DemandTec, Inc.
Form 10-Q
October 01, 2010

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

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

For the quarterly period ended August 31, 2010

OR

o **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: 001-33634
DemandTec, Inc.
(Exact name of registrant as specified in its charter)

Delaware	**94-3344761**
(State or Other Jurisdiction of Incorporation or Organization)	**(I.R.S. Employer Identification Number)**

One Franklin Parkway, Building 910
San Mateo, California 94403
(Address of Principal Executive Offices including Zip Code)
(650) 645-7100
(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 þ No o

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

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

Large accelerated filer o	Accelerated filer þ	Non-accelerated filer o	Smaller reporting company o
		(Do not check if a 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 o No þ

The number of shares of the registrant s common stock, par value $0.001, outstanding as of September 24, 2010 was: 30,472,401.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

DemandTec, Inc.
Condensed Consolidated Balance Sheets
(In thousands, except par value data)

	August 31, 2010 (Unaudited)	February 28, 2010
ASSETS		
Current assets:		
Cash and cash equivalents	$ 12,591	$ 21,335
Marketable securities	52,502	36,068
Accounts receivable, net of allowances of $630 and $145 as of August 31, 2010 and February 28, 2010, respectively	12,768	13,984
Prepaid expenses and other current assets	6,013	3,127
Total current assets	83,874	74,514
Marketable securities, non-current	2,616	9,881
Property, equipment and leasehold improvements, net	6,330	4,777
Intangible assets, net	2,812	4,328
Goodwill	16,599	16,599
Other assets, net	1,110	563
Total assets	$ 113,341	$ 110,662
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable and accrued expenses	$ 9,007	$ 12,441
Deferred revenue	49,300	38,462
Notes payable, current	8	434
Merger consideration payable		1,000
Total current liabilities	58,315	52,337
Deferred revenue, non-current	290	459
Other long-term liabilities	1,221	928
Commitments and contingencies (see Note 5)		
Stockholders equity:		
Common stock, $0.001 par value 175,000 shares authorized; 30,374 and 29,501 shares issued and outstanding, respectively, as of August 31, 2010 and February 28, 2010	30	29
Additional paid-in capital	150,632	145,600
Accumulated other comprehensive income	788	527
Accumulated deficit	(97,935)	(89,218)
Total stockholders equity	53,515	56,938

Total liabilities and stockholders equity	$	113,341	$	110,662

See Notes to Condensed Consolidated Financial Statements.

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DemandTec, Inc.
Condensed Consolidated Statements of Operations
(In thousands, except per share data)
(Unaudited)

	Three Months Ended August 31,		Six Months Ended August 31,	
	2010	2009	2010	2009
Revenue	$ 20,388	$ 19,796	$ 38,433	$ 39,341
Cost of revenue(1)(2)	7,082	6,300	14,196	13,004
Gross profit	13,306	13,496	24,237	26,337
Operating expenses:				
Research and development(2)	7,774	7,997	15,546	16,153
Sales and marketing(2)	5,662	5,414	11,987	10,845
General and administrative(2)	2,428	2,786	4,840	5,160
Restructuring charges				278
Amortization of purchased intangible assets	291	588	583	1,177
Total operating expenses	16,155	16,785	32,956	33,613
Loss from operations	(2,849)	(3,289)	(8,719)	(7,276)
Other income, net				
Interest income	67	162	128	391
Interest expense	(13)	(31)	(44)	(62)
Other income (expense)	(2)	21	(6)	107
Other income, net	52	152	78	436
Loss before provision for income taxes	(2,797)	(3,137)	(8,641)	(6,840)
Provision for income taxes	53	8	76	27
Net loss	$ (2,850)	$ (3,145)	$ (8,717)	$ (6,867)
Net loss per common share, basic and diluted	$ (0.09)	$ (0.11)	$ (0.29)	$ (0.24)
Shares used in computing net loss per common share, basic and diluted	30,210	28,535	29,994	28,346

(1) Includes amortization of purchased intangible assets	$ 466	$ 465	$ 931	$ 931
(2) Includes stock-based compensation expense as follows:				
Cost of revenue	$ 476	$ 523	$ 828	$ 941
Research and development	844	948	1,549	1,804
Sales and marketing	675	652	1,407	1,271

General and administrative	636	719	1,296	1,244
Total stock-based compensation expense	$ 2,631	$ 2,842	$ 5,080	$ 5,260

See Notes to Condensed Consolidated Financial Statements.

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DemandTec, Inc
Condensed Consolidated Statements of Cash Flows
(In thousands)
(Unaudited)

	Six Months Ended August 31, 2010	Six Months Ended August 31, 2009
Operating activities:		
Net loss	$ (8,717)	$ (6,867)
Adjustment to reconcile net loss to net cash provided by operating activities:		
Depreciation	1,568	1,551
Stock-based compensation expense	5,080	5,260
Amortization of purchased intangible assets	1,514	2,108
Provision for doubtful accounts	485	5
Other	(53)	9
Changes in operating assets and liabilities:		
Accounts receivable	567	6,395
Prepaid expenses and other current assets	(2,556)	660
Other assets	(402)	(5)
Accounts payable and accrued liabilities	(1,684)	486
Accrued compensation	(1,548)	(1,072)
Deferred revenue	10,669	(7,155)
Net cash provided by operating activities	4,923	1,375
Investing activities:		
Purchases of property, equipment and leasehold improvements	(3,125)	(481)
Purchases of marketable securities	(37,964)	(28,390)
Maturities of marketable securities	28,795	40,000
Acquisition of TradePoint	(426)	
Acquisition of Connect3	(900)	(12,544)
Net cash used in investing activities	(13,620)	(1,415)
Financing activities:		
Proceeds from issuance of common stock, net of repurchases	890	1,387
Payment of employee withholding tax in lieu of issuing common stock	(937)	
Payments on notes payable		(1,286)
Net cash provided by (used in) financing activities	(47)	101
Effect of exchange rate changes on cash and cash equivalents		36
Net increase (decrease) in cash and cash equivalents	(8,744)	97
Cash and cash equivalents at beginning of period	21,335	33,572

Cash and cash equivalents at end of period	$ 12,591	$ 33,669

See Notes to Condensed Consolidated Financial Statements.

DemandTec, Inc.
Notes to Condensed Consolidated Financial Statements

1. Business Summary and Significant Accounting Policies

Description of Business

DemandTec, Inc. (the Company or We) was incorporated in Delaware on November 1, 1999. We are a leading provider of on-demand optimization solutions to retailers and consumer products, or CP, companies. Our software services enable retailers and CP companies to separately or collaboratively define category, brand, and customer strategies based on a scientific understanding of consumer behavior and make actionable pricing, promotion, assortment, space, and other merchandising and marketing decisions to achieve their revenue, profitability, sales volume, and customer loyalty objectives. We deliver our applications by means of a software-as-a-service, or SaaS, model, which allows us to capture and analyze the most recent retailer and market-level data, enhance our software services rapidly to address our customers ever-changing merchandising and marketing needs, and connect retailers and CP companies via collaborative, Internet-based applications. We are headquartered in San Mateo, California, with additional sales presence in North America, Europe, and South America.

Basis of Presentation

Our condensed consolidated financial statements include our accounts and those of our wholly-owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation. Our fiscal year ends on the last day in February. References to fiscal 2011, for example, refer to our fiscal year ending February 28, 2011. The accompanying condensed consolidated balance sheet as of August 31, 2010, the condensed consolidated statements of operations for the three and six months ended August 31, 2010 and 2009, and the condensed consolidated statements of cash flows for the six months ended August 31, 2010 and 2009 are unaudited. The condensed consolidated balance sheet data as of February 28, 2010 was derived from the audited consolidated financial statements included in our Annual Report on Form 10-K for the fiscal year ended February 28, 2010 (the Form 10-K) filed with the Securities and Exchange Commission, or SEC, on April 23, 2010. The accompanying statements should be read in conjunction with the audited consolidated financial statements and related notes contained in the Form 10-K, as well as subsequent filings with the SEC.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States, or GAAP, for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, certain information and footnote disclosures normally included in consolidated financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations. The unaudited condensed consolidated financial statements have been prepared on the same basis as the audited consolidated financial statements and, in the opinion of our management, include all adjustments necessary, all of which are of a normal recurring nature, for the fair presentation of our statements of financial position and our results of operations for the periods included in this Quarterly Report on Form 10-Q. The results for the three and six months ended August 31, 2010 are not necessarily indicative of the results to be expected for any subsequent quarter or for the fiscal year ending February 28, 2011.

Subsequent Events

We have evaluated subsequent events through the time of filing this Quarterly Report on Form 10-Q. We are not aware of any significant events that occurred subsequent to the balance sheet date but prior to the filing of this report that would have a material impact on our condensed consolidated financial statements.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the condensed consolidated financial statements, as well as the reported amounts of revenue and expenses during the periods presented. Significant estimates and assumptions made by management include the determination of the fair value of share-based payments, the fair value of purchased intangible assets, the recoverability of long-lived assets, the allowance for doubtful accounts, and the provision for income taxes. We believe that the estimates and

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judgments upon which we rely are reasonable, based upon information available to us at the time that these estimates and judgments are made. To the extent there are material differences between these estimates and actual results, our condensed consolidated financial statements will be affected.

Revenue Recognition

We generate revenue from fees under agreements with initial terms that generally are one to three years in length. Our agreements contain multiple elements, which include the use of our software, SaaS delivery services, professional services, maintenance, and customer support, and may include software development services. Professional services consist of implementation, training, data modeling, and analytical services related to our customers use of our software. We have determined that the elements within our agreements do not qualify for treatment as separate units of accounting. Therefore, we account for all fees received under our agreements as a single unit of accounting and recognize them ratably over the term of the related agreement, commencing upon the later of the agreement start date or the date access to the application is provided to the customers, and when all of the following conditions are also met:

there is persuasive evidence of an arrangement;

the service has been provided to the customer;

the collection of the fees is probable; and

the amount of fees to be paid by the customer is fixed or determinable.

Deferred Revenue

Deferred revenue consists of amounts billed or payments received in advance of revenue recognition. Contracts under which we advance bill customers are generally non-cancellable. For agreements with terms over one year, we generally invoice our customers in annual installments. Accordingly, the deferred revenue balance associated with such multi-year, non-cancellable agreements does not represent the total contract value. Deferred revenue to be recognized in the succeeding twelve-month period is included in current deferred revenue on our consolidated balance sheets, with the remaining amounts included in non-current deferred revenue.

Concentrations of Credit Risk, Significant Customers and Suppliers and Geographic Information

Our financial instruments that are exposed to concentrations of credit risk consist primarily of cash and cash equivalents, marketable securities, accounts receivable, and a line of credit. Although we deposit our cash with multiple financial institutions, our deposits, at times, may exceed federally insured limits. Collateral is not required for accounts receivable.

As of August 31, 2010 and February 28, 2010, long-lived assets located outside the United States were not significant. As of August 31, 2010, one customer accounted for 19% of our accounts receivable balance. As of February 28, 2010, three customers accounted for 48% of our accounts receivable balance.

In the three months ended August 31, 2010, one customer accounted for 22% of total revenue. In the six months ended August 31, 2010, two customers accounted for 28% of total revenue. In the three and six months ended August 31, 2009, one customer accounted for 17% and 15%, respectively, of total revenue. Revenue by geographic region, based on the billing address of the customer, was as follows (in thousands):

	Three Months Ended August 31,		Six Months Ended August 31,	
	2010	**2009**	**2010**	**2009**
United States	$ 17,655	$ 17,153	$ 32,892	$ 34,002
International	2,733	2,643	5,541	5,339
Total revenue	$ 20,388	$ 19,796	$ 38,433	$ 39,341

The equipment hosting our software is in three third-party data center facilities located in San Jose, California, Sacramento, California, and Mesa, Arizona. We do not control the operation of these facilities, and our operations are vulnerable to damage or interruption in the event either of these third-party data center facilities fails.

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Impairment of Long-Lived Assets

Long-lived assets are reviewed for possible impairment whenever events or circumstances indicate that the carrying amount of these assets may not be recoverable. We evaluate the recoverability of each of our long-lived assets, including purchased intangible assets and property, equipment, and leasehold improvements, by comparison of its carrying amount to the future undiscounted cash flows we expect the asset to generate. If we consider the asset to be impaired, we measure the amount of any impairment as the difference between the carrying amount and the fair value of the impaired asset. We observed no impairment indicators through the filing of this Quarterly Report on Form 10-Q.

