NETSUITE INC
Form 10-Q
August 06, 2014
Table of Contents

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

FORM 10-Q

(Mark one)
x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 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 001-33870

NetSuite Inc.
(Exact name of registrant as specified in its charter)

Delaware	94-3310471
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
2955 Campus Drive, Suite 100 San Mateo, California	94403-2511
(Address of principal executive offices)	(Zip Code)

(650) 627-1000
(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§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). (Check one): Yes S No ¨

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

On July 31, 2014, 76,418,720 shares of the registrant’s Common Stock, $0.01 par value, were issued and outstanding.

Table of Contents

NetSuite Inc.

Index

Table of Contents

PART I – Financial Information

ITEM 1. Financial Statements

NetSuite Inc.
Condensed Consolidated Balance Sheets
(dollars in thousands)
(unaudited)

	June 30, 2014	December 31, 2013
Assets		
Current assets:		
Cash and cash equivalents	$479,191	$451,577
Accounts receivable, net of allowances of $1,498 and $833 as of June 30, 2014 and December 31, 2013, respectively	89,961	86,818
Deferred commissions	39,549	38,187
Other current assets	21,492	22,622
Total current assets	630,193	599,204
Property and equipment, net	51,786	48,183
Deferred commissions, non-current	10,404	8,405
Goodwill	84,042	84,478
Other intangible assets, net	16,408	20,460
Other assets	12,763	11,669
Total assets	$805,596	$772,399
Liabilities and total equity		
Current liabilities:		
Accounts payable	$3,124	$4,838
Deferred revenue	237,929	211,694
Accrued compensation	27,335	24,535
Accrued expenses	20,731	21,721
Other current liabilities (including note payable to related party of $2,713 and $3,054 as of June 30, 2014 and December 31, 2013, respectively)	13,530	16,776
Total current liabilities	302,649	279,564
Long-term liabilities:		
Convertible 0.25% senior notes, net	259,758	254,038
Deferred revenue, non-current	14,257	12,913
Other long-term liabilities (including note payable to related party of $7,330 and $8,702 as of June 30, 2014 and December 31, 2013, respectively)	14,733	15,832
Total long-term liabilities	288,748	282,783
Total liabilities	591,397	562,347
Commitments and contingencies (Note 4)		
Total equity:		
Common stock, par value $0.01, 500,000,000 shares authorized; 76,107,175 and 75,131,404 shares issued and outstanding at June 30, 2014 and December 31, 2013, respectively	761	751
Additional paid-in capital	708,178	658,717
Accumulated other comprehensive loss	(173)	(246)
Accumulated deficit	(494,567)	(449,170)
Total equity	214,199	210,052

Total liabilities and total equity	$805,596	$772,399

See accompanying Notes to Condensed Consolidated Financial Statements.

1

Table of Contents

NetSuite Inc.
Condensed Consolidated Statements of Operations and Comprehensive Loss
(dollars and shares in thousands, except per share data)
(unaudited)

	Six Months Ended June 30,		Three Months Ended June 30,	
	2014	2013	2014	2013
Revenue:				
Subscription and support	$205,246	$154,199	$105,851	$80,239
Professional services and other	49,509	38,426	25,943	20,757
Total revenue	254,755	192,625	131,794	100,996
Cost of revenue:				
Subscription and support	33,444	25,826	17,084	13,511
Professional services and other	46,830	37,225	24,513	19,895
Total cost of revenue	80,274	63,051	41,597	33,406
Gross profit	174,481	129,574	90,197	67,590
Operating expenses:				
Product development	49,548	35,446	25,376	18,796
Sales and marketing	133,406	100,712	69,726	53,960
General and administrative	28,139	25,174	14,106	13,429
Total operating expenses	211,093	161,332	109,208	86,185
Operating loss	(36,612)	(31,758)	(19,011)	(18,595)
Other income / (expense), net:				
Interest income	55	40	36	18
Interest expense	(7,042)	(1,427)	(3,542)	(1,323)
Other expense, net	(309)	(182)	(199)	(39)
Total other income / (expense), net	(7,296)	(1,569)	(3,705)	(1,344)
Loss before income taxes	(43,908)	(33,327)	(22,716)	(19,939)
Provision for income taxes	1,489	100	448	451
Net loss	$(45,397)	$(33,427)	(23,164)	(20,390)
Net loss per common share, basic and diluted	$(0.60)	$(0.45)	$(0.31)	$(0.28)
Weighted average number of shares used in computing net loss per share	75,677	73,547	75,919	73,946
Comprehensive loss:				
Foreign currency translation gains / (loss), net of taxes	(20)	(929)	718	(824)
Accumulated pension liability	93	65	47	32
Comprehensive loss	$(45,324)	$(34,291)	$(22,399)	$(21,182)

See accompanying Notes to Condensed Consolidated Financial Statements.

Table of Contents
NetSuite Inc.
Condensed Consolidated Statements of Cash Flows
(dollars in thousands)
(unaudited)

	Six Months Ended June 30,	
	2014	2013
Cash flows from operating activities:		
Net loss	$(45,397)	$(33,427)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	9,269	7,208
Amortization of other intangible assets	4,050	2,887
Amortization of debt discount and transaction costs	6,332	1,056
Provision for accounts receivable allowances	663	358
Stock-based compensation	43,873	35,266
Amortization of deferred commissions	34,699	25,839
Excess tax benefit on stock-based compensation	(369)	(195)
Changes in operating assets and liabilities, net of acquired assets and assumed liabilities:		
Accounts receivable	(3,760)	2,849
Deferred commissions	(38,060)	(27,098)
Other current assets	1,224	(7,511)
Other assets	(1,720)	(484)
Accounts payable	(1,678)	3,227
Accrued compensation	2,681	(590)
Deferred revenue	27,475	19,595
Other current liabilities	(1,176)	691
Other long-term liabilities	(390)	590
Net cash provided by operating activities	37,716	30,261
Cash flows from investing activities:		
Purchases of property and equipment	(10,326)	(7,131)
Capitalized internal use software	(1,049)	(1,276)
Cash paid in business combination, net of amounts received, and equity investment	—	(33,003)
Net cash used in investing activities	(11,375)	(41,410)
Cash flows from financing activities:		
Proceeds from issuance of convertible 0.25% senior notes	—	310,000
Payments of issuance costs on convertible 0.25% senior notes	—	(7,750)
Payments under capital leases	(155)	(370)
Payments under capital leases and long-term debt - related party	(1,713)	(1,366)
Payments to repurchase common stock	—	(30,000)
Payments related to business combinations	(2,293)	—
RSUs acquired to settle employee withholding liability	(53)	(123)
Excess tax benefit on stock-based compensation	369	195
Proceeds from issuance of common stock	4,668	10,725
Net cash provided by financing activities	823	281,311
Effect of exchange rate changes on cash and cash equivalents	450	(1,126)
Net change in cash and cash equivalents	27,614	269,036
Cash and cash equivalents at beginning of period	451,577	185,859

Cash and cash equivalents at end of period	$479,191	$454,895
Supplemental cash flow disclosure:		
Cash paid for interest to related parties	$250	$157
Cash paid for interest to other parties	$459	$11
Cash paid for income taxes, net of tax refunds	$693	$695
Noncash financing and investing activities:		
Fixed assets acquired under related party agreement	$—	$11,805

See accompanying Notes to Condensed Consolidated Financial Statements.

Table of Contents

NetSuite Inc.
Notes to Condensed Consolidated Financial Statements
(unaudited)

Note 1. Organization
NetSuite Inc. (the “Company”) provides cloud-based financials/Enterprise Resource Planning (“ERP”) and omnichannel commerce software suites. In addition, the Company offers a broad suite of applications, including financial management, Customer Relationship Management (“CRM”), Ecommerce and retail management, Professional Services Automation (“PSA”) and Human Capital Management ("HCM") that enable companies to manage most of their core business operations in its single integrated suite. The Company’s "real-time dashboard" technology provides an easy-to-use view into up-to-date, role-specific business information. The Company also offers customer support and professional services related to implementing and supporting its suite of applications. The Company delivers its suite over the Internet as a subscription service using the software-as-a-service ("SaaS") model. The Company’s headquarters are located in San Mateo, California. The Company conducts its business worldwide, with international locations in Canada, Europe, Asia, Australia and Uruguay.

Note 2. Basis of Presentation

The Condensed Consolidated Financial Statements as of and for the six and three months ended June 30, 2014 included in this Quarterly Report on Form 10-Q have been prepared by the Company, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (the “SEC”). The condensed consolidated balance sheet data as of December 31, 2013 was derived from the audited consolidated financial statements included in the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2013 filed on March 3, 2014. Certain information and footnote disclosures normally included in consolidated financial statements prepared in accordance with generally accepted accounting principles in the United States of America (“GAAP”) have been condensed or omitted pursuant to such rules and regulations. However, the Company believes that the disclosures contained in this Quarterly Report comply with the requirements of Section 13(a) of the Securities Exchange Act of 1934, as amended, for a Quarterly Report on Form 10-Q and are adequate to make the information presented not misleading. These Condensed Consolidated Financial Statements are meant to be, and should be, read in conjunction with the Consolidated Financial Statements and the notes thereto included in the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2013 filed on March 3, 2014.

The unaudited Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q reflect all adjustments (which include only normal, recurring adjustments and those items discussed in these Notes) that are, in the opinion of management, necessary to state fairly the financial position and results for the dates and periods presented. The results for such periods are not necessarily indicative of the results to be expected for the full fiscal year.

Recent Accounting Pronouncements

In May 2014, the FASB issued new accounting guidance related to revenue recognition. This new standard will replace most existing U.S. GAAP guidance on this topic. The new revenue recognition standard provides a unified model to determine when and how revenue is recognized. The core principle is that a company should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration for which the entity expects to be entitled in exchange for those goods or services. This guidance will be effective for the Company beginning January 1, 2017 and can be applied either retrospectively to each period presented or as a cumulative-effect adjustment as of the date of adoption. The Company is evaluating the impact of adopting this new accounting standard on its financial statements and has not selected a transition method.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. Intercompany balances and transactions have been eliminated.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make certain estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, as well as reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Table of Contents

Revenue Recognition

The Company generates revenue from two sources: (1) subscription and support; and (2) professional services and other. Subscription and support revenue includes subscription fees from customers accessing its on-demand application suite and support fees from customers purchasing support. Arrangements with customers do not provide the customer with the right to take possession of the software supporting the on-demand application service at any time. Professional services and other revenue includes fees generated from training and consulting services such as business process mapping, configuration, data migration and integration. Amounts that have been invoiced are recorded in accounts receivable and in deferred revenue or revenue, depending on whether the revenue recognition criteria have been met. For the most part, subscription and support agreements are entered into for 12 to 36 months. In aggregate, more than 90% of the professional services component of the arrangements with customers is performed within 300 days of entering into a contract with the customer.

The subscription agreements provide service level commitments of 99.5% uptime per period, excluding scheduled maintenance. The failure to meet this level of service availability may require the Company to credit qualifying customers up to the value of an entire month of their subscription and support fees. In light of the Company's historical experience with meeting its service level commitments, the Company has not accrued any liabilities on its balance sheet for these commitments.

The Company commences revenue recognition when all of the following conditions are met:

- There is persuasive evidence of an arrangement;
- The service is being provided to the customer;
- The collection of the fees is reasonably assured; and
- The amount of fees to be paid by the customer is fixed or determinable.

In most instances, revenue from new customer acquisition is generated under sales agreements with multiple elements, comprised of subscription and support fees from customers accessing the Company's on-demand application suite and professional services associated with consultation services. The Company evaluates each element in a multiple-element arrangement to determine whether it represents a separate unit of accounting. An element constitutes a separate unit of accounting when the delivered item has standalone value and delivery of the undelivered element is probable and within the Company's control. Subscription and support have standalone value because they are routinely sold separately by the Company. Professional services have standalone value because the Company has sold professional services separately and there are several third-party vendors that routinely provide similar professional services to its customers on a standalone basis.

The Company allocates revenue to each element in an arrangement based on a selling price hierarchy. The selling price for a deliverable is based on its vendor-specific objective evidence ("VSOE"), if available, third-party evidence ("TPE"), if VSOE is not available, or estimated selling price ("ESP"), if neither VSOE nor TPE is available. As the Company has been unable to establish VSOE or TPE for the elements of its arrangements, the Company establishes the ESP for each element primarily by considering the weighted average of actual sales prices of professional services sold on a standalone basis and subscription and support including various add-on modules when sold together without professional services, and other factors such as gross margin objectives, pricing practices and growth strategy. The consideration allocated to subscription and support is recognized as revenue over the contract period commencing when the subscription service is made available to the customer. The consideration allocated to professional services is recognized as revenue using the proportional performance method.
The total arrangement fee for a multiple element arrangement is allocated based on the relative ESP of each element. However, since the professional services are generally completed prior to completion of delivery of subscription and support services, the revenue recognized for professional services in a given reporting period does not include fees subject to delivery of subscription and support services. This results in the recognition of revenue for professional

services that is generally no greater than the contractual fees for those professional services.

For single element sales agreements, subscription and support revenue is recognized ratably over the contract term beginning on the provisioning date of the contract. The Company recognizes professional services revenue using the proportional performance method for single element arrangements.

Sales and other taxes collected from customers to be remitted to government authorities are excluded from revenues.

Concentration of Credit Risk and Significant Customers

Financial instruments potentially exposing the Company to concentration of credit risk consist primarily of cash and cash equivalents, restricted cash and trade accounts receivable. The Company maintains an allowance for doubtful accounts

Table of Contents

receivable balances. The allowance is based upon historical loss patterns and an evaluation of the potential risk of loss associated with problem accounts. The Company generally charges off the receivable balances of uncollectible accounts when accounts are 120 days past-due based on the account's contractual terms. Credit risk arising from accounts receivable is mitigated due to the large number of customers comprising the Company's customer base and their dispersion across various industries. As of June 30, 2014 and December 31, 2013, there were no customers that represented more than 10% of the net accounts receivable balance. There were no customers that individually exceeded 10% of the Company's revenue in any of the periods presented. As of June 30, 2014 and December 31, 2013, long-lived assets located outside the United States were not significant.

Revenue by geographic region, based on the billing address of the customer, was as follows for the periods presented:

	Six Months Ended June 30,		Three Months Ended June 30,	
	2014	2013	2014	2013
	(dollars in thousands)			
United States	$192,064	$143,702	$100,401	$75,812
International	62,691	48,923	31,393	25,184
Total revenue	$254,755	$192,625	$131,794	$100,996
Percentage of revenue generated outside of the United States	25 %	25 %	24 %	25 %

No single country outside the United States represented more than 10% of revenue during the six months ended June 30, 2014 or 2013.

