For multiple-element arrangements that include software and nonsoftware elements such as the Company's cloud-based service offerings, the Company allocates revenue between the software and software-related elements as a group and any nonsoftware elements based on a relative fair value allocation. The Company determines fair value for each deliverable using this hierarchy and utilizes VSOE of fair value if it exists.

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 the Company's limited experience selling each element separately, not pricing solutions or services within a narrow range, or only having a limited sales history. In addition, TPE may not be available. When the Company is unable to establish selling prices using VSOE or TPE, it uses BESP in its 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 among multiple deliverables.

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 consolidated balance sheets.

Business Combinations

We record tangible and intangible assets acquired and liabilities assumed in business combinations under the acquisition method of accounting. Amounts paid for each acquisition are allocated to the assets acquired and liabilities assumed based on their fair values at the date of acquisition.

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Significant management judgments and assumptions are required in determining the fair value of acquired assets and liabilities, particularly acquired intangible assets. The valuation of purchased intangible assets is based upon estimates of the future performance and cash flows from the acquired business. Each asset is measured at fair value from the perspective of a market participant.

The Company uses its best estimates and assumptions to accurately assign fair value to the tangible and intangible assets acquired and liabilities assumed at the acquisition date. The Company’s estimates are inherently uncertain and subject to refinement. During the measurement period, which may be up to one year from the acquisition date, the Company may record adjustments to the fair value of these tangible and intangible assets acquired and liabilities assumed, with the corresponding offset to goodwill. In addition, uncertain tax positions and tax-related valuation allowances are initially established in connection with a business combination as of the acquisition date. The Company continues to collect information and reevaluates these estimates and assumptions quarterly and records any adjustments to the Company’s preliminary estimates to goodwill, provided that the Company is within the measurement period. Upon the conclusion of the measurement period or final determination of the fair value of assets acquired or liabilities assumed, whichever comes first, any subsequent adjustments are recorded to the Company’s condensed consolidated statements of operations.

Internal-use software

Costs incurred to develop internal-use software during the development stage are capitalized, stated at cost, and depreciated using the straight-line method over the estimated useful lives of the assets. Development stage costs generally include salaries and personnel costs and third party contractor expenses associated with internal-use software configuration, coding, installation and testing. Capitalized internal-use software development costs related to the Company's cloud-based offerings were $0.5 million and $0.8 million for the three months ended September 30, 2014 and 2013, respectively, and $1.5 million and $2.4 million for each of the nine months ended September 30, 2014 and 2013, respectively. Capitalized internal-use software development costs related to our cloud-based offerings are amortized using the straight-line method over the useful life of the asset. For the three and nine months ended September 30, 2014, the Company amortized $0 million and $0.3 million, respectively, of capitalized internal-use software development costs related to its cloud-based offerings as compared to $0.1 million and $0.3 million, respectively, for the three and nine months ended September 30, 2013. Capitalized software for internal use is included in property and equipment, net in the unaudited condensed consolidated balance sheets. Amortization of capitalized internal-use software development costs related to the Company's cloud-based offerings is included in cost of subscription revenues in the accompanying unaudited condensed consolidated statements of comprehensive income.

Impairment of long-lived assets

Property and equipment are reviewed for impairment whenever an event or change in circumstances indicates that the carrying amount of an asset or group of assets may not be recoverable. The impairment review includes comparison of future cash flows expected to be generated by the asset or group of assets with the associated assets’ carrying value. If the carrying value of the asset or group of assets exceeds its expected future cash flows (undiscounted and without interest charges), an impairment loss is recognized to the extent that the carrying amount of the asset exceeds its fair value. During the second quarter of 2014, the Company recorded a $2.1 million impairment charge related to capitalized development costs associated with the expected future cash flows of certain assets. The Company did not record any impairment charges during the third quarter of 2014.

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 expenses in the Company's unaudited consolidated statement of comprehensive income on a straight-line basis over the periods 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, Restricted Stock Units ("RSUs"), Stock Appreciation Rights ("SARs"), and Market Stock Units ("MSUs"). RSUs include both time-based awards as well as performance-based awards in which the number of shares that vest are based upon the revenue expected to be earned by the Company from binding customer agreements for the provision of configure, price, and quote ("CPQ") solutions. MSUs are performance-based awards in which the number of shares that vest are based upon the Company's relative stockholder return.