Stock-Based Compensation

We account for and recognize all share-based payments as an expense in our statements of operations. Grants of stock options generally vest over four years. We measure the value of stock options based on the grant date fair value using the Black-Scholes pricing model. Performance-based stock units, or PSUs, vest pursuant to certain performance and time-based vesting criteria set by our Compensation Committee. We evaluate the probability of meeting the performance criteria at the end of each reporting period to determine how much compensation expense to record. Because the actual number of shares to be issued is not known until the end of the performance period, the actual compensation expense related to these awards could differ from our current expectations. We also have time-based restricted stock units, or RSUs, outstanding that entitle the recipient to receive shares of our common stock upon vesting and settlement of the awards pursuant to time-based vesting criteria set by our Compensation Committee. Stock-based compensation expense for PSUs and RSUs is based on the closing price of our common stock on the grant date. We amortize the fair value of those awards, net of estimated forfeitures, as stock-based compensation expense over the vesting period of the awards.

Net Loss per Common Share

Basic net loss per share is computed using the weighted average number of common shares outstanding during the period, excluding any unvested common shares subject to repurchase. All common shares subject to repurchase were fully vested prior to February 28, 2010 and the weighted average number of common shares subject to repurchase was immaterial in the three and six months ended August 31, 2009.

Potential common shares consist of the incremental common shares issuable upon the exercise of stock options or upon the settlement of PSUs and RSUs, and shares subject to issuance under our 2007 Employee Stock Purchase Program, or ESPP. The dilutive effect of such potential common shares is reflected in diluted loss per share by application of the treasury stock method and on an if-converted basis from the date of issuance. In the three months ended August 31, 2010 and 2009, weighted average outstanding shares subject to options to purchase common stock, PSUs and RSUs, and shares subject to issuance under our ESPP were approximately 2,613,000 shares and 4,085,000 shares, respectively. In the six months ended August 31, 2010 and 2009, weighted average outstanding shares subject to options to purchase common stock, PSUs and RSUs, and shares subject to issuance under our ESPP were approximately 2,803,000 shares and 4,004,000 shares, respectively. Because the Company has been in a loss position in all periods shown, shares used in computing basic and diluted net loss per common share were the same for all periods presented, as the impact of all potentially dilutive securities outstanding was anti-dilutive.

Recent Accounting Pronouncements

In April 2010, the Financial Accounting Standards Board (the FASB) issued guidance on defining a milestone and determining when it may be appropriate to apply the milestone method of revenue recognition for research or development transactions. The guidance is effective on a prospective basis for milestones achieved in fiscal years, and interim periods within those years, beginning on or after June 15, 2010, with early adoption permitted. We do not expect a material impact on our condensed consolidated financial statements upon the adoption of the new accounting standard.

In January 2010, the FASB issued guidance that requires additional disclosures for fair value measurements and provides clarification for existing disclosure requirements. The guidance requires a reporting entity to disclose separately the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurements and the reasons for these transfers. In addition, the guidance requires enhanced disclosure of activity in Level 3 fair value measurements. The guidance is effective for interim and annual periods beginning after December 15, 2009, except for gross presentation of activity in Level 3 which is effective for annual periods beginning after December 15, 2010, and for interim periods in those years. We adopted the guidance for new disclosures for fair value measurements and clarification for existing disclosure requirements on March 1, 2010 and there was no impact on our condensed consolidated financial statements. We do not expect any impact on our condensed consolidated financial statements upon effectiveness of the new standard for Level 3 activity.

In October 2009, the FASB issued a new accounting standard for revenue recognition for arrangements with multiple deliverables. The new standard impacts the determination of when the individual deliverables included in a multiple-element arrangement may be treated as separate units of accounting. Additionally, the new standard modifies the manner in which the transaction consideration is allocated across the separately identified deliverables by no longer permitting the residual method of allocating arrangement consideration. The new standard is effective for fiscal years beginning on or after June 15, 2010; however, early adoption of this standard is permitted. We have determined that there will be no impact on our condensed consolidated financial statements for existing customer arrangements upon adoption of the new accounting standard.

In October 2009, the FASB issued a new accounting standard for the accounting for certain revenue arrangements that include software elements. The new standard amends the scope of pre-existing software revenue guidance by removing from the guidance non-software components of tangible products and certain software components of tangible products. The new standard is effective for fiscal years beginning on or after June 15, 2010; however, early adoption of this standard is permitted. We have determined that there will be no impact on our condensed consolidated financial statements for existing customer arrangements upon adoption of the new accounting standard.

2. Acquisition

In February 2009, we acquired all of the issued and outstanding capital stock of privately-held Connect3 Systems, Inc., or Connect3, a provider of advertising planning and execution software, for a purchase price of approximately $13.5 million, which consisted of $13.3 million cash and $201,000 of acquisition costs. We paid approximately $12.3 million of the consideration in fiscal 2010 and paid $900,000 in July 2010, with the remaining $100,000 withheld to satisfy certain claims for indemnification that we made.

We accounted for the Connect3 acquisition under the purchase method of accounting. The assets acquired and liabilities assumed were recorded at fair market value, based on the valuation performed by an independent third-party valuation firm. We recorded approximately $11.3 million of goodwill, $4.5 million of identifiable intangible assets, and $2.3 million of net liabilities assumed. Intangible assets are being amortized on a straight-line basis over a period of one to two and a half years, with a remaining weighted average useful life of 1.0 year at August 31, 2010. The goodwill balance is not deductible for tax purposes. The results of Connect3 s operations are included in our condensed consolidated financial statements from the date of acquisition. Pro forma results of the acquired business have not been presented as it was not material to our condensed consolidated financial statements for all periods presented.

3. Balance Sheet Components

Marketable Securities

Marketable securities consisted of the following as of the dates indicated (in thousands):

	August 31, 2010				February 28, 2010			
		Unrecognized		Fair		Unrecognized		Fair
	Cost	Gain	Loss	Value	Cost	Gain	Loss	Value
Commercial paper	$ 3,697	$	$	$ 3,697	$ 3,999	$ 3	$	$ 4,002
Certificate of deposit	1,000	1		1,001	1,000	3		1,003
Corporate bonds	18,268	52	(1)	18,319	15,563	14	(10)	15,567
Obligations of government-sponsored enterprises	32,153	25	(1)	32,177	25,387	19		25,406
	$ 55,118	$ 78	$ (2)	$ 55,194	$ 45,949	$ 39	$ (10)	$ 45,978

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The following table summarizes the book value of our investments in marketable debt securities classified by the contractual maturity date of the security as of the dates indicated (in thousands):

	August 31, 2010	February 28, 2010
Due within one year	$ 52,502	$ 36,068
Due within one to two years	2,616	9,881
	$ 55,118	$ 45,949

Historically, all investments have been held to maturity, and thus, there were no gains or losses recognized during the periods presented. We have the ability and intent to hold our marketable securities to maturity and do not believe any of the marketable securities are impaired based on our evaluation of available evidence at August 31, 2010 and through the time of filing of this Quarterly Report on Form 10-Q. We expect to receive all principal and interest on all of our investment securities.

Accounts Payable and Accrued Expenses

Accounts payable and accrued expenses consisted of the following as of the dates indicated (in thousands):

	August 31, 2010	February 28, 2010
Accounts payable	$ 1,076	$ 2,751
Accrued professional services	555	807
Income taxes payable	90	32
Accrued bonuses	2,134	3,820
Other accrued compensation	3,235	3,097
Other accrued liabilities	1,917	1,934
Total accounts payable and accrued expenses	$ 9,007	$ 12,441

4. Goodwill and Purchased Intangible Assets

We record as goodwill the excess of the acquisition purchase price over the fair value of the tangible and identifiable intangible assets acquired. We do not amortize goodwill, but perform an annual impairment review of our goodwill during our third quarter, or more frequently if indicators of potential impairment arise. We have a single operating segment and consequently evaluate goodwill for impairment based on an evaluation of the fair value of our company as a whole. At each of August 31, 2010 and February 28, 2010, we had $16.6 million of goodwill from our acquisitions of Connect3 in February 2009 and TradePoint in November 2006.

We record purchased intangible assets at their respective estimated fair values at the date of acquisition. Purchased intangible assets are being amortized using the straight-line method over their estimated useful lives of approximately one to seven years, with a remaining weighted average useful life of 2.0 years at August 31, 2010. We evaluate the remaining useful lives of intangible assets on a periodic basis to determine whether events or circumstances warrant a revision to the remaining estimated amortization period. Amortization expense related to the purchased intangible assets was approximately $757,000 and $1.5 million in the three and six months ended August 31, 2010, respectively, and approximately $1.1 million and $2.1 million in the three and six months ended August 31, 2009, respectively.

We evaluate our goodwill annually in November and recognized no impairment charges as a result of the most recent review. Additionally, we observed no impairment indicators for both goodwill and intangible assets through the filing of this Quarterly Report on Form 10-Q.

5. Commitments and Contingencies

Commitments

We lease office space in various locations throughout the United States and Europe. In September 2009, we entered into a lease agreement for office space in San Mateo, California, under which the total lease term is eight years with an initial non-cancellable lease term of five years commencing December 1, 2009. We use the office space as our new corporate headquarters. The aggregate minimum lease commitment is approximately $10.1 million. To secure our obligations under the lease, we have provided the lessor a $223,000 cash security deposit and a $917,000 letter of credit, secured by using our existing revolving line of credit as described in Note 6. Additionally, the lessor provided us with a tenant improvement allowance of $265,000 and assumed our payment obligations (equal to approximately $200,000) under the previous sublease for our then-existing corporate headquarters in San Carlos, California for the period from December 1, 2009 through February 28, 2010, the expiration date of such sublease. The tenant improvement allowance and the $200,000 of assumed sublease obligations have been deferred and are being recognized on a straight-line basis over the lease term as reductions of rent expenses. The leasehold improvements are being amortized on a straight-line basis over the lesser of the lease term or the estimated useful lives of the assets.

In September 2009, we entered into equipment and facility operating leases associated with our new data center in Mesa, Arizona, with minimum lease terms of two years for the equipment lease and three years for the facility lease. The aggregate minimum lease payments are approximately $1.5 million.

Legal Proceedings

We have from time to time become involved in legal matters that arise in the normal course of business and otherwise. For example, we were recently involved in a dispute with a customer relating to certain services. There can be no assurance that third party claims and litigation that may arise in the future will not have a material adverse effect on our business, financial position, results of operations, or cash flows, including a loss of customers, or subject us to significant financial or other remedies.

6. Debt

In May 2009, we amended our revolving line of credit that we had entered in April 2008 to, among other things, extend the maturity date of the loan agreement and to increase the revolving line of credit from $15.0 million to $20.0 million. The amended revolving line of credit can be used to (a) borrow revolving loans, (b) issue letters of credit, and (c) enter into foreign exchange contracts. Revolving loans may be borrowed, repaid, and reborrowed until May 7, 2012. Amounts borrowed will bear interest, at our option, at either (1) a floating per annum rate equal to the financial institution s prime rate, or (2) the greater of (A) the LIBOR rate plus 250 basis points or (B) a per annum rate equal to 4.0%. A default interest rate shall apply during an event of default at a rate per annum equal to 500 basis points above the otherwise applicable interest rate. The line of credit is collateralized by substantially all of our assets and requires us to comply with working capital, net worth, and other non-financial covenants, including limitations on indebtedness and restrictions on dividend distributions, among others. In September 2009, the available balance was reduced by approximately $917,000 to $19.1 million due to the issuance of a letter of credit securing a new operating lease commitment. There were no outstanding amounts under the line of credit at August 31, 2010. Through the filing of this Quarterly Report on Form 10-Q, we were in compliance with all loan covenants.

7. Stock-Based Compensation

Equity Incentive Plans

1999 Equity Incentive Plan

In December 1999, our Board of Directors adopted the 1999 Equity Incentive Plan (the 1999 Plan). The 1999 Plan, provided for incentive or nonstatutory stock options, stock bonuses, and rights to acquire restricted stock to be granted to employees, outside directors, and consultants. We ceased issuing awards under the 1999 Plan upon the completion of our IPO in August 2007. As of August 31, 2010, options to purchase 4,196,280 shares were outstanding under the 1999 Plan. Such options are exercisable as specified in each option agreement, generally vest over four years, and expire no more than ten years from the date of grant. If options awarded under the 1999 Plan are forfeited or repurchased, then shares underlying those options will no longer be available for awards.