The Company maintains cash balances at several banks. Accounts located in the United States are insured by the Federal Deposit Insurance Corporation ("FDIC"), up to $250,000. Certain operating cash accounts may exceed the FDIC limits.

Intellectual Property Rights Indemnification

The Company's arrangements include provisions indemnifying customers against liabilities if the Company's products infringe a third-party's intellectual property rights. The Company has not incurred any costs as a result of such indemnifications and has not accrued any liabilities related to such obligations in the accompanying condensed consolidated financial statements.

Qualified Operating Expense Reimbursements

At the Company's product development facility in the Czech Republic, the Company participates in a government subsidy program for employing local residents. Under the program, the Czech government will reimburse the Company for certain operating expenses it incurs. In the period the Company incurs the reimbursable operating expense, it records a reduction in product development expense and a receivable from the Czech government. During the second quarter of 2014, the Company began participating in a second subsidy program, similar in nature to the initial program, as benefits under the initial program reached the program limits in the first quarter of 2014. During the six and three months ended June 30, 2014 , the Company's product development operating expenses were reduced by $864,000 and $257,000, respectively, for reimbursement of eligible operating expenses incurred during those respective time periods. During the six and three months ended June 30, 2013, the Company's product development operating expenses were reduced by $1.2 million and $630,000, respectively, for reimbursement of eligible operating expenses incurred during each respective time period. During the six and three months ended June 30, 2014, the Company received $1.3 million and $673,000, respectively, from the Czech Republic government. As of June 30, 2014, $876,000 in reimbursements, adjusted for foreign currency valuations, are due the Company and included in other current assets.

Business Combination

On March 6, 2013, the Company completed the purchase of all the outstanding equity of a website hosting provider company ("WH") that specializes in Ecommerce technology and services. On the transaction closing date, the Company paid $10.2 million in cash and withheld consideration of $1.8 million in cash for various periods up to 24 months following the close of the transaction as indemnification against certain losses the Company may incur in the event of certain breaches of representations and warranties in the purchase agreement. During the second quarter of 2014, the Company paid the former

Table of Contents

owners $1.0 million of the withheld consideration and reduced the remaining obligation by approximately $200,000 for various adjustments. As of June 30, 2014, $600,000 in consideration is still being withheld by the Company.

The following table details the Company's goodwill activity during the three months ended June 30, 2014:

	(dollars in thousands)
Balance as of January 1, 2014	$84,478
Business combination adjustments	(163)
Foreign exchange adjustment	(273)
Balance as of June 30, 2014	$84,042

Retail Anywhere

In November 2012, the Company purchased certain assets from Retail Anywhere ("RA"), an on-line retail solution service provider. The Company purchased certain RA assets and assumed certain liabilities to expand its retail software solutions in the Ecommerce vertical. RA software allows the Company to expand its Ecommerce services to brick and mortar store point of sale terminals. The RA assets, liabilities and operating results are reflected in the Company’s consolidated financial statements from the date of acquisition. On the closing date, the Company paid $5.0 million in cash. Additional consideration of $1.3 million in cash was being withheld for up to the 15 months following the close of the transaction as protection against certain losses the Company may incur in the event of certain breaches of representations and warranties covered in the purchase agreement. As of December 31, 2013, the Company's remaining obligation was $1.1 million. During the first quarter of 2014, the Company paid $900,000 to the former owners resulting in a remaining obligation of $155,000.

Accumulated Other Comprehensive Loss

Accumulated other comprehensive loss is comprised of foreign currency translation gains and losses, net of tax, and an accumulated pension liability for employees located in the Philippines. There were no significant reclassification adjustments out of accumulated other comprehensive loss to the condensed consolidated statement of operations and comprehensive loss.

Note 3. Financial Instruments

Fair Value Measurements

The Company measures certain financial assets at fair value on a recurring basis based on a fair value hierarchy that requires the Company to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. A financial instrument’s categorization within the fair value hierarchy is based upon the lowest level of input that is significant to the fair value measurement. The three levels of inputs that may be used to measure fair value are:

- Level 1 - Quoted prices in active markets for identical assets or liabilities.
- Level 2 - Observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets with insufficient volume or infrequent transactions (less active markets); or model-derived valuations in which all significant inputs are observable or can be derived principally from or corroborated by observable market data for substantially the full term of the assets or liabilities.
- Level 3 - Unobservable inputs to the valuation methodology that are significant to the measurement of fair value of assets or liabilities.

The fair value of the Company’s investments in certain money market funds approximates their face value. Such instruments are classified as Level 1 and are included in cash and cash equivalents.

The fair value of the Company's foreign currency forward contracts is based on foreign currency rates quoted by banks or foreign currency dealers and other public data sources. Such instruments are classified as Level 2 and are included in other current assets and liabilities.

As of June 30, 2014, financial assets stated at fair value on a recurring basis were comprised of money market funds included within cash and cash equivalents and foreign exchange forward contracts included within other current assets and

Table of Contents

liabilities. The fair value of these financial assets was determined using the following inputs as of June 30, 2014 and December 31, 2013:

	June 30, 2014 Fair value measurements at reporting date using				December 31, 2013 Fair value measurements at reporting date using			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
	(in thousands)				(in thousands)			
Assets:								
Money market funds	$252,578	$—	$—	$252,578	$122,527	$—	$—	$122,527
Foreign exchange contracts	—	17	—	17	—	375	—	375
Total	$252,578	$17	$—	$252,595	$122,527	$375	$—	$122,902
Liabilities:								
Foreign exchange contracts	$—	$171	$—	$171	$—	$—	$—	$—
Total	$—	$171	$—	$171	$—	$—	$—	$—

Restricted Cash

As of June 30, 2014, restricted cash consisted of $38,000 which is classified as other current assets. As of December 31, 2013, restricted cash was $753,000. Of the $753,000 restricted cash balance as of December 31, 2013, $38,000 is classified as other current assets and $715,000 is classified as long-term other assets. These restricted cash accounts secure letters of credit applied against certain of the Company’s facility lease agreements.

Balance Sheet Hedging - Hedging of Foreign Currency Assets and Liabilities

During the six months ended June 30, 2014, the Company hedged certain of its nonfunctional currency denominated assets and liabilities to reduce the risk that earnings would be adversely affected by changes in exchange rates. Gains and losses from these forward contracts are recorded each period as a component of other income / (expense) in the consolidated statements of operations. The notional amount of derivative instruments acquired during the period was $127.8 million. The Company accounts for derivative instruments as other current assets and liabilities on the balance sheet and measures them at fair value with changes in the fair value recorded as other income / (expense). These derivative instruments do not subject the Company to material balance sheet risk due to exchange rate movements because gains and losses on these derivatives are intended to offset gains and losses on the assets and liabilities being economically hedged.

Table of Contents

As of June 30, 2014 and December 31, 2013, the Company had the following outstanding foreign exchange forward contracts:

	June 30, 2014		December 31, 2013	
	Notional Value Sold	Notional Value Purchased	Notional Value Sold	Notional Value Purchased
	(US dollars in thousands)		(US dollars in thousands)	
Australian dollar	$13,941	$6,420	$11,416	$4,979
British pound	9,985	6,013	7,537	4,799
Philippines peso	6,500	6,500	5,940	3,940
Czech crown	6,230	5,000	5,240	3,490
Japan yen	2,645	—	2,285	—
Canadian dollar	1,281	1,304	2,445	1,817
Euro	1,457	462	1,356	—
New Zealand dollar	553	102	287	—
Mexican peso	129	—	158	116
Total	$42,721	$25,801	$36,664	$19,141

The fair value of the derivative instruments reported on the Company's Condensed Consolidated Balance Sheet were as follows:

	Asset Derivatives			Liability Derivatives		
Derivatives and forward contracts	Balance Sheet Location	June 30, 2014 Fair Value	December 31, 2013 Fair Value	Balance Sheet Location	June 30, 2014 Fair Value	December 31, 2013 Fair Value
	(in thousands)			(in thousands)		
Foreign exchange contracts	Other current assets	$17	$375	Other current liabilities	$171	$—
Total		$17	375		$171	$—

The effect of derivative instruments on the Statement of Operations and Comprehensive Loss was as follows for the periods presented:

		Amount of net gain (loss) recognized in income on derivatives during the			
		Six Months Ended June 30,		Three Months Ended June 30,	
Derivatives and forward contracts	Location of net gain (loss) recognized in income on derivatives	2014	2013	2014	2013
		(in thousands)			
Foreign exchange contracts	Other income/ (expense), net	$(653)	$1,137	$(322)	$695
Total		$(653)	$1,137	$(322)	$695

The Company has entered into all of its foreign exchange contracts with a single counterparty. During the periods such contracts are open, the Company is subject to a potential maximum amount of loss due to credit risk equal to the gross fair value of the derivative instrument, if the counterparty to the instruments failed completely to perform according to the terms of the contracts. Generally, the Company has the right of offset for gains earned and losses incurred under these agreements. The agreements with the counterparty do not require either party to provide collateral to mitigate the credit risk of the agreements.

Note 4. Commitments and Contingencies

9

Table of Contents

The Company is involved in various legal proceedings and receives claims from time to time, arising from the normal course of business activities. The Company has accrued for estimated losses in the accompanying condensed consolidated financial statements for matters with respect to which it believes the likelihood of an adverse outcome is probable and the amount of the loss is reasonably estimable.

During the six months ended June 30, 2014, the Company entered into various office space leases to expand its operations within the United States, the Czech Republic and Australia. The corresponding lease terms for these agreements expire at various dates through 2021. The Company will pay a total of $7.4 million, net of any lessor lease incentives, over the corresponding lease terms.

Future minimum lease payments under non-cancelable operating leases (with initial or remaining lease terms in excess of one year) as of June 30, 2014 are as follows:

	Operating leases (dollars in thousands)
Years ending:	
Remainder of 2014	$6,749
2015	12,322
2016	10,596
2017	9,348
2018	9,445
Thereafter	9,377
Future minimum lease payments	$57,837

Note 5. Stock-based Compensation

During the first quarter of 2012, the Company made provisions for certain executives and other key employees to be awarded a total of 177,400 performance shares (“PS”) related to 2014. In the first quarter of 2014, the Company's Board of Directors ("BoD") set the performance metrics for these PS. The PS vesting is contingent upon the Company meeting certain company-wide revenue performance goals (performance-based) in 2014. These shares are subject to term vesting conditions. The PS fair value of $102.61 per share and the related stock-based compensation expense are determined based on the value of the underlying shares on the date of grant, which is in the first quarter of 2014 when the performance metrics were set by the BoD, and is recognized over the vesting term. During the interim financial periods, management estimates the probable number of PS that will be vested until the achievement of the performance goals is known at year end December 31, 2014.

Effective the first quarter of 2014, the Company changed its methodology for estimating the expected term assumption used to determine employee stock option grant fair value. The Company changed from the simplified method to a historical data method because the Company believes it has sufficient data to estimate the stock option exercise period based on historical stock option activity and historical employee termination data. The Company used a 4.32 years weighted average expected term to determine the fair value of stock options granted during the first quarter of 2014.

Note 6. Debt

0.25% Convertible Senior Notes

In June 2013, the Company issued at par value $310.0 million of 0.25% convertible senior notes due June 1, 2018 (the “Notes”). Interest is payable semi-annually in arrears on December 1 and June 1 of each year, commencing December 1, 2013.

The Notes are governed by an indenture dated as of June 4, 2013, between the Company, as issuer, and Wells Fargo Bank, National Association, as trustee. The Notes do not contain any financial covenants or any restrictions on the payment of dividends, the incurrence of senior debt or other indebtedness, or the issuance or repurchase of securities by the Company. The Notes are unsecured and rank senior in right of payment to the Company's future indebtedness that is expressly subordinated in right of payment to the Notes, rank equal in right of payment to the Company's existing and future unsecured indebtedness that is not so subordinated. The Notes are effectively subordinated in right of payment to any of the Company's secured indebtedness to the extent of the value of the assets securing such indebtedness and are structurally subordinated to all existing and future indebtedness, liabilities incurred by our subsidiaries including trade payables, and preferred stock of the Company.

Table of Contents

Upon conversion, the Company may choose to pay or deliver, as the case may be, either cash, shares of the Company's common stock or a combination of cash and shares of the Company's common stock. If converted, holders will receive, at the Company's election, cash and/or shares of the Company's common stock for the principal amount of the Notes and any amounts in excess of the principal amounts. The Company intends to settle the principal amount of the Notes with cash if converted.
The initial conversion rate is 8.6133 shares of the Company's common stock per $1,000 principal amount of Notes, subject to anti-dilution adjustments. The initial conversion price is approximately $116.10 per share of the Company's common stock and represents a conversion premium of approximately 35% based on the last reported sale price of the Company's common stock of $86.00 on May 29, 2013, the date the Notes offering was priced. The conversion rate is subject to adjustment from time to time upon the occurrence of certain events, including, but not limited to, the issuance of stock dividends and payment of cash dividends. Holders of the Notes will not receive any cash payment representing accrued and unpaid interest upon conversion of a Note unless the conversion date occurs after a regular record date related to the Notes and prior to the related interest payment date. At any time prior to the close of business on the business day immediately preceding March 1, 2018, holders may convert their Notes at their option only under the following circumstances:

- during any calendar quarter commencing after the calendar quarter ended on September 30, 2013 (and only during such calendar quarter), if the last reported sale price of the common stock for at least 20 trading days (whether or not consecutive) during a period of 30 consecutive trading days ending on the last trading day of the immediately preceding calendar quarter is greater than or equal to 130% of the conversion price on each applicable trading day;

- during the five business day period after any five consecutive trading day period (the “measurement period”) in which the trading price per $1,000 principal amount of Notes for each trading day of the measurement period was less than 98% of the product of the last reported sale price of the Company's common stock and the conversion rate on each such trading day; or

- upon the occurrence of certain corporate transactions described in the indenture governing the Notes.