The following table presents the number of shares or units outstanding for each award type as of September 30, 2014 and December 31, 2013, respectively.

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Award type	September 30, 2014	December 31, 2013
Stock options	965,177	1,160,464
Restricted stock units (time based)	1,871,851	1,542,990
Restricted stock units (performance based)	34,000	—
Stock appreciation rights	673,443	721,028
Market stock units	444,272	469,000

Stock options, time based RSUs and SARs vest ratably between two and four years. The actual number of MSUs that will be eligible to vest is based on the total stockholder return of the Company relative to the total stockholder return of the Russell 2000 Index (“Index”) over their respective performance periods, as defined by each award's plan documents. The Company did not grant any stock options or SARs during the three month period ended September 30, 2014.

The fair value of the RSUs 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 expected volatility at the date of grant was based on the historical volatilities of the Company and the Index over the performance period.

The assumptions used to value the MSUs granted during the three and nine months ended September 30, 2014 were as follows:

	Grant Date		
	July 1, 2014	February 24, 2014	February 11, 2014
Volatility	50.25%	51.13%	50.74%
Risk-free interest rate	0.9%	0.66%	0.67%
Expected option life in years	3.00	2.85	2.89
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 RSUs and MSUs. Diluted earnings per share reflect 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 $10.4 million and $21.0 million invested in treasury money market funds at September 30, 2014 and December 31, 2013, 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, quarterly or annual basis through the maintenance and support period.

Credit Facility

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As of September 30, 2014, the Company had no outstanding borrowings under the Company's $50 million revolving credit facility ("Revolver"), and $0.1 million of unamortized debt issuance costs related to the Revolver is included in other long term assets in the condensed consolidated balance sheets. For each of the three and nine months ended September 30, 2014 and 2013, $12,500 and $37,500, respectively, of debt issuance cost amortization is included in Other Expense (Income), net in the unaudited condensed consolidated statements of comprehensive income.

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 months ended September 30, 2014 and 2013 was 6% and 33%, respectively. The effective tax rate for the nine months ended September 30, 2014 and 2013 was 9% and (22)%, respectively. The difference between the effective tax rate and the federal statutory rate of 34% for the three and nine months ended September 30, 2014 was due primarily to the limitation on the deductibility of certain officers' compensation and valuation allowances related to losses in certain jurisdictions.

The tax (benefit) provision recorded for the three months ended September 30, 2014 and 2013 was $(0.3) million and $0.5 million, respectively. The tax benefit for the nine months ended September 30, 2014 and 2013 was $2.1 million and $0.6 million, respectively. The change in the tax benefit was due to the Company's net loss for the three and nine months ended September 30, 2014 as compared to net income for the three and nine months September 30, 2013. This was principally the result of an increase in 2014 non-deductible officers compensation partially offset by the expiration of the federal Research and Experimentations ("R&E") tax credit in 2014, and changes in valuation allowances related to our acquisitions. In addition, the income tax benefit for the nine months ended September 30, 2013 included a $1.4 million discrete benefit attributed to the 2012 R&E tax credit that was retroactively reinstated and recorded in 2013.

The Internal Revenue Service is currently examining the Company's 2009 R&E credit and at the present time there is no indication of the potential outcome. The Company is not aware of any other significant audits in progress at this time.

Recent Accounting Pronouncements

In May 2014, the FASB issued Accounting Standards Update No. 2014-09 (ASU 2014-09) "Revenue from Contracts with Customers." ASU 2014-09 supersedes the revenue recognition requirements in "Revenue Recognition (Topic 605)", and requires entities to recognize revenue when they transfer promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled to in exchange for those goods or services. Early adoption is not permitted. This new accounting standards update becomes effective for the Company on January 1, 2017. The Company is currently evaluating the impact that this guidance will have on its financial statements.