2007 Equity Incentive Plan

In May 2007, our Board of Directors adopted, and in July 2007 our stockholders approved, the 2007 Equity Incentive Plan (the 2007 Plan). The 2007 Plan became effective upon our IPO. The 2007 Plan, which is administered by the Compensation Committee of our Board of Directors, provides for stock options, stock units, restricted shares, and stock appreciation rights to be granted to employees, outside directors and consultants. We initially reserved 3.0 million shares of our common stock for issuance under the

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2007 Plan. In addition, on the first day of each fiscal year commencing with fiscal year 2009, the aggregate number of shares reserved for issuance under the 2007 Plan is automatically increased by a number equal to the lowest of a) 5% of the total number of shares of common stock then outstanding, b) 3,750,000 shares, or c) a number determined by our Board of Directors. As of August 31, 2010, 7,202,390 shares were reserved for issuance under the 2007 Plan.

Stock Options

Options granted under the 2007 Plan may be either incentive stock options or nonstatutory stock options and are exercisable as determined by the Compensation Committee and as specified in each option agreement. Options vest over a period of time as determined by the Compensation Committee, generally four years, and generally expire seven years (but in any event no more than ten years) from the date of grant. The exercise price of any stock option granted under the 2007 Plan may not be less than the fair market value of our common stock on the date of grant. The term of the 2007 Plan is ten years. As of August 31, 2010, options to purchase 3,303,908 shares were outstanding under the 2007 Plan.

Performance Stock Units (PSUs)

PSUs are awards under the 2007 Plan that entitle the recipient to receive shares of our common stock upon vesting and settlement of the awards pursuant to certain performance and time-based vesting criteria set by our Compensation Committee.

In May and June 2009, our Compensation Committee granted 901,000 and 25,000 PSUs, respectively, to certain of our executive officers and other employees. These PSU grants related to fiscal 2010 company performance objectives and subsequent individual service requirements over a period of approximately 23 months subject to each grantee s continued service. In May 2010, our Compensation Committee granted 314,250 PSUs to our executive officers, which relate to fiscal 2011 company performance objectives and subsequent individual service requirements over a period of approximately 17 months subject to each grantee s continued service. As of August 31, 2010, there were approximately 495,000 shares subject to outstanding PSUs from these grants.

Restricted Stock Units (RSUs)

RSUs are awards under the 2007 Plan that entitle the recipient to receive shares of our common stock upon vesting and settlement of the awards pursuant to time-based vesting criteria set by our Compensation Committee.

In the fiscal quarter ended May 31, 2008, our Compensation Committee granted 545,900 RSUs to our executive officers and certain other employees. In the six months ended August 31, 2010, 459,450 of these RSUs, representing all remaining outstanding RSUs from this grant, were fully vested. In connection with the vesting and settlement of these RSUs, we withheld 148,523 shares of our common stock in settlement of employee income and payroll tax withholding obligations and paid the corresponding amounts in cash, approximately $937,000, to the appropriate federal and state taxing authorities.

In January 2010, our Compensation Committee granted 100,000 RSUs, which will vest over a period of approximately four years, subject to the grantee s continued services. In the six months ended August 31, 2010, our Compensation Committee granted 1,270,500 RSUs to certain of our executive officers and other employees. Such RSUs will vest over a period of approximately 24 to 27 months, subject to each grantee s continued service. In August 2010, our Compensation Committee granted a total of 79,317 RSUs to the non-employee members of our board of directors, which will be fully vested on the earlier of a) the date of our 2011 Annual Meeting of Stockholders, or b) one year from the date of grant. As of August 31, 2010, there were approximately 1,386,000 shares subject to outstanding RSUs.

A summary of the activity during the six months ended August 31, 2010 under our 1999 and 2007 Plans follows:

	Shares Available for Grant	Shares Subject to Options Outstanding	Weighted Average Option Exercise Price per Share	Shares Subject to PSUs Outstanding	Shares Subject to RSUs Outstanding
			(Shares in thousands)		
Balance at February 28, 2010	1,359	7,248	$ 5.72	387	560
Additional shares authorized	1,475				
Options granted	(896)	896	6.25		
PSUs granted	(314)			314	
RSUs granted	(1,350)				1,350
Options exercised		(277)	1.34		
1999 Plan options cancelled/forfeited (1)		(42)	9.67		
2007 Plan options cancelled/forfeited	325	(325)	8.76		
PSUs and RSUs released				(188)	(459)
PSUs and RSUs cancelled/forfeited	83			(18)	(65)
Balance at August 31, 2010	682	7,500	5.79	495	1,386

(1) Under the terms of the 1999 Plan, shares underlying cancelled or forfeited options are no longer available for awards.

Employee Stock Purchase Plan (ESPP)

In May 2007 our Board of Directors adopted, and in July 2007 our stockholders approved, the 2007 Employee Stock Purchase Plan. We subsequently amended the ESPP in March 2010. Under the ESPP, eligible employees may purchase shares of common stock at a price per share equal to 85% of the lesser of the fair market values of our common stock at the beginning or end of the applicable offering period. The initial offering period commenced on August 8, 2007 and ended on April 15, 2008. Each subsequent offering period lasts for six months. We initially reserved 500,000 shares of our common stock for issuance under the ESPP. In addition, on the first day of each fiscal year commencing with fiscal year 2009, the aggregate number of shares reserved for issuance under the ESPP is automatically increased by a number equal to the lowest of a) 1% of the total number of shares of common stock then outstanding, b) 375,000 shares, or c) a number determined by our Board of Directors. In the six months ended August 31, 2010, employees purchased 96,306 shares under the ESPP, and the weighted average per share fair value of the options to purchase those shares was approximately $2.30. As of August 31, 2010, a total of 911,037 shares were available for issuance under the ESPP.

Stock-Based Compensation Expense Associated with Awards to Employees

We have issued employee stock-based awards in the form of stock options, PSUs, RSUs, and shares subject to the ESPP. We measure the value of stock options and shares subject to the ESPP based on the grant date fair value using the Black-Scholes pricing model. Stock-based compensation expense for PSUs and RSUs is based on the closing price of our common stock on the grant date. The aggregate fair value of the PSUs and RSUs granted in the six months ended August 31, 2010 was approximately $2.1 million and $8.4 million, respectively.

The determination of the fair value of stock options and shares subject to the ESPP on the date of grant is affected by our stock price, as well as by assumptions regarding a number of complex and subjective variables. These variables include our expected stock price volatility over the term of the options and awards, actual and projected employee stock option exercise behaviors, risk-free interest rates, and expected dividends, which are set forth in the table below:

	Weighted Average Expected Term (in years)	Expected Stock Price Volatility	Risk-free Interest Rate	Expected Dividend Yield	Weighted Average per Options/FMV of Awards Granted During the Period
Three months ended August 31, 2010(1)					
Stock options	4.6	66%	2.3%	0%	$ 3.50
Three months ended August 31, 2009(1)					
Stock options	4.3	66%	2.1%	0%	$ 4.60
Six months ended August 31, 2010					
Stock options	4.6	68%	2.1%	0%	$ 3.45
ESPP	0.5	41%	0.3%	0%	$ 1.69
Six months ended August 31, 2009					
Stock options	4.3	65%	1.9%	0%	$ 4.10
ESPP	0.5	95%	0.3%	0%	$ 3.08

(1) No ESPP shares were issued in the three months ended August 31, 2010 and 2009.

We recognized approximately $2.6 million and $2.8 million of stock-based compensation expense in the three months ended August 31, 2010 and 2009, respectively, and recognized approximately $5.1 million and $5.3 million of stock-based compensation expense in the six months ended August 31, 2010 and 2009, respectively. The following table summarizes gross unrecognized stock-based compensation expenses as of August 31, 2010, excluding estimated forfeitures:

	Unrecognized Stock-Based Compensation (in thousands)	Remaining Weighted Average Recognition Period (in years)
Stock options	$ 9,038	2.6
PSUs	1,607	0.8
RSUs	7,308	1.9
ESPP	72	0.1
	$ 18,025	2.2

8. Income Taxes

In the three and six months ended August 31, 2010, we recorded income tax expense of approximately $53,000 and $76,000, respectively, compared to $8,000 and $27,000, respectively, in the corresponding periods of the prior year.

The effective tax rate for the three and six months ended August 31, 2010 was less than 1% based on our estimated taxable income for the year. We recorded tax expense primarily for state minimum taxes or income taxes in states where we have no net operating loss carryforwards and foreign taxes.

There were no material changes to our unrecognized tax benefits in the three and six months ended August 31, 2010 and we do not expect to have any significant changes to unrecognized tax benefits over the next twelve months. Because of our history of operating losses, all years remain open to audit.

9. Derivative Financial Instruments

We maintain a foreign currency risk management strategy that includes the use of derivative financial instruments designed to protect our economic value from the possible adverse effects of currency fluctuations. We do not enter into derivative financial instruments for speculative or trading purposes. Our hedging relationships are formally documented at the inception of the hedge, and hedges must be highly effective in offsetting changes to future cash flows on hedged transactions both at the inception of a hedge and on an ongoing basis. We record the ineffective portion of hedging instruments, if any, to other income (expense) in the consolidated statements of operations.

As of August 31, 2010, we had four outstanding forward contracts with an aggregate notional principal of approximately 4.4 million, which are summarized as follows (in thousands):

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	Notional Principal (Local Currency)	Notional Principal (USD)	Fair Value (USD)	Accumulated Amortized Implicit Interest (USD)
Euro maturing in February 2011	1,581	$ 2,241	$ 236	$ 8
Euro maturing in December 2010, 2011 and 2012 (1)	2,777	3,744	221	3
Total	4,358	$ 5,985	$ 457	$ 11

(1) Related to a three-year contract, under which we separately hedge each equal annual billing amounts. The forward contracts mature in December 2010, 2011 and 2012, respectively.

We designated these forward contracts as cash flow hedges of foreign currency denominated firm commitments. Our objective in purchasing these forward contracts was to negate the impact of currency exchange rate movements on our operating results. We record effective spot-to-spot changes in these cash flow hedges in accumulated other comprehensive income until the hedged transaction takes place. Combined implied interest on all forward contracts was excluded from effectiveness testing and is being recorded using the straight-line method over the terms of the forward contracts to interest expense and accumulated other comprehensive income. We did not incur any hedge ineffectiveness in the six months ended August 31, 2010 and 2009.

		Amount of Gain (Loss) Recognized In Income			
		Three Months Ended August 31,		Six Months Ended August 31,	
Derivatives Designated as Hedging Instruments	**Location**	**2010**	**2009**	**2010**	**2009**
Forward contracts	Revenue	$ 106	$ 34	$ 140	$ 34

In the three and six months ended August 31, 2010, we reclassified approximately $106,000 and $140,000, respectively, of the cumulative net unrealized gain from other comprehensive income into revenue. Over the next 12 months, we expect to reclassify to revenue approximately $101,000 and $218,000 in net unrealized gains associated with the forward contracts that settled in May 2009 and June 2010, respectively.

10. Fair Value Measurements

Effective March 1, 2008, we adopted new accounting standards for fair value measurements, which clarify that fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or a liability. As a basis for considering such assumptions, the new accounting standards establish a three-tier value hierarchy, which prioritizes the inputs used in the valuation methodologies in measuring fair value:

Level 1 Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets.

Level 2 Include other inputs that are directly or indirectly observable in the marketplace.

Level 3 Unobservable inputs which are supported by little or no market activity.

The fair value hierarchy requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

We measure our foreign currency forward contracts at fair value using Level 2 inputs, as the valuation inputs are based on quoted prices of similar instruments in active markets and do not involve management judgment.

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The following table summarizes the amounts measured at fair value (in thousands):

	Total	Significant Other Observable Inputs (Level 2)
August 31, 2010		
Assets:		
Foreign currency forward contracts(1)	$ 457	$ 457
February 28, 2010		
Assets:		
Foreign currency forward contracts(1)	$ 308	$ 308

(1) At August 31, 2010, $310 was included in prepaid expenses and other current assets and $147 was included in other assets, net on our condensed consolidated balance sheet. At February 28, 2010, $308 was included in prepaid expenses and current assets on our condensed consolidated balance sheet.