On and after March 1, 2018 until the close of business on the business day immediately preceding the maturity date, holders may convert their Notes at any time, regardless of the foregoing circumstances. If a make-whole fundamental change (as defined in the Indenture governing the Notes) occurs when the Company's stock price is between $86.00 and $275.00 per share and a holder elects to convert its Notes in connection with such make-whole fundamental change, such holder may be entitled to an increase in the conversion rate as provided for in the Indenture governing the Notes.
As of June 30, 2014, circumstances that would give rise to a conversion option for the holders of Notes do not exist. Holders of the Notes have the right to require the Company to purchase with cash all or a portion of the Notes upon the occurrence of any event that constitutes a fundamental change (as defined in the Indenture governing the Notes) at a purchase price equal to 100% of the principal amount of the Notes plus accrued and unpaid interest.

In accounting for the issuance of the Notes, the Company separated the Notes into liability and equity components. The carrying amount of the liability component was calculated by measuring the fair value of a similar liability that does not have an associated convertible feature. The carrying amount of the equity component representing the conversion option was determined by deducting the fair value of the liability component from the par value of the Notes as a whole. The excess of the principal amount of the liability component over its carrying amount (“debt discount”) is amortized to interest expense using the effective interest method over the term of the Note. The equity component is not remeasured as long as it continues to meet the conditions for equity classification.
In accounting for the $8.4 million in transaction costs related to the Note issuance, the Company allocated the total amount incurred to the liability and equity components based on their relative values. The $6.7 million in transaction

costs attributable to the liability component included in other assets are being amortized to interest expense over the term of the Notes, and the $1.7 million in transaction costs attributable to the equity component were netted with the equity component in additional paid-in capital. Debt issuance costs, net of amortization, were $5.3 million as of June 30, 2014. The Notes consisted of the following as of June 30, 2014

Table of Contents

	(in thousands)
Equity component (1)	$60,931
Liability component :	
Principal	$310,000
Less: debt discount, net	(50,242)
Net carrying amount	$259,758
Fair value - level 2	$318,835

(1) Included in the consolidated balance sheets within additional paid-in capital, net of the $1.7 million in equity issuance costs.

The Notes are carried at face value less any unamortized debt discount and also require disclosure of an estimate of fair value. The Company considers the fair value of the Notes at each balance sheet date to be a level 2 measurement because it is determined based on a recent quoted market price or dealer quote for the Notes. The Notes quoted market price or dealer quote is based on the trading price of the Company's common stock and market activity that is less than an active exchange.

As of June 30, 2014, the remaining life of the Notes is approximately 4.0 years.

The following table sets forth total interest expense recognized related to the Notes during the six and three months ended June 30, 2014:

	Six Months Ended June 30,		Three Months Ended June 30,	
	2014	2013	2014	2013
	(dollars in thousands)			
Contractual interest expense	$388	$65	$194	$65
Amortization of debt issuance costs	612	110	307	110
Amortization of debt discount	5,721	946	2,883	946
Total	$6,721	$1,121	$3,384	$1,121
Effective interest rate		5.4%		

Note 7. Income Taxes

The Company has incurred annual operating losses since inception. As a result of those continuing losses, management has determined insufficient evidence exists to support that it is more likely than not that the Company will realize the benefits of its U.S. net deferred tax assets and therefore has recorded a valuation allowance to reduce the net carrying value of these deferred tax assets to zero. Accordingly, the Company has not recorded a provision for income taxes for any of the periods presented other than provisions for state and foreign income taxes.

As of June 30, 2014, the Company had net deferred tax assets in certain foreign jurisdictions of approximately $210,000. Based on all available evidence, both positive and negative, management believes that it is more likely than not that the benefits of those foreign deferred tax assets will be realized in full. The Company also had deferred tax assets of $3.8 million for Japan where it had a full valuation allowance as of June 30, 2014, reducing its carrying value to zero.

The Company does not anticipate a material change in the total amount or composition of its unrecognized tax benefits within 12 months of the reporting date.

As of June 30, 2014, the Company has not provided for residual U.S. taxes on any of its income from foreign jurisdictions since it intends to indefinitely reinvest the net undistributed earnings of its foreign subsidiaries offshore.

The Company files federal, state and foreign income tax returns in jurisdictions with varying statutes of limitations. Due to the carry forward of net operating losses, the Company's income tax returns generally remain subject to examination by federal and most state tax authorities. In most of the Company's significant foreign jurisdictions, 2008 through the current taxable year remain subject to examination by their respective tax authorities.

Table of Contents

Note 8. Net Loss Per Share of Common Stock

Basic net loss per common share is computed by dividing net loss by the weighted-average number of shares of common stock outstanding during the period. Diluted net loss per share of common stock is computed by giving effect to all potential dilutive shares of common stock, including options, restricted stock units ("RSUs"), performance share units ("PSUs"), performance shares ("PS") and convertible debt shares. Basic and diluted net loss per share of common stock were the same for all periods presented as the impact of all potentially dilutive securities outstanding was anti-dilutive.

The following table presents the calculation of the numerator and denominator used in the basic and diluted net loss per share of common stock:

	Six Months Ended June 30,		Three Months Ended June 30,	
	2014	2013	2014	2013
	(dollars and shares in thousands, except per share amounts)			
Numerator:				
Net loss	$(45,397)	$(33,427)	$(23,164)	$(20,390)
Denominator:				
Weighted-average number of shares of common stock outstanding used in computing basic and diluted net loss per share of common stock	75,677	73,547	75,919	73,946
Net loss per share of common stock, basic and diluted	$(0.60)	$(0.45)	$(0.31)	$(0.28)

The Company’s unvested RSUs, PSUs and PS do not contain non-forfeitable rights to dividends and dividend equivalents. As such, unvested RSUs, PSUs and PS are not participating securities and the Company is not required to use the two-class method to calculate diluted earnings per share in periods when the Company has net income.

The following table presents the weighted average potential shares that are excluded from the computation of diluted net loss per common share for the periods presented because including them would have had an anti dilutive effect:

	Six Months Ended June 30,		Three Months Ended June 30,	
	2014	2013	2014	2013
	(Shares in thousands)			
Options to purchase shares of common stock	2,027	2,379	2,186	2,345
Unvested RSUs, PSUs and PS awards	2,649	3,165	2,722	3,313
Total	4,676	5,544	4,908	5,658

The effect of the convertible Notes is reflected in diluted earnings per share by application of the treasury stock method as the Company intends to settle the principal amount of the Note in cash upon conversion. During the six and three months ended June 30, 2014, the Company's weighted average common stock price was below the Notes conversion price for the periods during which the Notes were outstanding.

Note 9. Related Party Transactions

On February 28, 2013, the Company entered into the third amendment to the perpetual software license agreement with Oracle USA ("Amendment"). The Amendment provides for a 48 month extension to the May 2010 second amendment to the Oracle unlimited license agreement. The Amendment provides that the Company will pay a one-time fee of $13.1 million to extend the term for unlimited licenses from May 31, 2014 to May 31, 2018. The Amendment also provides for technical support services. The Company paid $2.4 million for the support services from February 28, 2013 to February 27, 2014. During the first quarter of 2014, the Company renewed the support service agreement for $4.3 million and may renew support services for the three subsequent annual periods at the same rate. The support services to be provided to the Company by Oracle automatically renew unless the Company provides written notice of cancellation at least 60 days prior to the support renewal date. The Company financed the license fees due under the Amendment pursuant to a note issued to Oracle Credit Corporation. The note bears interest at a rate of 2.00% per annum with payments scheduled over the term of the amendment. The Company discounted the note at a rate of 4.5% because it approximates the interest rate the Company would obtain on the open market.

Table of Contents

The $12.4 million discounted note value was recorded as an asset addition to property and equipment that will be depreciated over seven years.

Future debt payments under notes payable as of June 30, 2014 are as follows:

	(dollars in thousands)
Years ending:	
Remainder of 2014	$1,559
2015	3,119
2016	3,119
2017	3,119
Future debt payments	10,916
Amount representing interest	873
Present value of future debt payments	$10,043

The following table details schedule payments made to Oracle USA and Oracle Credit Corporation:

	Six Months Ended June 30,		Three Months Ended June 30,	
	2014	2013	2014	2013
	(dollars in thousands)			
License fee	$1,713	$1,366	$659	$973
Support	2,150	1,193	1,075	1,190
Interest	250	157	120	144
Total paid	$4,113	$2,716	$1,854	$2,307

The Company has also entered into various other software license agreements with Oracle Corporation. During the six months ended June 30, 2014 and 2013, the Company received payments totaling $216,000 and $123,000, respectively, from Oracle Corporation for services it performed.

In addition to the companies affiliated with Lawrence J. Ellison, the Company enters into sales and purchases agreements with various companies that have a relationship with the Company's executive officers or members of the Company's board of directors. The relationships are typically an equity investment by the executive officer or board member in the customer / vendor company or the Company's executive officer or board member is a member of the customer / vendor company's board of directors. The Company has renewed the license agreements and sold additional services to these customers or purchased services from these vendors at various points in time. As of June 30, 2014, the Company 's accounts receivable related to these customers totaled $505,000. Below is a summary of transactions between the Company and related parties other than Mr. Ellison:

	Six Months Ended June 30,		Three Months Ended June 30,	
	2014	2013	2014	2013
	(dollars in thousands)			
Revenue earned from related party	$1,585	$934	$792	$372
Fees NetSuite paid for services	$352	$397	$278	$397

Additional related party transactions entered into prior to December 31, 2013 are described in the Notes to Consolidated Financial Statements included in the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2013 filed on March 3, 2014.

Table of Contents

Note 10. Subsequent Event

On July 17, 2014, the Company completed the purchase of all the outstanding equity of Venda Limited (“Venda"), a private company that provides Ecommerce solutions to its customers. Venda expands the Company’s European customer base and adds certain functionality to the Company's product suite. Beginning in the third quarter of 2014, Venda assets, liabilities and operating results will be reflected in the Company’s condensed consolidated financial statements from the date of acquisition. On the closing date, the Company paid $25.3 million in cash and issued 304,364 shares of the Company's common stock valued at approximately $24.0 million to the former owners. Of the $25.3 million in consideration paid, $10.1 million is being held in escrow for up to two years following the close of the transaction as protection against taxes and certain losses the Company may incur in the event of certain breaches of representations and warranties covered in the purchase agreement. In the third quarter of 2014, the Company expects to identify the third party transaction costs incurred in connection with the Venda business combination and complete the valuation of the Venda assets acquired and the liabilities assumed on the transaction close date.

Table of Contents

ITEM 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis is intended to provide greater details of our results of operations and financial condition and should be read in conjunction with our condensed consolidated financial statements and the notes thereto included elsewhere in this document and the discussion contained in our Annual Report on Form 10-K for the year ended December 31, 2013 as filed with the SEC on March 3, 2014. Certain statements in this Quarterly Report constitute forward-looking statements and as such, involve risks and uncertainties, as well as assumptions that, if they never materialize or prove incorrect, could cause our results to differ materially from those expressed or implied by such forward-looking statements. Such forward-looking statements include any expectation of earnings, revenues or other financial items; any statements of the plans, strategies and objectives of management for future operations; factors that may affect our operating results; statements concerning new products or services; statements related to adding employees; statements related to future capital expenditures; statements related to future economic conditions or performance; statements related to the integration of acquired companies; statements as to industry trends and other matters that do not relate strictly to historical facts or statements of assumptions underlying any of the foregoing. These statements are often identified by the use of words such as “anticipate,” “believe,” “continue,” “could,” “estimate,” “exp “intend,” “may,” or “will,” and similar expressions or variations. Such forward-looking statements are subject to risks, uncertainties and other factors that could cause actual results and the timing of certain events to differ materially from future results expressed or implied by such forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to those discussed in the section titled “Risk Factors” included in Item 1A of Part II of this Quarterly Report on Form 10-Q, and the risks discussed in our other SEC filings.

We urge you to consider these factors carefully in evaluating the forward-looking statements contained in this Quarterly Report on Form 10-Q. These statements are based on the beliefs and assumptions of our management based on information currently available to management. The forward-looking statements included in this Quarterly Report are made only as of the date of this Quarterly Report. All subsequent written or oral forward-looking statements attributable to our company or persons acting on our behalf are expressly qualified in their entirety by these cautionary statements. We do not undertake, and specifically disclaim, any obligation to update any forward-looking statements to reflect the occurrence of events or circumstances after the date of such statements except as required by law.

Overview

NetSuite Inc. ("NetSuite" or the "Company") is the industry's leading provider of cloud-based financials / Enterprise Resource Planning (“ERP”) and omnichannel commerce software suites. In addition to financials/ERP and omnichannel commerce software suites, we offer a broad suite of applications, including financial management, Customer Relationship Management (“CRM”), Ecommerce and retail management, Professional Services Automation (“PSA”) and Human Capital Management ("HCM") that enable companies to manage most of their core business operations in our single integrated suite. Our "real-time dashboard" technology provides an easy-to-use view into up-to-date, role-specific business information. We also offer customer support and professional services related to implementing and supporting our suite of applications. We deliver our suite over the Internet as a subscription service using the software-as-a-service ("SaaS") model.
Our headquarters are located in San Mateo, California. We were incorporated in California in September 1998 and reincorporated in Delaware in November 2007. We conduct our business worldwide, with international locations in Canada, the United Kingdom, Spain, the Czech Republic, Japan, Hong Kong, the Philippines, Singapore, Australia and Uruguay.

Key Components of Our Results of Operations

Revenue

We generate sales directly through our sales team and, to a lesser extent, indirectly through channel partners. We sell our service to customers across a broad spectrum of industries, and we have tailored our service for wholesalers/distributors, manufacturers, e-tailers, services companies and software companies. The primary target customers for our service are medium-sized businesses and divisions of large companies. An increasing percentage of our customers and our revenue have been derived from larger businesses within this market. For the six and three months ended June 30, 2014, we did not have any single customer that accounted for more than 3% of our revenue.

We are pursuing a number of strategies that we believe will enable us to continue to grow. The goals of those strategic objectives are to continue to move up market; to increase use of NetSuite as a platform; and to extend the verticalization of our

Table of Contents

product line. Although we have made progress towards our goals in recent periods, there are still many areas where we believe that we can continue to grow. To achieve these goals, we are focused on the following initiatives:

- Growth of sales of OneWorld, our platform for ERP, CRM and Ecommerce capabilities in multi-currency environments across multiple subsidiaries and legal entities, which supports the needs of large, standalone companies, and divisions of very large enterprises;
- Strengthening our offerings for targeted industries such as wholesale/distribution, manufacturing, e-tail, retail, technology and professional services by adding deeper verticalized functionality; and
- Developing our SuiteCloud ecosystem to enable third parties to extend our offerings with their vertical expertise or horizontal solution.