With the exception of the new revenue standard discussed above, there have been no other recent accounting pronouncements or changes in accounting pronouncements during the nine months ended September 30, 2014, as compared to the recent accounting pronouncements described in our Annual Report on Form 10-K for the year ended December 31, 2013, that are of significance or potential significance to the Company.

3. Business Combination

Cameleon Software, SA

In October 2013, the Company entered into a tender offer agreement with Cameleon, indicating the Company's intent to acquire Cameleon through the tender offer for all of the outstanding share capital of Cameleon in an all cash tender offer. As part of the tender offer, the Company placed approximately $40 million in escrow to fund the acquisition, which was included in current restricted cash as of December 31, 2013. In January 2014, the Company announced that the tender offer for Cameleon was successful and upon completion of the tender offer, the Company controlled 81.7% of Cameleon’s common stock and 94.0% of Cameleon’s outstanding warrants, inclusive of the commitments from Cameleon's management regarding their Cameleon free shares. As a result of shares purchased by the Company in the market following the completion of the tender and the exercise of warrants in July 2014, the Company controlled 93.3% of Cameleon's common stock as of September 30, 2014. All amounts pertaining to the approximate 6.7% of Cameleon that the Company does not own are reported as non-controlling interest in the Company’s condensed consolidated financial statements.

During the three and nine months ended September 30, 2014, the Company incurred acquisition-related costs of $0.3 million and $1.3 million, respectively, consisting primarily of the cost for the retention of key employees, advisory and legal fees.

All of the assets acquired and the liabilities assumed in the transaction have been recognized at their acquisition date fair values at January 8, 2014.

The acquisition initially resulted in $16.2 million of goodwill. During the quarter ended September 30, 2014, the fair value of the other tangible assets and liabilities was increased by $0.4 million, and goodwill was reduced accordingly.

The allocation of the purchase price for Cameleon is updated as follows (in thousands):

Cash and cash equivalents	$ 7,086
Accounts receivables	10,395
Prepaid and other assets	1,418
Intangible assets	18,653
Goodwill	15,774
Accounts payable and accrued liabilities	(12,596)
Deferred revenue	(5,392)
Non-controlling interest	(6,204)
Net assets acquired	$ 29,134

The following are the identifiable intangible assets acquired and their respective useful lives (in thousands):

	Amount	Useful Life (years)
Trade Name	$ 1,020	8
Customer Relationships	1,455	2-5
Maintenance Relationships	3,808	8
Developed Technology	11,147	7
Other	1,223	2
Total	$ 18,653	

In performing the preliminary purchase price allocation, the Company considered, among other factors, its anticipated future use of the acquired assets, analysis of historical financial performance, and estimates of future cash flows from Cameleon's products and services. The allocation resulted in acquired intangible assets of $18.7 million. The acquired intangible assets consisted of developed technology, customer and maintenance relationships, trade name and other and were valued using the income approach in which the after-tax cash flows are discounted to present value. The cash flows are based on estimates used to price the transaction, and the discount rates applied were benchmarked with reference to the implied rate of return from the transaction model as well as the weighted average cost of capital. Additionally, the Company assumed certain liabilities in the acquisition, including deferred revenue to which a fair value of $5.4 million was ascribed using a cost-plus profit approach.

Liabilities assumed include $2.7 million related to the Company's offer to pay an additional €0.15 per share cash premium to the Cameleon stock and warrant holders tendering their shares and warrants in the initial tender offer if the Company acquired at least 95% of the share capital and voting rights of Cameleon on a fully diluted basis on or before December 31, 2014. The Company recorded this liability at fair value as the Company expected to meet this threshold prior to December 31, 2014. In addition, the net assets acquired include contingent consideration of $1.4 million related to the committed purchase of free shares owned by Cameleon management.

Goodwill of $15.8 million represents the excess of the purchase price over the fair value of the underlying net tangible and identifiable intangible assets, and represents the expected synergistic benefits of the transaction, the knowledge and experience of Cameleon's workforce in place, and the expectation that the combined company’s complementary products will significantly

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broaden the Company’s CPQ solution offering. The Company believes the combined company will benefit from a broader global presence and, with the Company’s direct sales force and larger channel coverage, significant cross selling opportunities. None of the goodwill is expected to be currently deductible for tax purposes. In accordance with applicable accounting standards, goodwill will not be amortized but instead will be tested for impairment at least annually, or, more frequently if certain indicators are present. In the event that the management of the combined company determines that the value of goodwill has become impaired, the combined company will incur an accounting charge for the amount of the impairment during the fiscal quarter in which the determination is made.