11. Comprehensive Loss

The following table summarizes the calculation and components of comprehensive loss, net of taxes (in thousands):

	Three Months Ended August 31,		Six Months Ended August 31,	
	2010	2009	2010	2009
Net loss	$ (2,850)	$ (3,145)	$ (8,717)	$ (6,867)
Gain reclassified from accumulated comprehensive income into revenue	(106)	(34)	(140)	(34)
Change in net unrealized gain and cumulative implied interest on forward contracts	(127)	(17)	401	(261)

Total comprehensive loss	$ (3,083)	$ (3,196)	$ (8,456)	$ (7,162)

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

This quarterly report on Form 10-Q contains forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended. In addition, we may make other written and oral communications from time to time that contain such statements. Forward-looking statements include statements as to industry trends and future expectations of ours and other matters that do not relate strictly to historical facts. These statements are often identified by the use of words such as may, will, expect, believe, anticipate, intend, could, estimate, or continue, and similar expressions or variations. These statements are based on the beliefs and assumptions of our management based on information currently available to management. 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. These forward-looking statements include statements in this Item 2, Management s Discussion and Analysis of Financial Condition and Results of Operations. Factors that could cause or contribute to such differences include, but are not limited to, those identified below, and those discussed in the section titled Risk Factors included elsewhere in this Form 10-Q and in our other Securities and Exchange Commission filings, including our Annual Report on Form 10-K for the fiscal year ended February 28, 2010. Furthermore, such forward-looking statements speak only as of the date of this report. We undertake no obligation to update any forward-looking statements to reflect events or circumstances after the date of such statements.

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the condensed consolidated financial statements and related notes thereto appearing elsewhere in this Form 10-Q and with the consolidated financial statements and notes thereto and management s discussion and analysis of financial condition and results of operation appearing in our Annual Report on Form 10-K for the fiscal year ended February 28, 2010.

Overview

We are a leading provider of on-demand optimization solutions to retailers and consumer products, or CP, companies. Our software services enable retailers and CP companies to separately or collaboratively define category, brand, and customer strategies based on a scientific understanding of consumer behavior and make actionable pricing, promotion, assortment, space and other merchandising and marketing recommendations to achieve their revenue, profitability, sales volume, and customer loyalty objectives. We deliver our applications by means of a software-as-a-service, or SaaS, model, which allows us to capture and analyze the most recent retailer and market-level data and enhance our software services rapidly to address our customers ever-changing merchandising and marketing needs, and connect retailers and CP companies via collaborative, Internet-based applications. During fiscal 2010, we introduced our nextGEN strategy, which combines category, brand and shopper-insights to provide our retail customers a unified understanding of shopper behavior and the ability to leverage those insights to make better business decisions on pricing, promotion, assortment and collaboration with their CP trading partners.

Our solutions consist of software services and complementary analytical services and analytical insights derived from the same platform that supports our software services. We offer our solutions individually or as a suite of integrated software services. Our solutions for the retail and CP industries include DemandTec Lifecycle Price Optimization™, DemandTec End-to-End Promotion Management™, DemandTec Assortment & Space™, DemandTec Shopper Insights™, DemandTec Targeted Marketing™, and DemandTec Trade Effectiveness™. The DemandTec TradePoint Network™ connects our solutions for the retail and CP industries. We sell our solutions through our direct sales force and receive a number of customer prospect introductions through third-parties, such as systems integrators, strategic consulting firms, and a data syndication company. We were incorporated in November 1999 and began selling our software in fiscal 2001. Our revenue has grown from $9.5 million in fiscal 2004 to $79.1 million in fiscal 2010, and was $38.4 million in the six months ended August 31, 2010. Our operating expenses have also increased significantly during these same periods. We have incurred losses to date and had an accumulated deficit of approximately $97.9 million at August 31, 2010.

We sell our software to retailers and CP companies under agreements with initial terms that generally are one to three years in length and provide a variety of services associated with our customers use of our software. Our software service agreements with retailers and CP companies are often large contracts. The annual contract value for each retail and CP company customer agreement is largely related to the size of the customer. These retail and CP customer agreements can create significant variability in the aggregate annual contract value of customer agreements signed in any given fiscal quarter. Our Advanced Deal Management agreements with CP companies that leverage the DemandTec TradePoint Network are principally one year in length and much smaller in annual and aggregate contract value than our other CP company customer software services contracts and our retail contracts. Generally, the agreements we have signed in the first fiscal quarter of a fiscal year have had an aggregate annual contract value less than that of the agreements signed in the preceding fiscal fourth quarter. In addition, the aggregate contract value of agreements signed can fluctuate significantly on a quarterly basis within any given fiscal year. A significant percentage of our new and existing customer add-on agreements are entered into during the last month, weeks, or even days of each quarter. We generally recognize the revenue we generate from each agreement ratably over the term of the agreement. Our ability to maintain or increase revenues depends on our attracting new customers, renewing agreements with our existing customers at comparable prices, and selling add-on software services to existing customers, as well as the success of our nextGEN strategy. Further, our revenue will be directly affected by the continued acceptance of our software in the marketplace, as well as the timing, size and term length of our customer agreements. If we are unable to successfully develop or acquire new software and enhance our existing applications, including solutions underlying our nextGEN strategy, we may not be able to attract and retain customers or increase or maintain our revenue.

During fiscal 2009 and 2010, the global economic environment deteriorated which resulted in delays in the execution of new and some renewal customer contracts, with some customers or potential customers electing not to enter into new or renewal contracts, and with some other customers renewing at lower prices or for shorter contract periods. Accordingly, our revenue growth slowed and our deferred revenue balances decreased during those periods. In each of the fiscal quarters ended February 28, 2010 and May 31, 2010, our revenue declined from the respective immediately preceding quarters. The impact of the adverse economic environment on our business also contributed to the net use of approximately $4.4 million of cash in operations in the quarter ended May 31, 2010 and the net use of $6.8 million of cash in operations in fiscal 2010. In the fiscal quarter ended August 31, 2010, our revenue increased approximately $2.3 million from the fiscal quarter ended May 31, 2010, and increased approximately $592,000 from the corresponding quarter of the prior year. In addition, we generated approximately $9.3 million of cash from operations in three months ended August 31, 2010. We expect that our revenue will increase in our third fiscal quarter ending November 30, 2010 and that revenue may continue to grow in the short term. However, we believe that long-term revenue growth is more difficult to predict. While there appear to be some signs of improvement in the global economic environment, we currently believe that the above global economic conditions will continue to result in a challenging environment that could negatively impact our business. Furthermore, our ability to achieve profitability will be affected by our revenue as well as our other operating expenses associated with growing our business. Our largest category of operating expenses is research and development expenses, and the largest component of our operating expenses is personnel costs.

In June 2010, we signed a multi-year agreement with Target for substantially all of our existing and certain potential future nextGEN software services. This agreement includes obligations for us to engage in certain development efforts on a commercially reasonable basis. We believe this agreement could result in this customer representing approximately 20% of our revenue during fiscal 2011. In addition, the agreement can be canceled by the customer without cause after three years and restricts our ability to sell certain future nextGEN software services and functionality to certain companies for a specific period of time.

We are headquartered in San Mateo, California, and have sales and marketing offices in North America and Europe. In the three and six months ended August 31, 2010, approximately 87% and 86%, respectively, of our revenue was attributable to sales of our software to companies located in the United States.

As of September 24, 2010, we had approximately 30.5 million shares of common stock outstanding, excluding approximately 9.4 million shares subject to outstanding options, performance stock units and restricted stock units. The issuance of shares upon the exercise of these options and settlement of these units, as well as the grant of additional options and units pursuant to our equity compensation plans, would result in additional dilution and may adversely impact our earnings per share. See Note 7 of Notes to Condensed Consolidated Financial Statements.

Critical Accounting Policies and Estimates

We prepare our consolidated financial statements in accordance with accounting principles generally accepted in the United States. These accounting principles require us to make certain estimates and judgments that can affect the reported amounts of assets and liabilities as of the date of our consolidated financial statements, as well as the reported amounts of revenue and expenses during the periods presented. We believe that our estimates and judgments were reasonable based upon information available to us at the time that these estimates and judgments were made. On an ongoing basis we evaluate our estimates and judgments. To the extent that there are material differences between these estimates and actual results, our consolidated financial statements could be adversely affected. The accounting policies that we believe reflect our more significant estimates, judgments and assumptions and which we believe are the most critical to aid in fully understanding and evaluating our reported financial results include the following:

Revenue Recognition

Stock-Based Compensation

Goodwill and Intangible Assets

Impairment of Long-Lived Assets

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. There are also areas in which management s judgment in selecting among available accounting policy alternatives would not produce a materially different result.

During the three and six months ended August 31, 2010, there were no significant changes in our critical accounting policies. Please refer to Management s Discussion and Analysis of Financial Condition and Results of Operations contained in our Annual Report on Form 10-K for the fiscal year ended February 28, 2010 and Note 1 of Notes to Condensed Consolidated Financial Statements included herein for a more complete discussion of our critical accounting policies and estimates.

Results of Operations

Revenue

We derive all of our revenue from customer agreements that cover the use of our software, various services associated with our customers use of our software, and may include software development services. We generally recognize all revenue ratably over the

term of the agreement. Our agreements are generally non-cancellable, but customers typically have the right to terminate their agreement for cause if we materially breach our obligations under the agreement and, in certain situations, may have the ability to extend the duration of their agreement on pre-negotiated terms. We invoice our customers in accordance with contractual terms, which generally provide that our customers are invoiced in advance for annual use of our software. We generally provide certain implementation services on a fixed fee basis and invoice our customers in advance. In addition, we also provide implementation and training services on a time and materials basis and invoice our customers monthly in arrears. Our payment terms typically require our customers to pay us within 30 days of the invoice date.

	Three Months Ended August 31,		Six Months Ended August 31,	
	2010	2009	2010	2009
	(in thousands)			
Revenue	$ 20,388	$ 19,796	$ 38,433	$ 39,341

Three and Six Months Ended August 31, 2010 Compared to the Three and Six Months Ended August 31, 2009. Revenue for the three months ended August 31, 2010 increased approximately $592,000, or 3%, from the corresponding period of the prior year, primarily due to a $534,000 increase in revenue from existing customers in the three months ended August 31, 2010. Revenue for the six months ended August 31, 2010 decreased approximately $908,000, or 2%, from the corresponding period of the prior year, primarily due to a $794,000 decrease in revenue from existing customers and a $763,000 decrease in revenue from customers in the six months ended August 31, 2009 who were no longer customers in the six months ended August 31, 2010. These decreases were partially offset by $649,000 of revenue from new customers in the six months ended August 31, 2010. Existing customers are those that contributed revenue in each of the periods presented. New customers are those that did not contribute any revenue in the corresponding periods of the prior year. Our revenue growth depends on our ability to attract new customers and to retain the existing revenues from our current customers over time. Some of our initial agreements with customers included fees for software, services, or hosting components that were not needed upon renewal. As a consequence, we received lower total fees upon renewal of those agreements. Additionally, during fiscal 2010, the adverse global economic conditions continued to result in delays in the execution of new and some renewal customer contracts. Some existing customers or potential customers elected not to enter into new or renewal contracts, some renewed at lower prices and/or on less favorable terms, and some delayed the timing and/or slowed the pace of certain professional services, including development projects. Accordingly, in the fiscal quarter ended May 31, 2010, our revenue declined from the immediately preceding quarter and declined from the corresponding period of the prior year. In the three months ended August 31, 2010, our revenue increased from the immediately preceding quarter, primarily because our renewals of and add-ons to existing customer contracts improved. We expect that our revenue will increase in our third quarter ending November 30, 2010 and may continue to grow in the short term. However, we believe long-term revenue growth is more difficult to predict.

Percentages of total revenue by customer type and geographic region for the periods presented were as follows:

	Three Months Ended August 31,		Six Months Ended August 31,	
	2010	2009	2010	2009
By customer type:				
Retail	81%	82%	80%	82%
CP	19	18	20	18
Total revenue	100%	100%	100%	100%
By location:				
United States	87%	87%	86%	86%

International	13	13	14	14
Total revenue	100%	100%	100%	100%

Revenue from CP companies increased as a percentage of total revenue by one and two percentage points, respectively, in the three and six months ended August 31, 2010 compared to the corresponding periods of the prior year. Revenue from customers located outside the United States as a percentage of total revenue remained flat in each of the three and six months ended August 31, 2010 compared to the corresponding periods of the prior year. Over the long term, we expect that revenue from CP companies and revenue from international customers will increase as a percentage of total revenue on an annual basis.