We experience competitive pricing pressure when our products are compared with solutions that address a narrower range of customer needs or are not fully integrated (for example, when compared with Ecommerce or CRM stand-alone solutions). In addition, since we sell primarily to medium-sized businesses, we also face pricing pressure in terms of the more limited financial resources or budgetary constraints of many of our target customers. We do not currently experience significant pricing pressure from competitors that offer a similar on-demand, integrated business management suite.

We sell our application suite pursuant to subscription agreements. For the most part, the duration of subscription and support agreements is 12 to 36 months. We rely in part on a large percentage of our customers to renew their agreements to drive our revenue growth. Our customers have no obligation to renew their subscriptions after the expiration of their subscription period.

We generally invoice our customers in advance in monthly, annual or quarterly installments, and typical payment terms provide that our clients pay us within 30 to 60 days of invoice. Amounts that have been invoiced where the customer has a legal obligation to pay are recorded in accounts receivable and deferred revenue. As of June 30, 2014, we had deferred revenue of $252.2 million.

Our subscription agreements provide service level commitments of 99.5% uptime per period, excluding scheduled maintenance. The failure to meet this level of service availability may require us to credit qualifying customers up to the value of an entire month of their subscription and support fees. In light of our historical experience with meeting our service level commitments, we have not accrued any liabilities on our balance sheet for these commitments.

As part of our overall growth, we expect the percentage of our revenue generated outside of the United States to increase as we invest in and enter new markets. Revenue by geographic region, based on the billing address of the customer, was as follows for the periods presented:

	Six Months Ended June 30,		Three Months Ended June 30,	
	2014	2013	2014	2013
	(dollars in thousands)			
United States	$192,064	$143,702	$100,401	$75,812
International	62,691	48,923	31,393	25,184
Total revenue	$254,755	$192,625	$131,794	$100,996
Percentage of revenue generated outside of the United States	25 %	25 %	24 %	25 %

Employees

The number of full-time employees as of June 30, 2014 was 2,762 as compared to 2,434 at December 31, 2013 and 2,138 at June 30, 2013. As of June 30, 2014, our headcount included 838 employees in sales and marketing; 1,002 employees in operations, professional services, training and customer support; 666 employees in product development; and 256 employees in a general and administrative capacity.

Cost of Revenue

Subscription and support cost of revenue primarily consists of costs related to hosting our application suite, providing customer support, data communications expenses, personnel and related costs of operations, stock-based compensation, software license fees, outsourced subscription services, costs associated with website development activities, allocated overhead, amortization expense associated with capitalized internal use software and acquired developed technology, and related plant and equipment depreciation and amortization expenses.

Professional services and other cost of revenue primarily consists of personnel and related costs for our professional services employees and executives, external consultants, stock-based compensation and allocated overhead.

We allocate overhead such as rent, information technology costs and employee benefit costs to all departments based on headcount. Recruiting costs are systematically allocated to the respective departments that utilize recruiting services during the period. As such, general overhead expenses are reflected in cost of revenue and each operating expense category.
We expect cost of revenue to increase in absolute dollars over the near term; however, it could fluctuate period to period depending on the growth of our professional services business.

Operating Expenses - Product Development

Product development expenses primarily consist of personnel and related costs for our product development employees and executives, including salaries, stock-based compensation, employee benefits and allocated overhead. Our product development efforts have been devoted primarily to increasing the functionality and enhancing the ease of use of our on-demand application suite, as well as localizing our product for international use. A key component of our strategy is to expand our business internationally. This will require us to conform our application suite to comply with local regulations and languages, causing us to incur additional expenses related to translation and localization of our application for use in other countries.

At our product development facility in the Czech Republic, we participate in a government program that subsidizes us for employing local residents. Under the program, the Czech government will reimburse us for certain operating expenses we incur. Since the first quarter of 2012, we have reduced our product development expenses for eligible operational expenses we expect the Czech government to reimburse. On a quarterly basis, we will accrue our expected subsidies for the duration of the program. During the second quarter of 2014, we began participating in a second subsidy program, similar in nature to the initial program, as benefits under the initial program reached the program limits in the first quarter of 2014.

We expect product development expenses to increase in absolute dollars as we continue to extend our service offerings internationally and as we expand and enhance our application suite technologies. Such expenses may vary due to the timing of these offerings and technologies.

Operating Expenses - Sales and Marketing

Sales and marketing expenses primarily consist of personnel and related costs for our sales and marketing employees and executives, including wages, benefits, bonuses, commissions and training, stock-based compensation, commissions paid to our channel partners, the cost of marketing programs such as on-line lead generation, promotional events, webinars and other meeting costs, amortization of intangible assets related to trade name and customer relationships and allocated overhead. We market and sell our application suite worldwide through our direct sales organization and indirect distribution channels such as strategic resellers. We capitalize and amortize our direct and channel sales commissions over the period the related revenue is recognized.
We expect to continue to invest in sales and marketing to pursue new customers and expand relationships with existing customers. As such, we expect our sales and marketing expenses to increase in terms of absolute dollars for the remainder of 2014.

Operating Expenses - General and Administrative

General and administrative expenses primarily consist of personnel and related costs for executive, finance, human resources and administrative personnel, stock-based compensation, legal and other professional fees, other corporate expenses and IT, facility and recruiting costs allocated to other departments.
We expect our general and administrative expenses to increase in terms of absolute dollars for the remainder of 2014.

Income Taxes

Table of Contents

Since inception, we have incurred annual operating losses and, accordingly, have not recorded a provision for income taxes for any of the periods presented other than provisions for state and foreign income taxes.

Critical Accounting Policies and Judgments

Our condensed consolidated financial statements are prepared in accordance with GAAP. The preparation of these condensed consolidated financial statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, costs and expenses and related disclosures. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances. In many instances, we could have reasonably used different accounting estimates, and in other instances changes in the accounting estimates are reasonably likely to occur from period-to-period. Accordingly, actual results could differ significantly from the estimates made by our management. To the extent that there are material differences between these estimates and actual results, our future financial statement presentation, financial condition, results of operations and cash flows will be affected.

In many cases, the accounting treatment of a particular transaction is specifically dictated by GAAP and does not require management's judgment in its application, while in other cases, significant judgment is required in selecting among available alternative accounting standards that allow different accounting treatment for similar transactions. We consider these policies requiring significant management judgment to be critical accounting policies. These critical accounting policies are:

- Revenue recognition;
- Internal use software and website development costs;
- Deferred commissions;
- Accounting for stock-based compensation; and
- Goodwill and other intangible assets

Effective the first quarter of 2014, we changed our methodology for estimating the expected term assumption used to determine employee stock option grant fair value. We changed from the simplified method to a historical data method because we believe we have sufficient data to estimate the stock option exercise period based on historical stock option activity and historical employee termination data.

Other than the change in determining the expected term assumption, there have been no significant changes in our critical accounting policies and estimates during the six months ended June 30, 2014 as compared to the critical accounting policies and estimates disclosed in "Management's Discussion and Analysis of Financial Condition and Results of Operations – Critical Accounting Policies and Judgments" included in our Annual Report on Form 10-K for the year ended December 31, 2013 filed on March 3, 2014. In addition, please see Note 2 of Notes to the Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q and Note 2 of the Notes to Consolidated Financial Statements included in our 2013 Annual Report on Form 10-K filed on March 3, 2014 for a description of our accounting policies.

Table of Contents

Results of Operations

Revenue, Cost of Revenue, Gross Profit and Gross Margin

Information about revenue, cost of revenue, gross profit and gross margin was as follows for the periods presented:

	Six Months Ended June 30,		Three Months Ended June 30,	
	2014	2013	2014	2013
	(dollars in thousands)			
Revenue:				
Subscription and support	$205,246	$154,199	$105,851	$80,239
Professional services and other	49,509	38,426	25,943	20,757
Total revenue	254,755	192,625	131,794	100,996
Cost of revenue (1):				
Subscription and support	33,444	25,826	17,084	13,511
Professional services and other	46,830	37,225	24,513	19,895
Total cost of revenue	80,274	63,051	41,597	33,406
Gross profit	$174,481	$129,574	$90,197	$67,590
Gross margin	68 %	67 %	68 %	67 %

(1) Includes stock-based compensation expense and amortization of intangible assets and severance and transaction costs associated with business combinations of:

Cost of revenue:				
Subscription and support	$3,837	$2,715	$1,851	$1,588
Professional services and other	4,799	4,298	2,317	2,452
	$8,636	$7,013	$4,168	$4,040

Six Months Ended June 30, 2014 as Compared to the Six Months Ended June 30, 2013

Revenue for the six months ended June 30, 2014 increased $62.1 million, or 32%, compared to the same period in 2013.

Subscription and support revenue: Subscription and support revenue for the six months ended June 30, 2014 increased $51.0 million, or 33%, compared to the same period in 2013. The increase was primarily the result of a $34.4 million increase in revenue resulting from the acquisition of new customers, and a $16.6 million increase in revenue from existing customers, both of which included the continued adoption of OneWorld.

Professional services and other revenue: Professional services and other revenue for the six months ended June 30, 2014 increased $11.1 million, or 29%, compared to the same period in 2013. The increase was primarily the result of a $24.3 million increase in revenue resulting from the acquisition of new customers. As we move up market to larger customers, the scope of our professional services engagements has increased resulting in an increase in demand for our professional services. Additionally, existing customers have purchased additional product modules which has also resulted in an increase in demand for our professional services. The increase in professional services and other revenue was partially offset by a $13.2 million decrease in revenue from existing customers related to services purchased in connection with the initial implementation of our product in 2013 that did not recur for those customers in 2014.

Revenue generated outside of the United States was $62.7 million, or 25%, of our total revenue for the six months ended June 30, 2014 as compared to $48.9 million, or 25%, for the same period in 2013. Revenue generated in the United States grew at higher rate than revenue outside of the United States except for in the United Kingdom.

Cost of revenue for the six months ended June 30, 2014 increased $17.2 million, or 27%, compared to the same period in 2013.

Table of Contents

Subscription and support cost of revenue: Subscription and support cost of revenue for the six months ended June 30, 2014 increased $7.6 million, or 29%, compared to the same period in 2013. The increase was primarily the result of a $4.4 million increase in data center production costs, a $2.4 million increase in personnel costs and a $874,000 increase in IT, facility and other operating expenses. Data center and other production costs increased due to an increase in support costs, depreciation, amortization of intangibles related to our 2013 business acquisitions, amortization of capitalized internal use software costs and other operational costs associated with an increase in our data center capacity and activity. Personnel costs increased due to an increase in headcount and incentive bonuses. IT, facility and other operating expenses related to our data center increased due to rising vendor costs and an increase in recruiting and other costs incurred to grow our business.

Professional services and other cost of revenue: Professional services and other cost of revenue for the six months ended June 30, 2014 increased $9.6 million, or 26%, compared to the same period in 2013. The increase was primarily the result of a $6.3 million increase in personnel costs, a $2.0 million increase in IT, facility and other operating expenses and a $1.3 million increase in fees related to outsourced consulting services. Personnel costs increased due to an increase in headcount and annual merit increases. Headcount increased as a result of an increase in the demand for our professional services. IT, facility, recruiting and other operating expenses related to our professional services increased by $2.0 million primarily due to our global expansion. The net increase in outsourced consulting fees resulted from professional service fees incurred to develop our professional services organization, partially offset by a decrease in other outside consultant costs.

Our gross margin increased to 68% during the six months ended June 30, 2014 from 67% during the same period in 2013. Our gross margin increased from the same period in 2013 primarily due to an increase in the average deal selling price and because our revenue growth rate for subscription services was higher than our revenue growth rate for professional services.

Three Months Ended June 30, 2014 as Compared to the Three Months Ended June 30, 2013

Revenue for the three months ended June 30, 2014 increased $30.8 million, or 30%, compared to the same period in 2013.
Subscription and support revenue: Subscription and support revenue for the three months ended June 30, 2014 increased $25.6 million, or 32%, compared to the same period in 2013. The increase was primarily the result of a $16.9 million increase in revenue resulting from the acquisition of new customers, the continued adoption of OneWorld and a $8.7 million increase in revenue from existing customers.

Professional services and other revenue: Professional services and other revenue for the three months ended June 30, 2014 increased $5.2 million, or 25%, compared to the same period in 2013. The increase was primarily the result of a $12.1 million increase in revenue resulting from the acquisition of new customers. As we move up market to larger customers, the scope of our professional services engagements has increased resulting in an increase in demand for our professional services. Additionally, existing customers have purchased additional product modules, which has also resulted in an increase in demand for our professional services. The increase in professional services and other revenue was partially offset by a $6.9 million decrease in revenue from existing customers related to services purchased in connection with the initial implementation of our product in 2013 that did not recur for those customers in 2014.

Revenue generated outside of the United States was $31.4 million, or 24%, of our total revenue for the three months ended June 30, 2014 as compared to $25.2 million, or 25%, for the same period in 2013. Revenue generated in the United States grew at higher rate than revenue outside of the United States except for in the United Kingdom.

Cost of revenue for the three months ended June 30, 2014 increased $8.2 million, or 25%, compared to the same period in 2013.

Subscription and support cost of revenue: Subscription and support cost of revenue for the three months ended June 30, 2014 increased $3.6 million, or 26%, compared to the same period in 2013. The increase was primarily the result of a $2.1 million increase in data center production costs, a $1.0 million increase in personnel costs and a $486,000 increase in IT, facility and other operating expenses. Data center and other production costs increased due to an increase in support costs, depreciation, amortization of intangibles related to our 2013 business acquisitions, amortization of capitalized internal use software costs and other operational costs associated with an increase in our data center capacity and activity. Personnel costs increased due to an increase in headcount and incentive bonuses. IT, facility and other operating expenses related to our data center increased due to rising vendor costs and an increase in recruiting and other costs incurred to grow our business.

Professional services and other cost of revenue: Professional services and other cost of revenue for the three months ended June 30, 2014 increased $4.6 million, or 23%, compared to the same period in 2013. The increase was primarily the

Table of Contents

result of a $3.3 million increase in personnel costs and a $1.3 million increase in IT, facility and other operating expenses. Personnel costs increased due to an increase in headcount, annual merit increases and incentive bonuses. Headcount increased as a result of an increase in the demand for our professional services. IT, facility and other operating expenses related to our professional services increased due to rising vendor costs and an increase in recruiting and other costs incurred to grow our business. The net increase in outsourced consulting fees resulted from professional service fees incurred to develop our professional services organization, partially offset by a decrease in other outside consultant costs.