SignalDemand, Inc.

In December 2013, the Company acquired SignalDemand, Inc. for total cash consideration of $13.5 million.

During the three and nine months ended September 30, 2014, the Company incurred acquisition-related costs of $0.3 million and $1.3 million, respectively, consisting primarily of the cost for the retention of key employees, advisory, and legal fees.

All of the assets acquired and the liabilities assumed in the transaction have been recognized at their acquisition date fair values at December 16, 2013.

The acquisition initially resulted in $7.0 million of goodwill. During the quarter ended September 30, 2014, the fair value of the other tangible assets and liabilities were adjusted by $0.2 million, and goodwill was adjusted accordingly.

The allocation of the total purchase price for SignalDemand is updated as follows (in thousands):

Current assets	$881	
Deferred tax asset - current	2,752	
Noncurrent assets	193	
Intangibles	8,300	
Goodwill	7,175	
Deferred tax asset - noncurrent	2,447	
Accounts payable and accrued liabilities	(1,560	)
Deferred revenue	(6,688	)
Net assets acquired	$13,500	

The following are the identifiable intangible assets acquired and their respective useful lives (in thousands):

	Amount	Useful Life (years)
Developed technology	$4,600	7
Internally developed technology	160	2
Customer relationships	3,500	8
Trade name	40	2
Total	$8,300	

In performing the preliminary purchase price allocation, the Company considered, among other factors, its anticipated future use of the acquired assets, analyses of historical financial performance, and estimates of future cash flows from SignalDemand's products and services. The allocation resulted in acquired intangible assets of $8.3 million. The acquired intangible assets consisted of developed technology, customer relationships and trade name and were valued using the income approach in which the after-tax cash flows are discounted to present value. The cash flows were based on estimates used to price the transaction, and the discount rates applied were benchmarked with reference to the implied rate of return from the transaction model as well as the weighted average cost of capital. Additionally, the Company assumed certain liabilities in the acquisition, including deferred revenue to which a fair value of $6.7 million was ascribed using a cost-plus profit approach.

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The Company has made a preliminary determination that $5.2 million of net deferred tax assets were assumed on the acquisition date. The deferred tax assets primarily relate to net operating losses and other expenses accrued but not expensed for tax purposes.

The excess of the purchase price over the estimated amounts of net assets as of the effective date of the acquisition was allocated to goodwill. The factors contributing to the recognition of the amount of goodwill are based on several strategic and synergistic benefits that are expected to be realized from the SignalDemand acquisition. These benefits include the expectation that the combined company's complementary products will significantly broaden the Company's offerings in sales optimization solutions. The Company believes the combined company will benefit from a broader global presence and, with the Company's direct sales force and larger channel coverage, significant cross selling opportunities. None of the goodwill is expected to be currently deductible for tax purposes. In accordance with applicable accounting standards, goodwill will not be amortized but instead will be tested for impairment at least annually, or, more frequently if certain indicators are present. In the event that the management of the combined company determines that the value of goodwill has become impaired, the Company will incur an accounting charge for the amount of the impairment during the fiscal quarter in which the determination is made.

Pro Forma Financial Information

The unaudited financial information in the table below summarizes the combined results of operations of the Company, Cameleon and SignalDemand, on a pro forma basis, as though the Company had acquired Cameleon and SignalDemand on January 1, 2013. The pro forma information for all periods presented also includes the effect of business combination accounting resulting from the acquisition, including amortization charges from acquired intangible assets.

	Three months ended September 30,		Nine months ended September 30,	
(in thousands, except earnings per share)	2014	2013	2014	2013
Total revenue	$46,719	$42,518	$132,252	$122,899
Net loss attributable to PROS Holdings, Inc.	(3,734)	(401)	(19,317)	(1,400