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Cost of Revenue

Cost of revenue includes expenses related to data centers, depreciation expenses associated with computer equipment and software, compensation and related expenses of operations, technical customer support, production operations and professional services personnel, amortization of purchased intangible assets, and allocated overhead expenses. We have contracts with three third parties for the use of their data center facilities, and our data center costs principally consist of the amounts we pay to these third parties for rack space, power and similar items. We amortize purchased intangible assets, principally for developed technology acquired in prior acquisitions. We allocate overhead costs, such as rent and occupancy costs, employee benefits, information management costs, and legal and other costs, to all departments predominantly based on headcount. As a result, we include allocated overhead expenses in cost of revenue and each operating expense category.

	Three Months Ended August 31,		Six Months Ended August 31,	
	2010	2009	2010	2009
	(dollars in thousands)			
Revenue	$ 20,388	$ 19,796	$ 38,433	$ 39,341
Cost of revenue	7,082	6,300	14,196	13,004
Gross profit	13,306	13,496	24,237	26,337
Gross margin	65%	68%	63%	67%

Three and Six Months Ended August 31, 2010 Compared to the Three and Six Months Ended August 31, 2009. Cost of revenue in the three and six months ended August 31, 2010 increased $782,000 and $1.2 million, or 12% and 9%, respectively, from the corresponding periods of the prior year. The increase in costs was primarily due to the expansion of hosting and equipment infrastructure to support our nextGEN strategy, and implementation support at certain of our customers.

Data center and equipment costs increased approximately $373,000 and $676,000, respectively, in the three and six months ended August 31, 2010 from the corresponding periods of the prior year. Our new data center in Mesa, Arizona provides the infrastructure required to handle the anticipated increase in the level of customer data processed and analyzed in our nextGEN service offerings. Contractor expense increased $200,000 and $259,000, respectively, in the three and six months ended August 31, 2010 from the corresponding periods of the prior year, to supplement our consulting workforce in implementations at certain of our customers. Additionally, our travel-related expenses increased $157,000 and $215,000, respectively, in the three and six months ended August 31, 2010 from the corresponding periods of the prior year, primarily as a result of supporting the customer implementations.

Our gross margin decreased to 65% and 63%, respectively, in the three and six months ended August 31, 2010 compared to the corresponding periods of the prior year. Both periods were adversely impacted by an increase in our infrastructure costs to support our nextGEN service offerings while the six month period ended August 31, 2010 was also adversely impacted by a simultaneous $908,000 decrease in revenue compared to the corresponding period of the prior year. We anticipate, in the short term, that our gross margin will increase from the quarter ended August 31, 2010, as we grow our revenue and leverage the infrastructure investments we have made to support our nextGEN service offerings.

Research and Development Expenses

Research and development expenses include personnel costs for our research, product management and software development personnel, and allocated overhead expenses. We devote substantial resources to extending our existing software applications as well as to developing new software.

	Three Months Ended August 31,		Six Months Ended August 31,	
	2010	2009	2010	2009
	(dollars in thousands)			
Research and development	$ 7,774	$ 7,997	$ 15,546	$ 16,153

Percent of revenue	38%	40%	40%	41%

Three and Six Months Ended August 31, 2010 Compared to the Three and Six Months Ended August 31, 2009. Research and development expenses in the three and six months ended August 31, 2010 decreased $223,000 and $607,000, or 3% and 4%, respectively, from the corresponding periods of the prior year, primarily due to decreased personnel costs, partially offset by an increase in consulting expenses and facility-related cost.

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Personnel costs decreased approximately $563,000 and $1.2 million, respectively, in the three and six months ended August 31, 2010 from the corresponding periods of the prior year, primarily because average headcount decreased by 13 and 11 in the respective periods. Stock-based compensation expense, which is a component of personnel costs, decreased $104,000 and $256,000, respectively, in the three and six months ended August 31, 2010 as PSUs and RSUs granted in fiscal 2008 and 2009 became fully vested. Partially offsetting the decrease in personnel costs, consulting service costs increased $290,000 and $410,000, respectively, in the three and six months ended August 31, 2010 compared to the corresponding periods of the prior year, primarily to support nextGEN initiatives. In addition, allocated facility-related costs increased approximately $80,000 and $209,000, respectively, in the three and six months ended August 31, 2010 from the corresponding periods of the prior year, mainly attributable to the usage of our hosting facility in Mesa, Arizona, and the increased costs of our San Mateo facility.

We intend to continue to invest significantly in our research and development efforts because we believe these efforts are essential to maintaining our competitive position. In the near term, we expect that research and development expenses will increase in absolute dollars, but decrease as a percentage of revenue as we continue to grow our business.

Sales and Marketing Expenses

Sales and marketing expenses include personnel costs for our sales and marketing personnel, including commissions and incentives, travel and entertainment expenses, marketing programs such as product marketing, events, corporate communications and other brand building expenses, and allocated overhead expenses.

	Three Months Ended August 31,		Six Months Ended August 31,	
	2010	**2009**	**2010**	**2009**
	(dollars in thousands)			
Sales and marketing	$ 5,662	$ 5,414	$ 11,987	$ 10,845
Percent of revenue	28%	27%	31%	28%

Three and Six Months Ended August 31, 2010 Compared to the Three and Six Months Ended August 31, 2009. Sales and marketing expenses in the three and six months ended August 31, 2010 increased approximately $248,000 and $1.1 million, or 5% and 11%, respectively, from the corresponding periods of the prior year, primarily as a result of increased personnel costs and accounts receivable reserves, partially offset by decreased marketing program and outside service costs.

Personnel costs increased $687,000 and $1.2 million, respectively, in the three and six months ended August 31, 2010 from the corresponding periods of the prior year, mainly due to increased compensation cost as a result of a headcount increase. Average sales and marketing headcount increased by 11 and 8, respectively, in the three and six months ended August 31, 2010 compared to the corresponding periods of the prior year. In addition, in the six months ended August 31, 2010, reserves for accounts receivable increased $480,000, of which $460,000 was recorded in the three months ended May 31, 2010, as we fully reserved for a customer invoice that was in dispute. Marketing program, event costs, and outside service expenses decreased $393,000 and $517,000, respectively, in the three and six months ended August 31, 2010 compared to the corresponding periods of the prior year as we undertook fewer marketing and branding initiatives.

In the near term, we expect that sales and marketing expenses will remain flat in absolute dollars, but decrease as a percentage of revenue as we continue to grow our revenue.

General and Administrative Expenses

General and administrative expenses include the unallocated portion of personnel costs for our executive, finance and accounting, human resources, legal, and information management personnel, third-party professional services, travel and entertainment expenses, and other corporate expenses.

	Three Months Ended August 31,		Six Months Ended August 31,	
	2010	**2009**	**2010**	**2009**

	(dollars in thousands)			
General and administrative	$ 2,428	$ 2,786	$ 4,840	$ 5,160
Percent of revenue	12%	14%	13%	13%

Three and Six Months Ended August 31, 2010 Compared to the Three and Six Months Ended August 31, 2009. General and administrative expenses in the three and six months ended August 31, 2010 decreased $358,000 and $320,000, or 13% and 6%, respectively, from the corresponding periods of the prior year, primarily due to a decrease in personnel costs and expenses associated with sales tax exposure.

Personnel costs decreased $138,000 in the three months ended August 31, 2010, and remained flat in the six months ended August 31, 2010, as compared to the corresponding periods of the prior year, mainly due to a $85,000 decrease in stock-based compensation expenses in the three months ended August 31, 2010, as PSUs and RSUs granted in fiscal 2008 and 2009 became fully vested. In addition, expense associated with sales tax exposure decreased by $235,000 and $324,000, respectively, in the three and six months ended August 31, 2010 as we reserved for sales tax exposures in certain states in the three months ended August 31, 2009.

In the near term, we expect that general and administrative expenses will remain relatively flat in absolute dollars, but decrease as a percentage of revenue as we grow our revenue.

Amortization of Purchased Intangible Assets

	Three Months Ended August 31,		Six Months Ended August 31,	
	2010	2009	2010	2009
	(dollars in thousands)			
Amortization of purchased intangible assets	$ 291	$ 588	$ 583	$ 1,177
Percent of revenue	1%	3%	2%	3%

Three and Six Months Ended August 31, 2010 Compared to the Three and Six Months Ended August 31, 2009. Expenses associated with amortization of purchased intangible assets decreased $297,000 and $594,000 in the three and six months ended August 31, 2010, respectively, from the corresponding periods of the prior year. The decrease was primarily due to the scheduled full amortization of intangible assets as of November 2009 associated with the purchase of rights to develop assortment optimization technology in May 2008 and certain intangible assets from the TradePoint acquisition. Intangible assets are being amortized using the straight-line method over their estimated useful lives, with an estimated remaining weighted average period of 2.0 years at August 31, 2010. The quarterly amortization expense of all existing purchased intangible assets will decline further beginning in the third quarter of fiscal 2011 and thereafter.

Other Income, Net

	Three Months Ended August 31,		Six Months Ended August 31,	
	2010	2009	2010	2009
	(in thousands)			
Interest income	$ 67	$ 162	$ 128	$ 391
Interest expense	(13)	(31)	(44)	(62)
Other income (expense)	(2)	21	(6)	107
Other income, net	$ 52	$ 152	$ 78	$ 436

Three and Six Months Ended August 31, 2010 Compared to the Three and Six Months Ended August 31, 2009. Other income, net decreased approximately $100,000 and $358,000 in the three and six months ended August 31, 2010, respectively, from the corresponding periods of the prior year, primarily due to decreased interest income as a result of lower interest rates.

Provision for Income Taxes

	Three Months Ended August 31,	Six Months Ended August 31,

	2010	2009	2010	2009
		(in thousands)		
Provision for income taxes	$ 53	$ 8	$ 76	$ 27

Three and Six Months Ended August 31, 2010 Compared to the Three and Six Months Ended August 31, 2009. In the three and six months ended August 31, 2010, we recorded income tax expense of approximately $53,000 and $76,000, respectively, compared to $8,000 and $27,000, respectively, in the corresponding period of the prior year. The effective tax rate for the three and six months

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ended August 31, 2010 was less than 1% based on our estimated taxable income for the year. We recorded tax expenses primarily for state minimum taxes and foreign taxes. The income tax expense in the corresponding period of the prior year was for federal alternative minimum income taxes, state income taxes in states where we have no net operating loss carryforwards, and foreign taxes.

Since inception, we have incurred annual operating losses and, accordingly, have recorded a provision for income taxes primarily for federal minimum income taxes, state income taxes principally in states where we have no net operating loss carryforwards, and foreign taxes. At February 28, 2010, we had federal and state net operating loss carryforwards of approximately $70.6 million and $43.4 million, respectively, to cover future taxable income.

Stock-Based Compensation Expense

Total stock-based compensation expense was slightly lower in the three and six months ended August 31, 2010 than in the corresponding periods of the prior year. The decrease in stock-based compensation expense was primarily a result of PSUs and RSUs granted in fiscal 2008 and 2009 being fully vested, partially offset by increase in stock-based compensation expense associated with stock options granted to new and existing employees subsequent to May and August 31, 2009, and RSUs granted during fiscal 2010. See Note 7 of Notes to our Condensed Consolidated Financial Statements contained herein for further explanation of how we derive and account for these estimates. We expect that stock-based compensation expense will vary in the future depending upon the magnitude and timing of equity incentive grants and revisions to our estimates of the number of outstanding awards expected to vest, as well as potential fluctuations in our stock price.

Liquidity and Capital Resources

At August 31, 2010, our principal sources of liquidity consisted of cash, cash equivalents, and marketable securities of $67.7 million, accounts receivable (net of allowance) of $12.8 million, and available borrowing capacity under our credit facility of $19.1 million, after reduction of approximately $917,000 to secure the operating lease commitment associated with our San Mateo headquarters facility.