Our gross margin increased to 68% during the three months ended June 30, 2014 from 67% during the same period in 2013. Our gross margin increased from the same period in 2013 primarily due to an increase in the average deal selling price and because our revenue growth rate for subscription services was higher than our revenue growth rate for professional services.

Operating Expenses

Operating expenses were as follows for the periods presented:

	Six Months Ended June 30,					
	2014			2013		
	Amount	% of revenue		Amount	% of revenue	
	(dollars in thousands)					
Operating expenses (1):						
Product development	$49,548	19	%	$35,446	18	%
Sales and marketing	133,406	52	%	100,712	52	%
General and administrative	28,139	11	%	25,174	13	%
Total operating expenses	$211,093	83	%	$161,332	84	%

	Three Months Ended June 30,					
	2014			2013		
	Amount	% of revenue		Amount	% of revenue	
	(dollars in thousands)					
Operating expenses (1):						
Product development	$25,376	19	%	$18,796	19	%
Sales and marketing	69,726	53	%	53,960	53	%
General and administrative	14,106	11	%	13,429	13	%
Total operating expenses	$109,208	83	%	$86,185	85	%

(1) Includes stock-based compensation expense, amortization of acquisition-related intangible assets and severance and transaction costs associated with business combinations as follows:

	Six Months Ended June 30,		Three Months Ended June 30,	
	2014	2013	2014	2013
	(dollars in thousands)			
Product development	$13,460	$11,190	$6,884	$6,342
Sales and marketing	16,796	12,554	9,087	7,379
General and administrative	9,422	9,559	4,683	5,613
Total	$39,678	$33,303	$20,654	$19,334

Six Months Ended June 30, 2014 as Compared to the Six Months Ended June 30, 2013

Product development expenses for the six months ended June 30, 2014 increased $14.1 million, or 40%, as compared to the same period in 2013. The increase was primarily the result of a $10.8 million increase in personnel costs resulting from an increase in headcount, annual salary increases, payroll tax increases and an increase in stock-based compensation. The increase in personnel costs includes a $2.2 million increase in stock-based compensation resulting primarily from the issuance of annual employee equity awards and equity grants to new hires. Additionally, IT, facility and other operating expenses related to our product development increased by $3.3 million due to an increase in outsourced product development services costs associated with our global expansion, data center costs incurred in connection with our product development and a decrease in government subsidies from the Czech Republic.

Sales and marketing expenses for the six months ended June 30, 2014 increased $32.7 million, or 32%, as compared to the same period in 2013. The increase was primarily the result of a $26.2 million increase in personnel costs, a $2.7 million increase in sales related expenses, a $2.1 million increase in IT, facility and recruiting costs, and $1.7 million increase in marketing and other operating expenses. The increase in personnel costs related primarily to increases in commission and payroll expenses resulting from higher sales and an increase in headcount. Additionally, personnel costs include a $3.6 million increase in stock-based compensation resulting primarily from the issuance of annual equity awards and grants to new employees. Sales related costs increased due to outsourced consulting service fees incurred to increase customer demand and an increase in amortization expenses resulting from customer relationship and trade name intangible assets acquired through our business acquisitions in 2013. IT, facility and recruiting costs increased by $2.1 million due to an increase in costs associated with our global expansion while marketing and other operating expenses increased due to our annual user conference, trade shows and product branding.

General and administrative expenses for the six months ended June 30, 2014 increased $3.0 million, or 12%, as compared to the same period in 2013. The increase was primarily the result of a $2.6 million increase in personnel costs and a $445,000 increase in other operational costs. The increase in personnel costs resulted from an increase in headcount, an increase in incentive pay and other personnel costs. Additionally, personnel costs include a $1.4 million increase in stock-based compensation costs resulting primarily from the issuance of annual equity awards and equity awards to new employees. Other operating expenses such as IT, facility and recruiting costs increased $1.1 million due to our global expansion. These cost increases were partially offset by a $669,000 decrease in business combination transaction costs because we acquired two companies during the first six months of 2013, but did not have similar transactions during the same period in 2014.

Three Months Ended June 30, 2014 as Compared to the Three Months Ended June 30, 2013

Product development expenses for the three months ended June 30, 2014 increased $6.6 million, or 35%, as compared to the same period in 2013. The increase was primarily the result of a $4.9 million increase in personnel costs resulting from an increase in headcount, annual salary increases, payroll tax increases and an increase in stock-based compensation. The increase in personnel costs includes a $501,000 increase in stock-based compensation resulting primarily from the issuance of annual equity awards to a larger employee base. Additionally, IT, facility and other operating expenses related to our product development increased by $1.7 million due to an increase in costs associated with our global expansion, data center production costs incurred in connection with our product development and a decrease in government subsidies from the Czech Republic.

Sales and marketing expenses for the three months ended June 30, 2014 increased $15.8 million, or 29%, as compared to the same period in 2013. The increase was primarily the result of a $12.4 million increase in personnel costs, a $1.2 million increase in sales related expenses, a $1.2 million increase in marketing and other operating expenses and a $1.0 million increase in IT, facility and recruiting costs. The increase in personnel costs related primarily to increases in commission and payroll expenses resulting from higher sales and an increase in headcount. Additionally, personnel costs include a $1.5 million increase in stock-based compensation resulting primarily from the issuance of annual equity awards and grants to new employees. Sales related costs increased due to outsourced consulting service fees incurred to increase customer demand and an increase in amortization expenses resulting from customer relationship and trade name intangible assets acquired through our business acquisitions in 2013. IT, facility and recruiting costs increased due to an increase in costs associated with our global expansion while marketing and other operating expenses increased due to our annual user conference, trade shows and product branding.

General and administrative expenses for the three months ended June 30, 2014 increased $677,000, or 5%, as compared to the same period in 2013. The increase was primarily the result of a $684,000 increase in personnel costs. The increase in personnel costs resulted from an increase in headcount, an increase in incentive pay and other personnel costs. Additionally, personnel costs includes a $334,000 increase in stock-based compensation costs resulting primarily from the

Table of Contents

issuance of annual equity awards and equity awards to new employees. During the three months ended June 30, 2014, business combination transaction costs incurred remained constant with the prior year as we continue to evaluate businesses to acquire.

Non-operating Items

Non-operating items, including interest income and expense, other expense, net and income taxes were as follows for the periods presented:

	Six Months Ended June 30,			
	2014		2013	
	Amount	% of revenue	Amount	% of revenue
	(dollars in thousands)			
Interest income	$55	— %	$40	— %
Interest expense	(7,042)	(3)%	(1,427)	(1)%
Other expense, net	(309)	— %	(182)	— %
Provision for income taxes	1,489	1 %	100	— %

	Three Months Ended June 30,			
	2014		2013	
	Amount	% of revenue	Amount	% of revenue
	(dollars in thousands)			
Interest income	$36	— %	$18	— %
Interest expense	(3,542)	(3)%	(1,323)	(1)%
Other expense, net	(199)	— %	(39)	— %
Provision for income taxes	448	— %	451	— %

In connection with the issuance of $310.0 million in aggregate principal amount of 0.25% convertible senior notes in June 2013, our interest costs have increased significantly. During the six and three months ended June 30, 2014, interest expense increased by $5.5 million and $2.2 million, respectively, because the convertible notes were outstanding for the full six months of 2014 compared to one month during the same period in 2013.

In connection with the acquisition of WH in the first quarter of 2013, we recorded $1.1 million in federal deferred income tax liabilities which resulted in a corresponding decrease in our income tax provision during the quarter. A similar transaction did not occur in 2014.

Liquidity and Capital Resources

As of June 30, 2014, our primary sources of liquidity were our cash and cash equivalents totaling $479.2 million and $90.0 million in accounts receivable, net of allowance.

In the six months ended June 30, 2014, cash flows from operations were $37.7 million.

As of June 30, 2014, restricted cash consisted of $38,000 classified as other current assets. As of December 31, 2013, restricted cash was $753,000. Of the $753,000 restricted cash balance as of December 31, 2013, $38,000 was classified as other current assets and $715,000 was classified as long-term other assets. These restricted cash accounts secure letters of credit applied against certain of the Company’s facility lease agreements.

As of June 30, 2014, we had an accumulated deficit of $494.6 million. We have funded this deficit primarily through the net proceeds raised from the sale of our capital stock, issuance of convertible debt and proceeds from operations.

Table of Contents

A summary of our cash flow activities was as follows for the periods presented:

	Six Months Ended June 30,	
	2014	2013
	(dollars in thousands)	
Net cash provided by operating activities	$37,716	$30,261
Net cash used in investing activities	(11,375)	(41,410)
Net cash provided by financing activities	823	281,311
Effect of exchange rate changes on cash and cash equivalents	450	(1,126)
Net change in cash and cash equivalents	$27,614	$269,036

Cash provided by operating activities was driven by sales of our application suite offset by costs incurred to deliver that service. The timing of our billings and collections relating to our sales and the timing of the payment of our liabilities have a significant impact on our cash flows. Cash flows from operations increased during the six months ended June 30, 2014 as compared to the same period in 2013, primarily as a result of an increase in collections from customers and the timing of payments to vendors, partially offset by an increase in commissions paid.

Cash used in investing activities during the six months ended June 30, 2014 decreased from the same period in 2013 primarily due to a $22.4 million cash payment, net of cash acquired, for the acquisition of OrderMotion in the second quarter of 2013, a $9.9 million cash payment, net of cash acquired, for the acquisition of WH and a $500,000 equity investment in a small Ecommerce company in the first quarter of 2013 with no similar transactions in 2014. This decrease was partially offset by a $3.3 million increase in capital expenditures for property and equipment.

Cash provided by financing activities for the six months ended June 30, 2014 decreased from the same period in 2013 due to $272.3 million in net proceeds received from the issuance of $310.0 million at par value of 0.25% convertible senior notes and the repurchase of $30.0 million of our common stock in June 2013, a $6.1 million decrease in proceeds received from employee stock option exercises and $2.3 million in payments to the former owners of businesses acquired in late 2012 and 2013.

We intend to use our cash for general corporate purposes, including potential future acquisitions or other transactions. Further, we expect to incur additional expenses in connection with our international expansion. We believe that our cash and cash equivalents are adequate to fund those potential or anticipated activities.

While we believe that our uncommitted current working capital and anticipated cash flows from operations will be adequate to meet our cash needs for daily operations and capital expenditures for at least the next 12 months, we may elect to raise additional capital through the sale of additional equity or debt securities, obtain a credit facility or sell certain assets. If additional funds are raised through the issuance of additional debt securities, these securities could have rights, preferences and privileges senior to holders of common stock or holders of the convertible notes, and terms of any debt could impose restrictions on our operations. The sale of additional equity or convertible debt securities could result in additional dilution to our stockholders and additional financing may not be available in amounts or on terms acceptable to us. If additional financing becomes necessary and we are unable to obtain the additional funds, we may be required to reduce the scope of our planned product development and marketing efforts, potentially harming our business, financial condition and operating results.

Off Balance Sheet Arrangements and Contractual Obligations

During the six months ended June 30, 2014 and 2013, we did not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off balance sheet arrangements or other contractually narrow or limited purposes.

During the six months ended June 30, 2014, we entered into various office space leases to expand our operations within the United States, the Czech Republic and Australia. The corresponding lease terms for these agreements expire at

Table of Contents

various dates through 2021. We will pay a total of $7.4 million, net of any lessor lease incentives, over the corresponding lease terms.

ITEM 3. Quantitative and Qualitative Disclosures about Market Risk

Interest Rate Sensitivity

We had cash and cash equivalents of $479.2 million as of June 30, 2014. These amounts were held primarily in money market funds.

Cash and cash equivalents are held for working capital purposes, and restricted cash amounts are held as security against various lease obligations. Due to the short term nature of these investments, we believe 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.

Market Risk

In June 2013, we issued at par value $310.0 million of 0.25% convertible senior notes due June 1, 2018. The Notes have a fixed annual interest rate of 0.25% and we, therefore, do not have economic interest rate exposure on the Notes. However, the value of the Notes is exposed to interest rate risk. Generally, the fair value of the Notes will increase as interest rates fall and decrease as interest rates rise. These Notes are also affected by volatility in our common stock price. As of June 30, 2014, the fair value of the Notes was $318.8 million.

Foreign Currency Risk

Our results of operations and cash flows are subject to fluctuations due to changes in foreign currency exchange rates, particularly changes in the British Pound Sterling, Canadian Dollar, Japanese Yen, Australian Dollar, Philippine Peso, Uruguayan Peso and the Czech Crown. Our revenue is generally denominated in the local currency of the contracting party. The majority of our invoicing relates to sales occurring in the United States and therefore is denominated in U.S. dollars. A certain percentage of sales are denominated in foreign currencies including, but not limited to, the local currencies of Australia, the United Kingdom and Canada. Our expenses are incurred primarily in the United States, Canada, the Philippines, Australia and the United Kingdom, with a small portion of expenses incurred in other countries where our international sales, development and operations offices are located. Our results of operations and cash flows are, therefore, subject to fluctuations due to changes in foreign currency exchange rates. During the six and three months ended June 30, 2014, the U.S. dollar strengthened by 2.4% and 1.5%, respectively, against the foreign currencies which our invoicing and operational expenses are denominated in when compared to the same period in the prior year. For the six and three months ended June 30, 2014, the fluctuation in foreign currency rates reduced our net losses by approximately $1.7 million and $522,000, respectively.

During the six and three months ended June 30, 2014, we continued a hedging program to limit the exposure of foreign currency risk resulting from the revaluation of foreign denominated assets and liabilities through the use of forward exchange contracts. See “Balance Sheet Hedging - Hedging of Foreign Currency Assets and Liabilities” in Note 3 (Financial Instruments) under the heading “Notes to Condensed Consolidated Financial Statements” of Part 1, Item 1, “Financial Statements” herein for further disclosures.

Fair Value of Financial Instruments

We do not have material exposure to market risk with respect to investments, as our investments consist primarily of highly liquid investments purchased with a remaining maturity of three months or less. We do not use derivative financial instruments for speculative or trading purposes. However, this does not preclude our adoption of specific hedging strategies in the future.

ITEM 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

An evaluation was performed by management, with the participation of our Chief Executive Officer ("CEO") and our Chief Financial Officer (“CFO”), with respect to the effectiveness of our disclosure controls and procedures as of June 30, 2014 (as defined in Rules 13a-15(e) and 15d - 15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Disclosure controls and procedures are controls and procedures that are designed to ensure that information required to be

Table of Contents

disclosed in our reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. Based on that evaluation, our CEO and CFO have concluded that as of June 30, 2014, our disclosure controls and procedures are effective, provide reasonable assurance that information required to be disclosed by us in reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified by the SEC's rules and forms, and that such information is accumulated and communicated to management including the CEO and CFO, as appropriate, to allow timely decisions regarding required disclosures.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting during our most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Inherent Limitations of Internal Controls

Our management, including our CEO and CFO, does not expect that our disclosure controls and procedures or our internal controls will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of a simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, controls may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and may not be detected.

PART II – OTHER INFORMATION

ITEM 1. Legal Proceedings

We are involved in various legal proceedings and receive claims from time to time, arising from the normal course of business activities. We have accrued for estimated losses in the accompanying condensed consolidated financial statements for matters with respect to which we believe the likelihood of an adverse outcome is probable and the amount of the loss is reasonably estimable.

ITEM 1A. Risk Factors

A description of the risks and uncertainties associated with our business is set forth below. This description includes any material changes to and supersedes the description of the risks and uncertainties associated with our business previously disclosed in Part I, Item 1A of our Annual Report on Form 10-K for the fiscal year ended December 31, 2013 filed on March 3, 2014. You should carefully consider such risks and uncertainties, together with the other information contained in this report, our Annual Report on Form 10-K for the fiscal year ended December 31, 2013 and in our other public filings. If any of such risks and uncertainties actually occurs, our business, financial condition or operating results could differ materially from the plans, projections and other forward-looking statements included in the section titled "Management's Discussion and Analysis of Financial Condition and Results of Operations" and elsewhere in this report and in our other public filings. In addition, if any of the following risks and uncertainties, or if any other risks and uncertainties, actually occurs, our business, financial condition or operating results could be harmed substantially, which could cause the market price of our stock to decline, perhaps significantly.

Table of Contents

Risks Related to Our Business

Continued adverse economic conditions or reduced investments in cloud-based applications and information technology spending may harm our business.

Our business depends on the overall demand for cloud-based applications and information technology spending and on the economic health and general willingness of our current and prospective customers to make capital commitments. If the conditions in the U.S. and global economic environment remain uncertain or continue to be volatile, or if they deteriorate further, our business, operating results, and financial condition may be materially adversely affected. Continued weak or volatile economic conditions, or a reduction in spending for cloud-based applications and information technology even if economic conditions improve, would likely harm our business and operating results in a number of ways, including longer sales cycles, extended payment terms, lower prices for our products and services, reduced sales, and lower customer retention rates.

We have a history of losses, and we may not achieve profitability in the future.

We have not been profitable on a generally accepted accounting principles ("GAAP") basis during any quarterly or annual period since our formation. We experienced a net loss of $45.4 million for the six months ended June 30, 2014. As of that date, our accumulated deficit was $494.6 million. We expect to make significant future expenditures related to the development and expansion of our business. As a result of these increased expenditures, we will have to generate and sustain increased revenue to achieve and maintain future profitability. While historically our revenue has grown, this growth may not be sustainable and we may not achieve sufficient revenue to achieve or maintain profitability. We may incur significant losses in the future for a number of reasons, including due to the other risks described in this Quarterly Report, and we may encounter unforeseen expenses, difficulties, complications and delays and other unknown factors. Accordingly, we may not be able to achieve or maintain profitability and we may continue to incur significant losses for the foreseeable future.

Many of our customers are small- and medium sized businesses and divisions of large companies, which may result in increased costs as we attempt to reach, acquire and retain customers.
We market and sell our application suite to small- and medium-sized businesses and divisions of large companies. To grow our revenue quickly, we must add new customers, sell additional services to existing customers and encourage existing customers to renew their subscriptions. However, selling to and retaining small- and medium-sized businesses can be more difficult than selling to and retaining large enterprises because small- and medium-sized business customers:

•are more price sensitive;
•are more difficult to reach with broad marketing campaigns;
•have high churn rates in part because of the nature of their businesses;
•often lack the staffing to benefit fully from our application suite's rich feature set; and
•often require higher sales, marketing and support expenditures by vendors that sell to them per revenue dollar generated for those vendors.

If we are unable to cost effectively market and sell our service to our target customers, our ability to grow our revenue and become profitable will be harmed.

Our business depends substantially on customers renewing, upgrading and expanding their subscriptions for our services. Any decline in our customer renewals, upgrades and expansions would harm our future operating results.
We sell our application suite pursuant to service agreements that are generally one year in length. Our customers have no obligation to renew their subscriptions after their subscription period expires, and they may not renew their

subscriptions at the same or higher levels. Moreover, under specific circumstances, our customers have the right to cancel their service agreements before they expire. In addition, in the first year of a subscription, customers often purchase a higher level of professional services than they do in renewal years. As a result, our ability to grow is dependent in part on customers purchasing additional subscriptions and modules after the first year of their subscriptions. We may not accurately predict future trends in customer renewals. Our customers' renewal rates may decline or fluctuate because of several factors, including their satisfaction or dissatisfaction with our services, the prices of our services, the prices of services offered by our competitors or reductions in our customers' spending levels due to the macroeconomic environment or other factors. If our customers do not renew their subscriptions for our services, renew on less favorable terms, or do not purchase additional functionality or subscriptions, our revenue may grow more slowly than expected or decline and our profitability and gross margin may be harmed.

Any disruption of service at our data centers could interrupt or delay our ability to deliver our service to our customers.

We host our services, serve our customers and support our operations primarily from California-based data centers, which we operate in conjunction with CenturyLink. However, we host our OpenAir applications from a Massachusetts-based data center, which we also operate in conjunction with CenturyLink. We also operate some customer and partner accounts along with Release Preview and trial accounts from a Massachusetts-based data center, which we operate in conjunction with CenturyLink. The OrderMotion applications are hosted from a Texas-based datacenter which we operate in conjunction with RackSpace. The Element Fusion applications are hosted from a datacenter which we operate in conjunction with SoftLayer. The Tribe HR applications are hosted from a Canada-based datacenter which we operate in conjunction with VM Farms. We

Table of Contents

do not have sole control over the operations of these facilities. These facilities are vulnerable to damage or interruption from earthquakes, hurricanes, floods, fires, cyber security attacks, terrorist attacks, power losses, telecommunications failures and similar events. The occurrence of a natural disaster or an act of terrorism, a decision to close the facilities without adequate notice or other unanticipated problems could result in lengthy interruptions in our services. As part of our current disaster recovery arrangements, our customer data in our California-based data center production environment is replicated to a data center operated in conjunction with CenturyLink located on the East coast of the United States. In particular, our California-based data facilities are located in an area known for seismic activity, increasing our susceptibility to the risk that an earthquake could significantly harm the operations of these facilities. Likewise, facilities operated on the East coast of the United States are susceptible to hurricanes, winter storms and other regionally disruptive events. The facilities also could be subject to break-ins, computer viruses, sabotage, intentional acts of vandalism and other misconduct.

Our data center facilities providers have no obligations to renew their agreements with us on commercially reasonable terms, or at all. If we are unable to renew our agreements with the facilities providers on commercially reasonable terms, if our agreements with our facility providers are prematurely terminated, or if in the future we add additional data center facility providers, we may experience costs or downtime in connection with the transfer to, or the addition of, new data center facilities.

Any errors, defects, disruptions or other performance problems with our services could harm our reputation and may damage our customers' businesses. Interruptions in our services might reduce our revenue, cause us to issue credits to customers, subject us to potential liability, cause customers to terminate their subscriptions and harm our renewal rates.

We may become liable to our customers and lose customers if we have defects or disruptions in our service or if we provide poor service.

Because we deliver our application suite as a service, errors or defects in the software applications underlying our service, or a failure of our hosting infrastructure, may make our service unavailable to our customers. We are also reliant on third-party software and infrastructure, including the infrastructure of the Internet, to provide our services. Any failure of or disruption to this software and infrastructure could also make our service unavailable to our customers. Since our customers use our suite to manage critical aspects of their business, any errors, defects, disruptions in service or other performance problems with our suite, whether in connection with the day to day operation of our suite, upgrades or otherwise, could damage our customers' businesses. If we have any errors, defects, disruptions in service or other performance problems with our suite, customers could elect not to renew, or delay or withhold payment to us, we could lose future sales or customers may make warranty claims against us, which could result in an increase in our provision for doubtful accounts, an increase in collection cycles for accounts receivable or costly litigation.

The market for cloud-based applications may develop more slowly than we expect.

Our success will depend, to a large extent, on the willingness of medium-sized businesses to accept cloud-based services for applications that they view as critical to the success of their business. Many companies have invested substantial effort and financial resources to integrate traditional enterprise software into their businesses and may be reluctant or unwilling to switch to a different application or to migrate these applications to cloud-based services. Other factors that may affect market acceptance of our application include:

- the security capabilities, reliability and availability of cloud-based services;
- customer concerns with entrusting a third party to store and manage their data, especially confidential or sensitive data;
- our ability to minimize the time and resources required to implement our suite;
- our ability to maintain high levels of customer satisfaction;
- our ability to implement upgrades and other changes to our software without disrupting our service;
- the level of customization or configuration we offer;
- our ability to provide rapid response time during periods of intense activity on customer websites; and
- the price, performance and availability of competing products and services.

The market for these services may not develop further, or may develop more slowly than we expect, either of which would harm our business.

If our security measures are breached and unauthorized access is obtained to a customer's data, we may incur significant liabilities, our service may be perceived as not being secure and customers may curtail or stop using our suite.

The services we offer involve the storage of large amounts of our customers' sensitive and proprietary information. If our security measures are breached as a result of third party action, employee error, malfeasance or otherwise, and someone disrupts the confidentiality, integrity, or availability our customers' data, we could incur significant liability to our customers and to individuals or businesses whose information was being stored by our customers, our business may suffer and our reputation will be damaged. Because techniques used to obtain unauthorized access to, or to sabotage, systems change frequently and generally are not recognized until launched against a target, we may be unable to anticipate these techniques or to implement adequate preventive measures. If an actual or perceived breach of our security occurs, the market perception of the effectiveness of our security measures could be harmed and we could lose sales and customers. Such an actual or perceived breach could also cause a significant and rapid decline in our stock price and the value of our convertible senior notes (the "Notes").

Table of Contents

We provide service-level commitments to our customers, which could cause us to issue credits for future services if the stated service levels are not met for a given period and could significantly harm our revenue.

Our customer agreements provide service-level commitments. If we are unable to meet the stated service-level commitments or suffer extended periods of unavailability for our service, we may be contractually obligated to provide these customers with credits for future services. Our revenue could be significantly impacted if we suffer unscheduled downtime that exceeds the allowed downtimes under our agreements with our customers. In light of our historical experience with meeting our service-level commitments, we do not currently have any liabilities on our balance sheet for these commitments. Our service-level commitment to customers is 99.5% uptime per period, excluding scheduled maintenance. The failure to meet this level of service availability may require us to credit qualifying customers for the value of an entire month of their subscription fees, not just the value of the subscription fee for the period of the downtime. As a result, a failure to deliver services for a relatively short duration could cause us to issue these credits to all qualifying customers. Any extended service outages could harm our reputation, revenue and operating results.

Assertions by a third party that we infringe its intellectual property, whether successful or not, could subject us to costly and time consuming litigation or expensive licenses.

The software and technology industries are characterized by the existence of a large number of patents, copyrights, trademarks and trade secrets and by frequent and an increasing amount of litigation based on allegations of infringement or other violations of intellectual property rights. We have from time to time received claims from third parties alleging we are infringing their intellectual property, and as we continue to grow, the possibility of these and other intellectual property rights claims against us may increase. Our technologies or technologies that we license may not be able to withstand any third party claims that they infringe or otherwise violate intellectual property rights. Furthermore, many of our service agreements require us to indemnify our customers for certain third party intellectual property infringement claims, which could increase our costs as a result of defending such claims and may require that we pay damages if there were an adverse ruling related to any such claims. These types of claims could harm our relationships with our customers, may deter future customers from subscribing to our services or could expose us to litigation for these claims. Even if we are not a party to any litigation between a customer and a third party, an adverse outcome in any such litigation could make it more difficult for us to defend our intellectual property in any subsequent litigation in which we are a named party.

Any intellectual property rights claim against us or our customers, with or without merit, could be time consuming, expensive to litigate or settle and could divert management attention and financial resources. An adverse determination also could prevent us from offering our suite to our customers and may require that we procure or develop substitute services that do not infringe.

For any intellectual property rights claim against us or our customers, we may have to pay damages, license fees and/or stop using technology found to be in violation of a third party's rights. We may have to seek a license for the technology. Such license may not be available on reasonable terms, if at all, and may significantly increase our operating expenses or may require us to restrict our business activities and limit our ability to deliver certain products and services. As a result, we may also be required to develop alternative non infringing technology, which could require significant effort and expense and/or cause us to alter our product and service offerings which could negatively affect our business.

Our success depends in large part on our ability to protect and enforce our intellectual property rights.

We rely on a combination of patent, copyright, service mark, trademark and trade secret laws, as well as confidentiality procedures and contractual restrictions, to establish and protect our proprietary rights, all of which provide only limited protection. We have numerous issued US patents and pending US patent applications. We cannot assure you that any patents will issue from our currently pending patent applications in a manner that gives us the protection that we seek, if at all, or that any of our current patents or future patents issued to us will not be challenged, invalidated or circumvented. Any of our current patents or patents that may issue in the future from pending or future patent applications may not provide sufficiently broad protection or they may not prove to be enforceable in actions against alleged infringers. Additionally, although we have licensed from other parties proprietary technology covered by patents, we cannot be certain that any such patents will not be challenged, invalidated or circumvented. Also, we cannot assure you that any future service mark or trademark registrations will be issued for pending or future applications or that any registered service marks or trademarks will be enforceable or provide adequate protection of our proprietary rights.

We endeavor to enter into agreements with our employees and contractors and agreements with parties with whom we do business to limit access to and disclosure of our proprietary information. The steps we have taken, however, may not prevent unauthorized use or the reverse engineering of our technology. Moreover, others may independently develop technologies that are competitive to ours or infringe our intellectual property. Enforcement of our intellectual property rights also depends on our successful legal actions against these infringers, but these actions may not be successful, even when our rights have been infringed.

Furthermore, effective patent, trademark, service mark, copyright and trade secret protection may not be available in every country in which our services are available. In addition, the legal standards relating to the validity, enforceability and scope of protection of intellectual property rights in Internet related industries are uncertain and still evolving.