Our $20.0 million revolving line of credit may be borrowed, repaid, and reborrowed until May 7, 2012 and includes a number of covenants and restrictions with which we must comply. For example, our ability to incur debt, grant liens, make investments, enter into mergers and acquisitions, pay dividends, repurchase our outstanding common stock, change our business, enter into transactions with affiliates, and dispose of assets is limited. To secure the line of credit, we have granted our lenders a first priority security interest in substantially all of our assets. Through the filing of this Quarterly Report on Form 10-Q, we were in compliance with all loan covenants.

	Six Months Ended August 31,	
	2010	**2009**
	(in thousands)	
Net cash provided by operating activities	$ 4,923	$ 1,375
Net cash used in investing activities	(13,620)	(1,415)
Net cash provided by (used in) financing activities	(47)	101

Operating Activities

Our cash flows from operating activities in any period are significantly influenced by the number of customers using our software, the number and size of new customer contracts, the timing of renewals of existing customer contracts, and the timing of payments by these customers. Our largest source of operating cash flows is cash collections from our customers, which results in decreases to accounts receivable. Our primary uses of cash in operating activities are for personnel-related expenditures and rent payments. Our cash flows from operating activities in any period will continue to be significantly affected by the extent to which we add new customers, renew existing customers, collect payments from our customers and increase personnel to grow our business.

In the six months ended August 31, 2010, we generated approximately $4.9 million of net cash from operating activities compared to approximately $1.4 million in the corresponding period of the prior year. Compared to the respective balance at February 28, 2010, deferred revenue at August 31, 2010 increased as a result of improved renewals and add-on agreements with existing customers, and accounts receivable at August 31, 2010 decreased due to strong cash collections and improved days-sales-outstanding. The net impact of the changes in deferred revenue and accounts receivable resulted in an increase in net cash from operations of approximately

$12.0 million compared to the corresponding period of the prior year. Partially offsetting the increase in cash generated from our customer collections, our loss from operations, after adjustment of noncash charges, in the six months ended August 31, 2010 increased approximately $2.2 million, as we continued to maintain our infrastructure spending and headcount levels to support our nextGEN service offerings despite the expected decrease in revenue as compared to the corresponding period of the prior year. In addition, other working capital items decreased cash from operations in the six months ended August 31, 2010 by approximately $6.3 million compared to the corresponding period of the prior year, primarily due to the timing of vendor and bonus payments.

While we generated approximately $4.9 million cash from operations in the six months ended August 31, 2010, we anticipate that the economic environment may not improve in the near term and, as a result, the signing of customer contracts and the collection of cash will continue to remain challenging and unpredictable, thereby potentially impacting our cash generation.

Investing Activities

Our primary investing activities have been capital expenditures on equipment for our data center, net purchases of marketable securities, and payments for the acquisition of businesses.

In the six months ended August 31, 2010, we used $13.6 million of net cash in investing activities compared to $1.4 million in the corresponding period of the prior year. In the six months ended August 31, 2010, we made a $900,000 cash payment associated with the Connect3 acquisition and used $426,000 of cash in payment of short-term notes payable held by former TradePoint shareholders. The net of purchases and maturities of marketable securities resulted in an approximately $9.2 million net cash outflow. Additionally, we spent approximately $3.1 million for capital equipment, mainly associated with nextGEN service offerings and the expansion of our customer base. In the six months ended August 31, 2009, we paid $12.5 million cash associated with the Connect3 acquisition, which was offset by approximately $11.6 million of net cash inflow from maturities of marketable securities.

Financing Activities

Our primary financing activities have been issuances of common stock related to our IPO in 2007, the exercise of stock options, the sale of shares pursuant to our ESPP, and borrowings and repayments under our credit facilities.

In the six months ended August 31, 2010, we used $47,000 of net cash in financing activities compared to $101,000 generated from financing activities in the corresponding period of the prior year. In April 2010, we used $937,000 to fulfill employee federal and state withholding tax obligations in connection with the vesting and settlement of certain outstanding RSUs. We withheld 148,523 shares of our common stock in lieu of the tax withholding obligations upon settlement of these RSUs. Cash used to fulfill the withholding tax obligations was largely offset by approximately $890,000 of cash proceeds from the issuance of common stock under our equity incentive plans. In the six months ended August 31, 2009, we received $1.4 million cash proceeds from issuance of common stock under our equity incentive plans, offset by approximately $1.3 million payment of short-term notes payable held by a former Connect3 officer and shareholder.

We believe that our cash, cash equivalents, and marketable securities balances at August 31, 2010, along with cash provided by operating activities, if any, will be sufficient to fund our projected operating requirements for at least the next twelve months. We may need to raise additional capital or incur debt to continue to fund our operations over the long term. Our future capital requirements will depend on many factors, including revenues, profits or losses incurred there from, any expansion of our workforce, the timing and extent of any expansion into new markets, the timing of introductions of any new functionality and enhancements to our software, the timing and size of any acquisitions of other companies or assets and the continuing market acceptance of our software. We may enter into arrangements for potential acquisitions of complementary businesses, services or technologies, either in the near or longer term, which also could require us to seek additional equity or debt financing. Additional funds may not be available on terms favorable to us or at all.

Contractual Obligations

Our principal commitments consist of obligations under operating leases for office space in the United States and data center facilities and equipment obligations. Our future operating lease obligations will change if we enter into new lease agreements upon the expiration of our existing lease agreements or if we enter into new lease agreements to expand our operations.

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At August 31, 2010, the future minimum payments under these commitments, as well as payments due under other contractual commitments, were as follows (in thousands):

	Payments Due by Period				
	Total	Less Than 1 Year	1-3 Years	3-5 Years	More Than 5 Years
Operating leases(1)	$ 10,203	$ 2,230	$ 4,600	$ 3,373	$
Contractual commitments(2)	2,117	2,117			
Total contractual obligations	$ 12,320	$ 4,347	$ 4,600	$ 3,373	$

(1) Includes approximately $9.2 million in future minimum lease payments associated with our headquarters facility in San Mateo, California, and approximately $1.0 million in future minimum lease payments for equipment and facility operating leases associated with our data center in Mesa, Arizona, all entered into in September 2009. See Note 6 of Notes to Condensed Consolidated Financial Statements.

(2) Amounts are associated with agreements that are enforceable and legally binding and that

specify all significant terms, including fixed or minimum services to be used, fixed, minimum or variable price provisions, and the approximate timing of the transaction. Obligations under contracts that we can cancel without a significant penalty are not included.

Off-Balance Sheet Arrangements

We do 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 purposes of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes, nor do we have any undisclosed material transactions or commitments involving related persons or entities.

Recent Accounting Pronouncements

For information with respect to recent accounting pronouncements and the impact of these pronouncements on our condensed consolidated financial statements, see Note 1 of Notes to Condensed Consolidated Financial Statements.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Foreign Currency Risk

As we operate internationally and fund our international operations, our cash and cash equivalents could be affected by fluctuations in foreign exchange rates. The foreign currency exchange rate effect on our cash and cash equivalents were not significant in each of the three months ended August 31, 2010 and 2009 and six months ended August 31, 2010. We recorded approximately $107,000 of foreign currency gains in the six months ended August 31, 2009.

Certain of our international sales agreements are denominated in the country of origin currency, and therefore our revenue and receivables are subject to foreign currency risk. Also, some of our operating expenses and cash flows are denominated in foreign currencies and, thus, are subject to fluctuations due to changes in foreign currency exchange rates, particularly changes in the exchange rates for the British Pound and the Euro. We periodically enter into foreign exchange forward contracts to reduce exposure in non-U.S. dollar denominated receivables. We formally assess, both at a hedge s inception and on an ongoing basis, whether the derivatives used in hedging transactions are highly effective in negating currency risk. At August 31, 2010, we had four outstanding forward foreign exchange contracts to sell Euros for U.S. dollars through December 2012, with an aggregate notional principal of approximately 4.4 million (or approximately $6.0 million). We do not enter into derivative financial instruments for speculative or trading purposes.

With respect to our international operations, which are primarily sales and marketing support entities, we have remeasured our accounts denominated in non-U.S. currencies using the U.S. dollar as the functional currency and recorded the resulting gains (losses) within other income (expense) for the period. We remeasure all monetary assets and liabilities at the current exchange rate at the end

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of the period, non-monetary assets and liabilities at historical exchange rates, and revenue and expenses at average exchange rates in effect during the period.

Interest Rate Sensitivity

We had cash and cash equivalents totaling $12.6 million and marketable securities totaling $55.1 million at August 31, 2010. These amounts were invested primarily in government securities and corporate notes and bonds with credit ratings of at least A-1 or better, money market funds registered with the SEC under rule 2a-7 of the Investment Company Act of 1940, and interest-bearing demand deposit accounts. By policy, we limit the amount of credit exposure to any one issuer and we do not enter into investments for trading or speculative purposes. Our cash and cash equivalents and marketable securities are held and invested with capital preservation as the primary objective.

Our cash equivalents and marketable securities are subject to market risk due to changes in interest rates. Fixed-rate interest securities may have their market value adversely impacted due to a rise in interest rates, while floating rate securities may produce less income than expected if interest rates fall. Due in part to these factors, our future investment income may fall short of expectations due to changes in interest rates or we may suffer losses in principal if we are forced to sell securities that decline in market value due to changes in interest rates. However, because we classify our marketable securities as held-to-maturity, no gains or losses are recognized due to changes in interest rates unless such securities are sold prior to maturity or declines in fair value are determined to be other-than-temporary. 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. Declines in interest rates, however, will reduce future investment income, if any. For instance, a fluctuation in interest rates of 100 basis points at August 31, 2010 would result in a change of approximately $677,000 in annual interest income.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

We evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of August 31, 2010, the end of the period covered by this Quarterly Report on Form 10-Q. This evaluation (the controls evaluation) was done under the supervision and with the participation of management, including our Chief Executive Officer (CEO) and Chief Financial Officer (CFO). Disclosure controls and procedures means controls and other procedures that are designed to provide reasonable assurance that information required to be disclosed in the reports that we file or submit under the Securities and Exchange Act of 1934, as amended (the Exchange Act), such as this Quarterly Report on Form 10-Q, is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed such that information is accumulated and communicated to our management, including the CEO and CFO, as appropriate to allow timely decisions regarding required disclosure. Based on the controls evaluation, our CEO and CFO have concluded that as of August 31, 2010, our disclosure controls and procedures were effective to provide reasonable assurance that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the time periods specified by the SEC and to ensure that material information relating to the Company and our consolidated subsidiaries is made known to management, including the CEO and CFO, particularly during the period when our periodic reports are being prepared.

Our management, including our CEO and CFO, believe that our disclosure controls and procedures are effective at the reasonable assurance level. However, our management, including the CEO and CFO, does not expect that our disclosure controls and procedures will prevent all errors 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. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. 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 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 controls. 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.

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Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

Changes in Internal Control over Financial Reporting

No change in our internal control over financial reporting occurred during the period covered by this Quarterly Report on Form 10-Q that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting. Internal control over financial reporting means a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings

We have from time to time become involved in legal matters that arise in the normal course of business and otherwise. For example, we were recently involved in a dispute with a customer relating to certain services. There can be no assurance that third party claims and litigation that may arise in the future will not have a material adverse effect on our business, financial position, results of operations, or cash flows, including a loss of customers, or subject us to significant financial or other remedies.

Item 1A. Risk Factors

Set forth below and elsewhere in this Quarterly Report on Form 10-Q, and in other documents we file with the Securities and Exchange Commission, or SEC, are risks and uncertainties that could cause actual results to differ materially from the results contemplated by the forward-looking statements contained in this Quarterly Report on Form 10-Q and in other written and oral communications from time to time. Because of the following factors, as well as other variables affecting our operating results, past financial performance should not be considered as a reliable indicator of future performance and investors should not use historical trends to anticipate results or trends in future periods.

Risks Related to Our Business and Industry

We may experience significant quarterly fluctuations in our operating results due to a number of factors, which makes our future operating results difficult to predict and could cause our operating results to fall below expectations.

Our quarterly operating results may fluctuate significantly due to a variety of factors, many of which are outside of our control. As a result, comparing our operating results on a period-to-period basis may not be meaningful. You should not rely on our past results as an indication of our future performance. If our operating results fall below the expectations of investors or securities analysts or below the guidance, if any, we provide to the market, the price of our common stock could decline substantially.