Table of Contents

Our quarterly and annual operating results may fluctuate in the future. As a result, we may fail to meet or exceed the expectations of research analysts or investors, which could cause our stock price to decline.

Our quarterly and annual operating results may fluctuate as a result of a variety of factors, many of which are outside of our control. A decline in general macroeconomic conditions could adversely affect our customers' ability or willingness to purchase our application suite, which could adversely affect our operating results or financial outlook. Fluctuations in our quarterly operating annual results or financial outlook may also be due to a number of additional factors, including the risks and uncertainties discussed elsewhere in this report.

Fluctuations in our operating results could cause our stock price to decline rapidly, may lead analysts to change their long term model for valuing our common stock, may impact our ability to retain or attract key personnel, or may cause other unanticipated issues. If our operating results or financial outlook fall below the expectations of research analysts or investors, the price of our common stock and the market value of the Notes could decline substantially.

We believe that our revenue and operating results may vary significantly in the future and that period to period comparisons of our operating results may not be meaningful. You should not rely on the results of one quarter as an indication of future performance.

The markets in which we compete are intensely competitive, and if we do not compete effectively, our operating results may be harmed.

The markets for financials/ERP, CRM, Ecommerce, PSA and HCM applications are intensely competitive and rapidly changing with relatively low barriers to entry. With the introduction of new technologies and market entrants, we expect competition to intensify in the future. In addition, pricing pressures and increased competition generally could result in reduced sales, reduced margins or the failure of our service to achieve or maintain more widespread market acceptance. Often we compete to sell our application suite against existing systems that our potential customers have already made significant expenditures to install. Competition in our market is based principally upon service breadth and functionality; service performance, security and reliability; ability to tailor and customize services for a specific company, vertical or industry; ease of use of the service; speed and ease of deployment, integration and configuration; total cost of ownership, including price and implementation and support costs; professional services implementation; and financial resources of the vendor.

We face competition from both traditional software vendors and SaaS providers. Our principal competitors include Epicor Software Corporation, Intuit Inc., Microsoft Corporation, Oracle Corporation, SAP, The Sage Group plc and salesforce.com, inc. Many of our actual and potential competitors enjoy substantial competitive advantages over us, such as greater name recognition, longer operating histories, more varied products and services and larger marketing budgets, as well as substantially greater financial, technical and other resources. In addition, many of our competitors have established marketing relationships and access to larger customer bases, and have major distribution agreements with consultants, system integrators and resellers. If we are not able to compete effectively, our operating results will be harmed.

Our brand name and our business may be harmed by aggressive marketing strategies of our competitors.

Because of the early stage of development of our markets, we believe that building and maintaining brand recognition and customer goodwill is critical to our success. Our efforts in this area have, on occasion, been complicated by the marketing efforts of our competitors, which may include incomplete, inaccurate and false statements about our company and our services that could harm our business. Our ability to respond to our competitors' misleading marketing efforts may be limited under certain circumstances by legal prohibitions on permissible public communications by us as a public company.

If the prices we charge for our services are unacceptable to our customers, our operating results will be harmed.

As the market for our services matures, or as new competitors introduce new products or services that compete with ours, we may be unable to renew our agreements with existing customers or attract new customers at the same price or based on the same pricing model as previously used. As a result, it is possible that competitive dynamics in our market may require us to change our pricing model or reduce our prices, which could harm our revenue, gross margin and operating results.

If we are unable to develop new services or sell our services into new markets, our revenue growth will be harmed and we may not be able to achieve profitability.

Our ability to attract new customers and increase revenue from existing customers will depend in large part on our ability to enhance and improve our existing application suite and to introduce new services and sell into new markets. The success of any enhancement or new service depends on several factors, including the timely completion, introduction and market acceptance of the enhancement or service. Any new service we develop or acquire may not be introduced in a timely or cost effective manner and may not achieve the broad market acceptance necessary to generate significant revenue. Any new markets into which we attempt to sell our application, including new vertical markets and new countries or regions, may not be receptive. If we are unable to successfully develop or acquire new services, enhance our existing services to meet customer requirements or sell our services into new markets, our revenue will not grow as expected and we may not be able to achieve profitability.

Because we are a global organization and our long term success depends, in part, on our ability to expand our sales and operations outside of the United States, our business is susceptible to risks associated with international sales and operations.

Table of Contents

We currently maintain offices outside of the United States and have sales personnel or independent consultants in several countries. Approximately one quarter of our employees are located in an office in the Philippines. We have limited experience operating in foreign jurisdictions and are rapidly building our international operations. Managing a global organization is difficult, time consuming and expensive. Our inexperience in operating our business outside of the United States increases the risk that any international expansion efforts that we may undertake will not be successful. In addition, conducting international operations subjects us to new risks that we have not generally faced in the United States. These risks include:

- localization of our services, including translation into foreign languages and adaptation for local practices and regulatory requirements;
- lack of familiarity with and unexpected changes in foreign regulatory requirements;
- longer accounts receivable payment cycles and difficulties in collecting accounts receivable;
- difficulties in managing and staffing international operations;
- fluctuations in currency exchange rates;
- potentially adverse tax consequences, including the complexities of foreign value added tax systems and restrictions on the repatriation of earnings;
- dependence on certain third parties, including channel partners with whom we do not have extensive experience;
- the burdens of complying with a wide variety of foreign laws and legal standards;
- increased financial accounting and reporting burdens and complexities;
- political, social and economic instability abroad, terrorist attacks and security concerns in general; and
- reduced or varied protection for intellectual property rights in some countries.

Operating in international markets also requires significant management attention and financial resources. The investment and additional resources required to establish operations and manage growth in other countries may not produce desired levels of revenue or profitability.

We rely on third party software, including Oracle database software, which may be difficult to replace or could cause errors or failures of our service that could lead to lost customers or harm to our reputation.

We rely on software licensed from third parties to offer our service, including database software from Oracle. This software may not continue to be available to us on commercially reasonable terms, or at all. Any loss of the right to use any of this software could result in delays in the provisioning of our service until equivalent technology is either developed by us, or, if available, is identified, obtained and integrated, which could harm our business. Any errors or defects in third party software could result in errors or a failure of our service which could harm our business.

If we fail to maintain proper and effective internal controls, our ability to produce accurate and timely financial statements could be impaired and investors' views of us could be harmed.

Ensuring that we have adequate internal financial and accounting controls and procedures in place so that we can produce accurate financial statements on a timely basis is a costly and time consuming effort that needs to be re evaluated frequently. Our internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with GAAP. Although we have completed the process of documenting, reviewing and improving our internal controls and procedures for compliance with Section 404 of the Sarbanes Oxley Act of 2002, for the fiscal year ended December 31, 2013, there can be no assurances that control deficiencies will not be identified in the future. Implementing any additional required changes to our internal controls may distract our officers and employees, entail substantial costs to modify our existing processes and add personnel and take significant time to complete. These changes may not, however, be effective in maintaining the adequacy of our internal controls. Any failure to maintain that adequacy, or as consequent inability to produce accurate financial statements on a timely basis, could increase our operating costs and harm our business. In addition, investors' perceptions that our internal controls are inadequate or that we are unable to produce accurate financial statements on a timely basis may harm our stock price and make it more difficult for us to effectively market and sell our service to new and existing customers.

Our business is subject to changing regulations regarding corporate governance and public disclosure that will increase both our costs and the risk of noncompliance.

As a public company, we incur significant legal, accounting and other expenses associated with compliance with applicable laws, rules, regulations and listing requirements. In addition, the Sarbanes-Oxley Act, the Dodd-Frank Act, and rules subsequently implemented by the SEC and The New York Stock Exchange, have imposed a variety of compliance requirements on public companies, including requiring changes in corporate governance practices. In addition, the SEC and the U.S. Congress may continue to increase the scope of applicable disclosure and corporate governance-related rules. Our management and other personnel may need to devote a substantial amount of time to the compliance requirements associated with being a public company. Moreover, these laws, rules and regulations have increased and may continue to increase the scope, complexity and cost of our corporate governance, reporting and disclosure practices.

Because we recognize subscription revenue over the term of the applicable agreement, the lack of subscription renewals or new service agreements may not be reflected immediately in our operating results.

Table of Contents

The majority of our quarterly revenue is attributable to service agreements entered into during previous quarters. A decline in new or renewed service agreements in any one quarter will not be fully reflected in our revenue in that quarter but will harm our revenue in future quarters. As a result, the effect of significant downturns in sales and market acceptance of our services in a particular quarter may not be fully reflected in our operating results until future periods. Our subscription model also makes it difficult for us to rapidly increase our revenue through additional sales in any period, because revenue from new customers must be recognized over the applicable subscription term.

Material defects or errors in the software we use to deliver our services could harm our reputation, result in significant costs to us and impair our ability to sell our services.

The software applications underlying our services are inherently complex and may contain material defects or errors, particularly when first introduced or when new versions or enhancements are released. We have from time to time found defects in our service, and new errors in our existing service may be detected in the future. Any defects that cause interruptions to the availability of our services could result in:

- a reduction in sales or delay in market acceptance of our services;
- sales credits or refunds to our customers;
- loss of existing customers and difficulty in attracting new customers;
- diversion of development resources;
- harm to our reputation; and
- increased warranty and insurance costs.

After the release of our services, defects or errors may also be identified from time to time by our internal team and by our customers. The costs incurred in correcting any material defects or errors in our services may be substantial and could harm our operating results.

Government regulation of the Internet and Ecommerce is evolving, and unfavorable changes or our failure to comply with regulations could harm our operating results.

As Internet commerce continues to evolve, increasing regulation by federal, state or foreign agencies becomes more likely. For example, we believe increased regulation is likely in the area of data privacy, and laws and regulations applying to the solicitation, collection, processing or use of personal or consumer information could affect our customers' ability to use and share data, potentially reducing demand for financials/ERP, CRM, PSA and Ecommerce solutions and restricting our ability to store, process and share our customers' data. In addition, taxation of services provided over the Internet or other charges imposed by government agencies or by private organizations for accessing the Internet may also be imposed. Any regulation imposing greater fees for Internet use or restricting information exchanged over the Internet could result in a decline in the use of the Internet and the viability of Internet based services, harming our business and operating results.

Privacy concerns and laws or other domestic or foreign regulations may reduce the effectiveness of our application suite and harm our business.

Our customers can use our service to store personal or identifying information regarding their customers and contacts. Federal, state and foreign government bodies and agencies, however, have adopted or are considering adopting laws and regulations regarding the collection, use and disclosure of personal information obtained from consumers and other individuals. The costs of compliance with, and other burdens imposed by, such laws and regulations that are applicable to the businesses of our customers may limit the use and adoption of our service and reduce overall demand for it.

In addition to government activity, privacy advocacy groups and the technology and other industries are considering various new, additional or different self regulatory standards that may place additional burdens on us. If the gathering of personal information were to be curtailed, financials/ERP, CRM, PSA and Ecommerce solutions would be less effective, likely reducing demand for our service and harming our business.

If benefits currently available under the Czech Republic government subsidy program are reduced or disallowed, our product development costs could increase.

At our product development facility in the Czech Republic, we participate in a government subsidy program for employing local residents. Under the program, the Czech Republic government will reimburse us for certain operating expenses we incur. The reimbursements are based upon qualifying product development expenditures which are primarily salaries for persons conducting product development activities. During the six and three months ended June 30, 2014 , our product development operating expenses were reduced by $864,000 and $257,000, respectively, for reimbursement of eligible operating expenses incurred during those respective time periods. During the six and three months ended June 30, 2013, our

Table of Contents

product development operating expenses were reduced by $1.2 million and $630,000, respectively, for reimbursement of eligible operating expenses incurred during each respective time periods. During the six and three months ended June 30, 2014, we received $1.3 million and $673,000, respectively, from the Czech Republic government. As of June 30, 2014, $876,000 in reimbursements, adjusted for foreign currency valuations, are due us and included in other current assets. During the second quarter of 2014, we began participating in a second subsidy program, similar in nature to the initial program, as benefits under the initial program reached the program limits in the first quarter of 2014. The Czech Republic government will determine if we met the program requirements and that our expenses are reimbursable. If the Czech Republic government determines that our expense are ineligible for reimbursement, our financial condition and operating results may be harmed.

Changes in financial accounting standards or practices may cause adverse, unexpected financial reporting fluctuations and harm our operating results.

A change in accounting standards or practices could harm our operating results and may even affect our reporting of transactions completed before the change is effective. New accounting pronouncements and varying interpretations of accounting pronouncements have occurred and may occur in the future. Changes to existing rules or the questioning of current practices may harm our operating results or the way we conduct our business.

Unanticipated changes in our effective tax rate could harm our future operating results.

We are subject to income taxes in the United States and various foreign jurisdictions, and our domestic and international tax liabilities are subject to the allocation of expenses in differing jurisdictions. Our tax rate is affected by changes in the mix of earnings and losses in countries with differing statutory tax rates, certain non deductible expenses arising from the requirement to expense stock options and the valuation of deferred tax assets and liabilities, including our ability to utilize our net operating losses. Increases in our effective tax rate could harm our operating results.

We may be unable to integrate acquired businesses and technologies successfully or to achieve the expected benefits of such acquisitions. We may acquire or invest in additional companies, which may divert our management’s attention, result in additional dilution to our stockholders and consume resources that are necessary to sustain our business.

We have undertaken acquisitions in the past and may continue to evaluate and consider potential strategic transactions, including acquisitions and dispositions of businesses, technologies, services, products and other assets in the future. An acquisition, investment or business relationship may result in unforeseen operating difficulties and expenditures. In particular, we may encounter difficulties assimilating or integrating the businesses, technologies, products, personnel or operations of the acquired companies, particularly if the key personnel of the acquired company choose not to work for us, the company's software is not easily adapted to work with ours or we have difficulty retaining the customers of any acquired business due to changes in management or otherwise. Acquisitions may also disrupt our business, divert our resources and require significant management attention that would otherwise be available for development of our business. Moreover, the anticipated benefits of any acquisition, investment or business relationship may not be realized or we may be exposed to unknown liabilities.

We may in the future seek to acquire or invest in additional businesses, products, technologies or other assets. We also may enter into relationships with other businesses to expand our service offerings or our ability to provide service in foreign jurisdictions, which could involve preferred or exclusive licenses, additional channels of distribution, discount pricing or investments in other companies. Negotiating these transactions can be time consuming, difficult and expensive, and our ability to close these transactions may often be subject to approvals that are beyond our control. Consequently, these transactions, even if undertaken and announced, may not close. For one or more of those transactions, we may:

•issue additional equity securities that would dilute our stockholders;
•use cash that we may need in the future to operate our business;
•incur debt on terms unfavorable to us or that we are unable to repay;
•incur large charges or substantial liabilities;

- encounter difficulties retaining key employees of the acquired company or integrating diverse software codes or business cultures; and
- become subject to adverse tax consequences, substantial depreciation or deferred compensation charges.

Any of these risks could harm our business and operating results.

We rely on our management team and need additional personnel to grow our business, and the loss of one or more key employees or our inability to attract and retain qualified personnel could harm our business.

Our success and future growth depends to a significant degree on the skills and continued services of our management team. We do not maintain key man insurance on any members of our management team. Meeting our growth plan and our future success depends on our ability to attract, retain and motivate highly skilled technical, managerial, sales, marketing and service and support personnel, including members of our management team. Competition for sales, marketing and technology

Table of Contents

development personnel is particularly intense in the software and technology industries. As a result, we may be unable to successfully attract or retain qualified personnel. Our inability to attract and retain the necessary personnel could harm our business.

Risks Related to Ownership of our Common Stock and the Notes

Lawrence J. Ellison or members of his family, and related entities, beneficially own a significant portion of our outstanding shares of common stock, which may limit your ability to influence or control certain of our corporate actions. This concentration of ownership may also reduce the market price of our common stock and the value of the Notes and impair a takeover attempt of us.

Entities beneficially owned by Lawrence J. Ellison held an aggregate of approximately 42.0% of our common stock as of June 30, 2014. Further, Mr. Ellison, his family members, trusts for their benefit, and related entities together beneficially owned an aggregate of approximately 47.9% of our common stock as of that date. Mr. Ellison is able to exercise control over approval of significant corporate transactions, including a change of control or liquidation. In addition, if the voting restrictions that apply to NetSuite Restricted Holdings LLC, the investment entity to which Mr. Ellison has transferred his shares, lapse or are amended, Mr. Ellison will be able to exercise control over additional corporate matters, including elections of our directors. So long as Mr. Ellison continues to be either an officer or director of Oracle, these voting restrictions cannot be changed without the approval of an independent committee of Oracle’s board of directors. Mr. Ellison’s interests and investment objectives may differ from our other stockholders. Mr. Ellison is also the Chief Executive Officer, a principal stockholder and a director of Oracle Corporation. Oracle supplies us with database and other software on which we rely to provide our service and is also a potential competitor of ours.

Our Board of Directors adopted resolutions which renounce and provide for a waiver of the corporate opportunity doctrine as it relates to Mr. Ellison. As a result, Mr. Ellison has no fiduciary duty to present corporate opportunities to us. In addition, Mr. Ellison’s indirect majority interest in us could discourage potential acquirers or result in a delay or prevention of a change in control of our company or other significant corporate transactions, even if a transaction of that sort would be beneficial to our other stockholders or in our best interest and, as a result, reduce the market price of our common stock and the value of the Notes.

Volatility in the market price and trading volume of our common stock and the Notes could adversely impact the trading price of our common stock and the Notes.

The stock market in recent years has experienced significant price and volume fluctuations that have often been unrelated to the operating performance of companies. The market price of our common stock could fluctuate significantly for many reasons, including in response to the risks described in this section, elsewhere in this report or for reasons unrelated to our operations, such as reports by industry analysts, investor perceptions or negative announcements by our customers, competitors or suppliers regarding their own performance, as well as industry conditions and general financial, economic and political instability. A decrease in the market price of our common stock would likely adversely impact the trading price of the Notes. The market price of our common stock could also be affected by possible sales of our common stock by investors who view the Notes as a more attractive means of equity participation in us and by hedging or arbitrage trading activity that we expect to develop involving our common stock. This trading activity could, in turn, affect the trading prices of our common stock and the Notes.

We may not have the ability to raise the funds necessary to settle conversions of the Notes or to repurchase the Notes upon a fundamental change, which may affect the trading price of our common stock, and our future debt may contain limitations on our ability to repurchase the Notes.

Holders of the Notes will have the right to require us to repurchase their Notes upon the occurrence of a fundamental change at a repurchase price equal to 100% of their principal amount, plus accrued and unpaid interest, if any. In addition, upon conversion of the Notes, unless we elect to deliver solely shares of our common stock to settle such conversion (other than paying cash in lieu of delivering any fractional share), we will be required to make cash payments in respect of the Notes being converted. However, we may not have enough available cash or be able to obtain financing at the time we are required to make repurchases of Notes surrendered therefor or Notes being converted, which could harm our reputation and affect the trading price of our common stock.

In addition, our ability to repurchase the Notes may be limited by law, by regulatory authority or by agreements governing our future indebtedness. Our failure to repurchase Notes at a time when the repurchase is required by the indenture would constitute a default under the indenture and could harm our reputation and affect the trading price of our common stock.

Table of Contents

A default under the indenture or the fundamental change itself could also lead to a default under agreements governing our future indebtedness. If the repayment of the related indebtedness were to be accelerated after any applicable notice or grace periods, we may not have sufficient funds to repay the indebtedness and repurchase the Notes.

The conditional conversion feature of the Notes, if triggered, may harm our financial condition and operating results.

In the event the conditional conversion feature of the Notes is triggered, holders of Notes will be entitled to convert the Notes at any time during specified periods at their option. If one or more holders elect to convert their Notes, unless we elect to satisfy our conversion obligation by delivering solely shares of our common stock (other than paying cash in lieu of delivering any fractional share), we would be required to settle a portion or all of our conversion obligation through the payment of cash, which could adversely affect our liquidity. In addition, even if holders do not elect to convert their Notes, we could be required under applicable accounting rules to reclassify all or a portion of the outstanding principal of the Notes as a current rather than long-term liability, which would result in a material reduction of our net working capital.

The accounting method for convertible debt securities that may be settled in cash, such as the Notes, is the subject of recent changes that could have a material effect on our reported financial results.

In May 2008, the Financial Accounting Standards Board, which we refer to as FASB, issued FASB Staff Position No. APB 14-1, Accounting for Convertible Debt Instruments That May Be Settled in Cash Upon Conversion (Including Partial Cash Settlement), which has subsequently been codified as Accounting Standards Codification 470-20, Debt with Conversion and Other Options, which we refer to as ASC 470-20. Under ASC 470-20, an entity must separately account for the liability and equity components of the convertible debt instruments (such as the Notes) that may be settled entirely or partially in cash upon conversion in a manner that reflects the issuer's economic interest cost. The effect of ASC 470-20 on the accounting for the Notes is that the equity component is required to be included in the additional paid-in capital section of stockholders' equity on our consolidated balance sheet, and the value of the equity component would be treated as original issue discount for purposes of accounting for the debt component of the Notes. As a result, we will be required to record a greater amount of non-cash interest expense in current periods presented as a result of the amortization of the discounted carrying value of the Notes to their face amount over the term of the Notes. We will report lower net income in our financial results because ASC 470-20 will require interest to include both the current period's amortization of the debt discount and the instrument's coupon interest, which could adversely affect our reported or future financial results, the trading price of our common stock and the trading price of the Notes.

In addition, under certain circumstances, we may apply the treasury stock method with respect to the Notes, the effect of which is that only the number of shares of common stock that would be necessary to settle the conversion spread, if any, are included in the diluted earnings per share calculation. If we are unable to use the treasury stock method, then we would assume issuance of the number of shares of common stock that would be necessary to settle both the principal balance of the Notes and the conversion spread, if any, and our diluted earnings per share would be harmed.

Future sales of shares by existing stockholders could cause our stock price to decline and adversely impact the trading price of the Notes.

If our existing stockholders sell or otherwise dispose of, or indicate an intention to sell or dispose of, substantial amounts of our common stock in the public market, the trading price of our common stock could decline. As of June 30, 2014, we had a total of 76,107,175 shares of our common stock outstanding. Although shares that are held by NetSuite Restricted Holdings LLC are subject to certain restrictions on disposition and a portion of the remaining shares are subject to our Insider Trading Compliance Policy during certain periods of each quarter, substantially all of the shares held by parties other than NetSuite Restricted Holdings LLC, representing 58.0% of our outstanding shares as of June 30, 2014, are freely tradable, subject to our quarterly black-out policy that applies to these shares held by our directors, officers, employees and consultants. If a significant number of the shares are sold, or if it is perceived that they will be sold, in the public market, the trading price of our common stock could decline.

Further, in the future, we may sell additional shares of our common stock to raise capital. In addition, a substantial number of shares of our common stock are reserved for issuance upon the exercise of stock options, the vesting of restricted stock units and performance share units and performance shares and upon conversion of the Notes. We cannot predict the size of future issuances or the effect, if any, that they may have on the market price for our common stock. The issuance and sale of substantial amounts of common stock, or the perception that such issuances and sales may occur, could adversely affect the trading price of the Notes and the market price of our common stock and impair our ability to raise capital through the sale of additional equity securities.

Table of Contents

The increase in the conversion rate for Notes converted in connection with a make-whole fundamental change may not adequately compensate the holders of the Notes for any lost value of their Notes as a result of such transaction and may cause our existing stockholders to experience additional dilution.

If a make-whole fundamental change occurs prior to the maturity date, under certain circumstances, we will increase the conversion rate by a number of additional shares of our common stock for Notes converted in connection with such make-whole fundamental change, which may cause our existing stockholders to experience additional dilution. The increase in the conversion rate will be determined based on the date on which the specified corporate transaction becomes effective and the price paid (or deemed to be paid) per share of our common stock in such transaction. The increase in the conversion rate for Notes converted in connection with a make-whole fundamental change may not adequately compensate the holders of the Notes for any lost value of their Notes as a result of such transaction. In addition, if the price of our common stock in the transaction is greater than $275.00 per share or less than $86.00 per share (in each case, subject to adjustment), no additional shares will be added to the conversion rate. Moreover, in no event will the conversion rate per $1,000 principal amount of Notes as a result of this adjustment exceed shares of common stock, subject to adjustment pursuant to the terms of the Notes.

Our obligation to increase the conversion rate for Notes converted in connection with a make-whole fundamental change could be considered a penalty, in which case the enforceability thereof would be subject to general principles of reasonableness and equitable remedies.

Provisions in the indenture for the Notes may deter or prevent a business combination that may be favorable to our stockholders.

If a fundamental change occurs prior to the maturity date of the Notes, holders of the Notes will have the right, at their option, to require us to repurchase all or a portion of their Notes. In addition, if a make-whole fundamental change occurs prior to the maturity date of the Notes, we will in some cases be required to increase the conversion rate for a holder that elects to convert its Notes in connection with such fundamental change. Furthermore, the indenture for the Notes prohibits us from engaging in certain mergers or acquisitions unless, among other things, the surviving entity assumes our obligations under the Notes. These and other provisions in the indenture could deter or prevent a third party from acquiring us even when the acquisition may be favorable to our stockholders.

Any adverse rating of the Notes may cause their trading price to fall, which may affect the trading price of our common stock.

We do not intend to seek a rating on the Notes. However, if a rating service were to rate the Notes and if such rating service were to lower its rating on the Notes below the rating initially assigned to the Notes or otherwise announces its intention to put the Notes on credit watch, the trading price of the Notes could decline and the trading price of our common stock may be affected.

Anti takeover provisions contained in our amended and restated certificate of incorporation and amended and restated bylaws, as well as provisions of Delaware law, could delay changes in management or impair a takeover attempt of us and, as a result, reduce the market price of our common stock and the value of the Notes.

Our amended and restated certificate of incorporation, amended and restated bylaws and Delaware law contain provisions that could have the effect of rendering more difficult or discouraging an acquisition deemed undesirable by our Board of Directors. Our corporate governance documents include provisions:

- authorizing blank check preferred stock, which could be issued with voting, liquidation, dividend and other rights superior to our common stock;
- limiting the liability of, and providing indemnification to, our directors and officers;
- limiting the ability of our stockholders to call and bring business before special meetings and to take action by written consent in lieu of a meeting;
- requiring advance notice of stockholder proposals for business to be conducted at meetings of our stockholders and for nominations of candidates for election to our Board of Directors;
- controlling the procedures for the conduct and scheduling of board and stockholder meetings;
- providing the Board of Directors with the express power to postpone previously scheduled annual meetings and to cancel previously scheduled special meetings;
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- limiting the determination of the number of directors on our board and the filling of vacancies or newly created seats on the board to our Board of Directors then in office; and
- providing that directors may be removed by stockholders only for cause.

These provisions, alone or together, could delay hostile takeovers and changes in control or changes in our management.

Table of Contents

As a Delaware corporation, we are also subject to provisions of Delaware law, including Section 203 of the Delaware General Corporation law, which prevents some stockholders holding more than 15% of our outstanding common stock from engaging in certain business combinations without approval of the holders of substantially all of our outstanding common stock. Under Section 203, our majority stockholder, which is beneficially owned by Lawrence J. Ellison, and our current stockholders associated with members of Mr. Ellison's family are not subject to the prohibition from engaging in such business combinations.
Any provision of our amended and restated certificate of incorporation or bylaws or Delaware law that has the effect of delaying or deterring a change in control could limit the opportunity for our stockholders to receive a premium for their shares of our common stock, and could also affect the price that some investors are willing to pay for our common stock and the Notes.

Our failure to raise additional capital or generate the cash flows necessary to expand our operations and invest in our application services could reduce our ability to compete successfully.

We may need to raise additional funds, and we may not be able to obtain additional debt or equity financing on favorable terms, if at all. If we raise additional equity or convertible debt financing, our stockholders may experience significant dilution of their ownership interests and the per share value of our common stock could decline. If we engage in additional debt financing, we may be required to accept terms that restrict our ability to incur additional indebtedness and force us to maintain specified liquidity or other ratios. If we need additional capital and cannot raise it on acceptable terms, we may not be able to, among other things:

- develop or enhance our application and services;
- continue to expand our product development, sales and marketing organizations;
- acquire complementary technologies, products or businesses;
- expand operations, in the United States or internationally;
- hire, train and retain employees; or
- respond to competitive pressures or unanticipated working capital requirements.

ITEM 6. Exhibits

The exhibits listed below are filed or incorporated by reference as part of this Report.

Exhibit No	Description of Exhibits
31.1	Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act.
31.2	Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act.
32.1	Certification of the Chief Executive Officer and the Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act.
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

** The information in these XBRL documents is unaudited.

Table of Contents

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.

Date:	August 6, 2014	NETSUITE INC.
	By:	/S/ RONALD GILL Ronald Gill Chief Financial Officer