Factors that may affect our operating results include:

- our ability to increase sales to existing customers and to renew agreements with our existing customers at comparable prices, particularly larger retail customers;
- our ability to attract new customers, particularly larger retail and consumer products customers in both domestic and foreign markets;
- our ability to achieve success with our nextGEN strategy;
- changes in our pricing policies or those of our competitors, or pricing pressure on our software services;
- periodic fluctuations in demand for our software and services;
- volatility in the sales of our solutions on a quarterly basis and timing of the execution of new and renewal agreements within such quarterly periods;
- reductions in customers budgets for information technology purchases and delays in their purchasing cycles, particularly in light of recent adverse global economic conditions;
- our ability to develop and implement in a timely manner new software and enhancements that meet customer requirements, including our ability to develop certain substantial and customer-specific functionality as required under certain customer engagements;
- our ability to hire, train and retain key personnel;

any significant changes in the competitive dynamics of our market, including new entrants or substantial discounting of products;

our ability to control costs, including our operating expenses;

any significant change in our facilities-related costs;

the timing of hiring personnel and of large expenses such as those for trade shows and third-party professional services;

general economic conditions in the retail and CP markets;

our ability to appropriately resolve any disputes with customers;

outages and capacity constraints with our hosting partners; and

the impact of a recession or any other adverse global economic conditions on our business, including a delay in signing or a failure to sign significant customer agreements.

We have in the past experienced, and we may continue to experience, significant variations in our level of sales on a quarterly basis. In recent periods, several of our customers have delayed or failed to renew their agreements with us upon expiration, or have renewed at lower prices. Such variations in our sales, or delays in signing or a failure to sign or renew significant customer agreements, have led to significant fluctuations in our cash flows and deferred revenue on a quarterly and annual basis. For example, we used approximately $6.8 million of net cash in operations in fiscal 2010, primarily due to the use of $10.5 million of net cash in operations in the third quarter, while we generated approximately $13.8 million of net cash from operations in fiscal 2009 and $4.9 million cash in the six months ended August 31, 2010. Our operating results have been impacted, and will likely continue to be impacted in the near term, by any delays in signing or failures to sign significant customer agreements. If the global economic environment does not improve in the short term and delays in signing customer agreements continue in any future fiscal quarters, our future operating results for any such quarter and for subsequent quarters may be below the expectations of securities analysts or investors, which may result in a decline in our stock price.

In September 2009, we entered into a lease agreement for office space in San Mateo, California that we use as our new corporate headquarters, replacing our then-existing corporate headquarters in San Carlos, California. The lease has a total lease term of eight years with an initial non-cancellable lease term of five years commencing December 1, 2009. The aggregate minimum lease commitment is approximately $10.1 million. Upon commencement of this lease, our monthly rent payments increased significantly both immediately and in the long term over our monthly rent payments for our prior space, and quarterly real estate-related operating expenses that we incur increased by approximately $207,000. If our revenue does not increase or our operating expenses do not decrease to offset this increase in real estate-related operating expenses, or if we are unable to find suitable tenants to sublease a significant portion of this space in the event we are unable to sufficiently grow our business in the future, then our results of operations and financial position will be materially adversely impacted.

In addition, in the past, certain of our customers have filed for bankruptcy protection. For example, during fiscal 2010, two of our customers, Bi-Lo LLC and The Penn Traffic Company, filed voluntary petitions for relief under Chapter 11 of the United States Bankruptcy Code. Our agreements with these customers have subsequently been terminated. It is possible that any customers or potential customers seeking bankruptcy protection could seek to cancel their agreements with us, or could elect not to purchase new or additional services or renew such services with us, or could fail to pay us according to our contractual terms, any of which would negatively impact our results of operations or financial position in the future.

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

We have a history of losses and have not achieved profitability in any fiscal year. We experienced net losses of $11.8 million, $5.0 million and $4.5 million in fiscal 2010, fiscal 2009 and fiscal 2008, respectively, and a net loss of

$8.7 million in the six months ended August 31, 2010. At August 31, 2010, we had an accumulated deficit of $97.9 million. We expect to continue to incur net losses in fiscal 2011 and perhaps beyond. In addition, our cost of revenue and operating expenses may increase in future periods as we implement initiatives to continue to grow our business. If the recent adverse global economic environment continues to negatively impact our business and our revenue does not increase to offset these expected increases in cost of revenue and operating expenses, we will not be profitable. For example, in fiscal 2010 our costs grew faster than our revenue such that our net loss increased to $11.8 million in fiscal 2010 compared to $5.0 million in fiscal 2009. In the near term, our revenue growth may slow. For instance, our revenue in each of the fiscal quarters ended February 28, 2010 and May 31, 2010 declined from the immediately preceding quarters. Accordingly, we cannot assure you that we will be able to achieve or maintain profitability in the future.

The effects of recent adverse global economic conditions may adversely impact our business, operating results or financial condition.

Recent adverse global economic conditions have caused a general tightening in the credit markets, lower levels of liquidity, increases in the rates of default and bankruptcy, extreme volatility in credit, equity and fixed income markets, and economic contraction. The retail and consumer products industries have been and may continue to be especially hard hit by these economic developments, which in recent periods has resulted in some customers delaying or not entering into new agreements or renewing their existing agreements with us. In addition, current or potential customers may not have funds to enter into or renew their agreements for our software and services, which could cause them to delay, decrease or cancel purchases of our software and services, to renew at lower prices, or to not pay us or to delay paying us for previously purchased software and services. Financial institution failures may cause us to incur increased expenses or make it more difficult either to utilize our existing debt capacity or otherwise obtain financing for our operations, investing activities (including the financing of any future acquisitions), or financing activities. Finally, our investment portfolio, which includes short-term debt securities, is subject to general credit, liquidity, counterparty, market and interest rate risks that may be exacerbated by the ongoing global financial conditions. If the banking system or the fixed income, credit or equity markets deteriorate or remain volatile, our investment portfolio may be impacted and the values and liquidity of our investments could be adversely affected.

We depend on a small number of customers, which are primarily large retailers, and our growth, if any, depends upon our ability to add new and retain existing large customers.

We derive a significant percentage of our revenue from a relatively small number of customers, and the loss of any one or more of those customers could decrease our revenue and harm our current and future operating results. Our retail customers accounted for 80% of our revenue in the six months August 31, 2010. Two customers accounted for approximately 28% of our revenue in the six months ended August 31, 2010 and one customer accounted for 15% of our revenue in the six months ended August 31, 2009. In addition, in June 2010, we signed a multi-year agreement with Target for substantially all of our current and certain potential future nextGEN software services, and we believe this agreement could result in Target representing approximately 20% of our revenue during fiscal 2011. Although our largest customers may vary from period to period, we anticipate that we will continue to depend on revenue from a relatively small number of our large retail customers. Further, our ability to grow revenue depends on our ability to increase sales to existing customers, to renew agreements with our existing customers and to attract new customers. In fiscal 2010 we did not add any significant large new retail customers. If economic factors, including the recent adverse global economic conditions, were to have a continued or increasingly negative impact on the retail market segment, it could reduce the amount that these customers spend on information technology, which would adversely affect our revenue and results of operations.

Our business depends substantially on customers renewing their agreements for our software. Any decline in our customer renewals would harm our operating results.

To maintain and grow our revenue, we must achieve and maintain high levels of customer renewals. We sell our software pursuant to agreements with initial terms that are generally from one to three years in length. Our customers have no obligation to renew their agreements after the expiration of their term, and we cannot assure you that these agreements will be renewed on favorable terms, renewed timely, or at all. The fees we charge for our solutions vary based on a number of factors, including the software, service and hosting components provided, the size of the customer, and the duration of the agreement term. Our initial agreements with customers may include fees for software, services or hosting components that may not be needed upon renewal. As a consequence, if we renew these agreements, we may receive lower total fees. In addition, if an agreement is renewed for a term longer than the preceding term, we may receive total fees in excess of total fees received in the initial agreement but a smaller average annual fee because we generally charge lower annual fees in connection with agreements with longer terms. In any of these situations, we would need to sell additional software, services or hosting in order to maintain the same level of annual fees from that customer. There can be no assurance that we will be able to renew these agreements, sell additional software or services or sell to new customers. In recent periods certain of our customers have elected not to renew their agreements with us or have renewed on less favorable terms. We have limited historical data with respect to customer renewals, so we may not be able to predict future customer renewal rates and amounts accurately. Our customer renewal rates may decline or fluctuate as a result of a number of factors, including our customers satisfaction or dissatisfaction with our software, the price of our software, the prices of competing products and services, consolidation within our customer base, customer bankruptcies, or reductions in our customers information technology spending levels. If our customers do not renew their agreements for our software for any reason, or if they renew on less favorable terms, our revenue will decline and our cash flow will be negatively impacted.

Because we generally recognize revenue ratably over the terms of our customer agreements, the lack of renewals or the failure to enter into new agreements may not immediately be reflected in our statement of operations in any significant manner but may negatively affect revenue in future quarters.

We generally recognize revenue ratably over the terms of our customer agreements and invoice our customers in advance for annual use of our software and certain implementation services on a fixed fee basis. As a result, most of our quarterly revenue results from agreements entered into during previous quarters. Consequently, a decline in new or renewed agreements in a particular quarter, as well as any renewals at reduced annual dollar amounts, will not be reflected in any significant manner in our revenue for that quarter, but it will negatively affect revenue in future quarters. For example, in fiscal 2009 and fiscal 2010 the global economic environment deteriorated compared to prior periods. This resulted in delays in the execution of new and some renewal customer contracts, with some customers or potential customers electing not to enter into new or renewal contracts, and some other customers renewing at lower prices. Accordingly, our revenue growth slowed and revenue even declined in each of the quarters in the six month period ended May 31, 2010 compared to the immediately prior quarter.

We may expand through acquisitions of and/or partnerships with other companies, which may divert our management s attention and result in unexpected operating and technology integration difficulties, increased costs and dilution to our stockholders.

Our business strategy may include acquiring complementary software, technologies, or businesses. For instance, in February 2009, we acquired Connect3, a provider of advertising planning and execution software. Acquisitions may result in unforeseen operating difficulties and expenditures. In particular, we may encounter difficulties in assimilating or integrating the businesses, technologies, services, products, personnel, or operations of the acquired companies (including those of Connect3), especially if the key personnel of the acquired company choose not to work for us, and we may have difficulty retaining the existing customers or signing new customers of any acquired business or migrating them to a software-as-a-service model. For instance, we are currently integrating Connect3 s technology, which was offered solely on an installed, behind-the-firewall basis, into our DemandTec End-to-End Promotion Management solution, and we may not be successful in completing this integration on a timely basis or at all. Acquisitions may also disrupt our ongoing business, divert our resources and require significant management attention that would otherwise be available for ongoing development of our current business. We also may be required to use a substantial amount of our cash or issue equity securities to complete an acquisition, which could deplete our cash reserves and dilute our existing stockholders and could adversely affect the market price of our common stock. Moreover, we cannot assure you that the anticipated benefits of any acquisition, including our revenue or return on investment assumptions, would be realized or that we would not be exposed to unknown liabilities.

In addition, an acquisition may negatively impact our results of operations because we may incur additional expenses relating to one-time charges, write-downs, amortization of intangible assets, or tax-related expenses. For example, our acquisition of TradePoint in November 2006 resulted in approximately $911,000 of amortization of purchased intangible assets in fiscal 2010, and $967,000 in each of fiscal 2009 and 2008, and will result in amortization of approximately $800,000 in fiscal 2011 with declining amounts for more than six years thereafter. Our acquisition of Connect3 resulted in the write-off of $150,000 of in-process research and development costs in fiscal 2009 and amortization of purchased intangible assets of approximately $2.2 million in fiscal 2010, and will result in approximately $1.8 million and $626,000 of amortization expense in fiscal 2011 and 2012, respectively.

We might require additional capital to support our business growth, and this capital might not be available on acceptable terms, or at all.

We intend to continue to make investments to support our business growth and may require additional funds to respond to business challenges, including continued economic concerns as well as the need to develop new software or enhance our existing software, enhance our operating infrastructure and acquire complementary businesses and technologies. In May 2009, we amended our loan agreement that we had entered in April 2008 with a financial institution to, among other things, extend the maturity date to May 7, 2012 and increase our revolving line of credit from $15.0 million to $20.0 million. However, we may need to engage in equity or debt financings or enter into additional credit agreements to secure additional funds. If we raise additional funds through further issuances of equity or convertible debt securities, our existing stockholders could suffer significant dilution, and any new equity securities we issue could have rights, preferences and privileges superior to those of holders of our common stock. Any debt financing secured by us in the future could involve restrictive covenants relating to our capital-raising activities and other financial and operational matters that make it more difficult for us to obtain additional capital and to pursue business opportunities, including potential acquisitions. In addition, we may not be able to obtain additional financing on terms favorable to us, if at all. If we are unable to obtain adequate financing or financing on terms satisfactory to us, when we require it, our ability to continue to support our business growth and to respond to business challenges could be significantly limited.

Our sales cycles are long and unpredictable, and our sales efforts require considerable time and expense.

We market our software to large retailers and CP companies, and sales to these customers are complex efforts that involve educating our customers about the use and benefits of our software, including its technical capabilities. Customers typically undertake a significant evaluation process that can result in a lengthy sales cycle, in some cases over 12 months. We spend substantial time, effort, and money in our sales efforts without any assurance that our efforts will generate long-term agreements. In addition, customer sales decisions are frequently influenced by global macroeconomic factors, budget constraints, multiple approvals, and unplanned administrative, processing and other delays. If sales expected from a specific customer are not realized, our revenue and, thus, our future operating results could be adversely impacted.

Our business will be adversely affected if the retail and CP industries do not widely adopt technology solutions incorporating scientific techniques to understand and predict consumer demand to make pricing and other merchandising decisions.

Our software addresses the new and emerging market of applying econometric modeling and optimization techniques through software to enable retailers and CP companies to understand and predict consumer demand in order to improve their pricing, promotion, and other merchandising and marketing decisions. These decisions are fundamental to retailers and CP companies. Accordingly, our target customers may be hesitant to accept the risk inherent in applying and relying on new technologies or methodologies to supplant traditional methods. Our business will not be successful if retailers and CP companies do not embrace the use of software to enable more strategic pricing and other merchandising decisions.

If we are unable to continue to enhance our current software, which is becoming increasingly complex, or to develop or acquire new software to address changing business requirements, we may not be able to attract or retain customers.

Our ability to attract new customers, renew agreements with existing customers and maintain or increase revenue from existing customers will depend in large part on our ability to anticipate the changing needs of the retail and CP industries, to enhance our increasingly complex existing software and to introduce new software that meet those needs. Certain of our implementation and integration engagements, particularly with respect to initial deployment with larger customers, have become increasingly complex. Further, certain of our engagements require, and other future engagements may require, us to develop certain substantial and customer-specific functionality. Such engagements can be significantly more time-consuming and complicated than our other customer engagements. Any new software may not be introduced in a timely or cost-effective manner and may not achieve market acceptance, meet customer expectations or contractual commitments, or generate revenue sufficient to recoup the cost of development or acquisition of such software. For example, we have not yet completed development or achieved market acceptance of certain components of our solutions underlying our nextGEN strategy with respect to which we have made certain commitments to engage in development efforts on a commercially reasonable basis. If we are unable to successfully develop or acquire new software and enhance our existing applications to meet customer requirements, we may not be able to attract or retain customers.

Understanding and predicting consumer behavior is dependent upon the continued availability of accurate and relevant data from retailers and third-party data aggregators. If we are unable to obtain access to relevant data, or

if we do not enhance our core science and econometric modeling methodologies to adjust for changing consumer behavior, our software may become less competitive or obsolete.

The ability of our econometric models to forecast consumer demand depends upon the assumptions we make in designing the models and in the quality of the data we use to build them. Our models rely on point of sale (POS), transaction log or loyalty program data provided to us directly by our retail customers and by third-party data aggregators. Consumer behavior is affected by many factors, including evolving consumer needs and preferences, new competitive product offerings, more targeted merchandising and marketing, emerging industry standards, and changing technology. Data adequately representing all of these factors may not be readily available in certain geographies or in certain markets. In addition, the relative importance of the variables that influence demand will change over time, particularly with the continued growth of the Internet as a viable retail alternative and the emergence of non-traditional marketing channels. If our retail customers are unable to collect POS, transaction log or loyalty program data or we are unable to obtain such data from them or from third-party data aggregators, or if we fail to enhance our core science and modeling methodologies to adjust for changes in consumer behavior, customers may delay or decide against purchases or renewals of our software.

We rely on our management team and will 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 depends to a significant degree on our ability to attract, retain and motivate our management team and our other key personnel. Our professional services organization and other customer-facing groups, in particular, play an instrumental role in ensuring our customers satisfaction. In addition, our science, engineering, and modeling team requires experts in econometrics and advanced mathematics, and there are a limited number of individuals with the education and training necessary to fill these roles should we experience employee departures. All of our employees work for us on an at-will basis, and there is no assurance that any employee will remain with us. Our competitors may be successful in recruiting and hiring members of our executive management team or other key employees, and it may be difficult for us to find suitable replacements on a timely basis. Many of the members of our management team and key employees are substantially vested in their shares of our common stock or options to purchase shares of our common stock, and therefore retention of these employees may be difficult in the highly competitive market and geography in which we operate our business.

We have derived most of our revenue from sales to our retail customers. If our software is not widely accepted by CP companies, our ability to grow our revenue and achieve our strategic objectives will be harmed.

To date, we have derived most of our revenue from retail customers. In the six months ended August 31, 2010, we generated approximately 80% of our revenue from sales to retail customers, while we generated approximately 20% of our revenue from sales to CP companies. In the six months ended August 31, 2009, we generated approximately 82% of our revenue from sales to retail customers while we generated approximately 18% of our revenue from sales to CP companies. In order to grow our revenue and to achieve our long-term strategic objectives, including growth of our retail and CP customer network, it is important for us to expand our sales to derive a more significant portion of our revenue from new and existing CP customers. If CP companies do not widely accept our software, our revenue growth and business will be harmed.

We face intense competition that could prevent us from increasing our revenue and prevent us from becoming profitable.

The market for our software is highly competitive and we expect competition to intensify in the future. Competitors vary in size and in the scope and breadth of the products and services they offer. Currently, we face competition from traditional enterprise software application vendors such as Oracle Corporation and SAP AG, niche retail software vendors such as KSS Group (recently acquired by dunnhumby USA) and Revionics, Inc., and statistical tool vendors such as SAS, Inc. To a lesser extent, we also compete or potentially compete with marketing information providers for the CP industry such as The Nielsen Company and Information Resources, Inc., as well as business consulting firms such as McKinsey & Company, Inc., Deloitte & Touche LLP and Accenture LLP, which offer merchandising consulting services and analyses. Because the market for our solutions is relatively new, we expect to face additional competition from other established and emerging companies and, potentially, from internally-developed applications. This competition could result in increased pricing pressure, reduced profit margins, increased sales and marketing expenses and a failure to increase, or the loss of, market share.

Competitive offerings may have better performance, lower prices and broader acceptance than our software. Many of our current or potential competitors have longer operating histories, greater name recognition, larger customer bases and significantly greater financial, technical, sales, research and development, marketing and other resources than we have. As a result, our competition may be able to offer more effective software or may opt to include software competitive to our software as part of broader, enterprise software solutions at little or no charge.

We may not be able to maintain or improve our competitive position against our current or future competitors, and our failure to do so could seriously harm our business.

We rely on three third-party service providers to host our software, and any interruptions or delays in services from these third parties could impair the delivery of our software as a service.

We deliver our software to customers over the Internet. The software is hosted in three third-party data centers located in San Jose, California, Sacramento, California, and Mesa, Arizona. We do not control the operation of any of these facilities, and we rely on these service providers to provide all power, connectivity and physical security. These facilities could be vulnerable to damage or interruption from earthquakes, floods, fires, power loss, telecommunications failures and similar events. They are also subject to break-ins, computer viruses, sabotage, intentional acts of vandalism and other misconduct. The occurrence of a natural disaster or intentional misconduct, a decision to close these facilities without adequate notice or other unanticipated problems could result in lengthy interruptions in our services. Additionally, because we currently rely upon disk and tape bond back-up procedures, but do not operate or maintain a fully-redundant back-up site, there is an increased risk of service interruption.

If our security measures are breached and unauthorized access is obtained to our customers data, our operations may be perceived as not being secure, customers may curtail or stop using our software and we may incur significant liabilities.

Our operations involve the storage and transmission of our customers confidential information, and security breaches could expose us to a risk of loss of this information, litigation and possible liability. If our security measures are breached as a result of third-party action, employee error, malfeasance or otherwise, and, as a result, someone obtains unauthorized access to our customers data, our reputation will be damaged, our business may suffer and we could incur significant liability. Because techniques used to obtain unauthorized access 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 preventative 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 potential sales and existing customers.

If we fail to respond to rapidly changing technological developments or evolving industry standards, our software may become less competitive or obsolete.

Because our software is designed to operate on a variety of network, hardware and software platforms using standard Internet tools and protocols, we will need to modify and enhance our software continuously to keep pace with changes in Internet-related hardware, software, communication, browser and database technologies. Furthermore, uncertainties about the timing and nature of new network platforms or technologies, or modifications to existing platforms or technologies, could increase our research and development expenses. If we are unable to respond in a timely manner to these rapid technological developments, our software may become less marketable and less competitive or obsolete.

Our use of open source software and third-party technology could impose limitations on our ability to commercialize our software.

We incorporate open source software into our software. Although we monitor our use of open source software closely, the terms of many open source licenses have not been interpreted by United States courts, and there is a risk that these licenses could be construed in a manner that imposes unanticipated conditions or restrictions on our ability to commercialize our software. In that event, we could be required to seek licenses from third parties in order to continue offering our software, to re-engineer our technology or to discontinue offering our software in the event re-engineering cannot be accomplished on a timely basis, any of which could adversely affect our business, operating results and financial condition. We also incorporate certain third-party technologies, including software programs and algorithms, into our software and may desire to incorporate additional third-party technologies in the future. Licenses to new third-party technologies may not be available to us on commercially reasonable terms, or at all.

If we are unable to protect our intellectual property rights, our competitive position could be harmed and we could be required to incur significant expenses in order to enforce our rights.

To protect our proprietary technology, including our core statistical and mathematic models and our software, we rely on trade secret, patent, copyright, service mark, trademark and other proprietary rights laws and confidentiality agreements with employees and

third parties, all of which offer only limited protection. Despite our efforts, the steps we have taken to protect our proprietary rights may not be adequate to preclude misappropriation of our proprietary information or infringement of our intellectual property rights, and our ability to police that misappropriation or infringement is uncertain, particularly in countries outside of the United States, including China where a third party conducts a portion of our development activity for us. Further, we do not know whether any of our pending patent applications will result in the issuance of patents or whether the examination process will require us to narrow our claims. Our current patents and any future patents that may be issued may be contested, circumvented or invalidated. Moreover, the rights granted under any issued patents may not provide us with proprietary protection or competitive advantages, and, as with any technology, competitors may be able to develop technologies similar or superior to our own now or in the future.

Protecting against the unauthorized use of our trade secrets, patents, copyrights, service marks, trademarks and other proprietary rights is expensive, difficult and not always possible. Litigation may be necessary in the future to enforce or defend our intellectual property rights, to protect our trade secrets or to determine the validity and scope of the proprietary rights of others. This litigation could be costly and divert management resources, either of which could harm our business, operating results and financial condition. Furthermore, many of our current and potential competitors have the ability to dedicate substantially greater resources to enforcing their intellectual property rights than we do. Accordingly, despite our efforts, we may not be able to prevent third parties from infringing upon or misappropriating our intellectual property.

We cannot be certain that the steps we have taken will prevent the 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. The enforcement of our intellectual property rights also depends on our legal actions against these infringers being successful, but we cannot be sure these actions will 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 or where we have development work performed. 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.

Material defects or errors in our software or any failure to meet service level agreements with our customers could harm our reputation, result in significant expense to us and impair our ability to sell our software.

Our software is inherently complex and may contain material defects or errors that may cause it to fail to perform in accordance with customer expectations. Any defects that cause interruptions to the availability of our software could result in lost or delayed market acceptance and sales, require us to provide sales credits or issue refunds to our customers, cause existing customers not to renew their agreements and prospective customers not to purchase our software, divert development resources, hurt our reputation and expose us to claims for liability. After the release of our software, defects or errors may also be identified from time to time by our internal team and by our customers. In addition, we have entered into service level agreements with some of our customers warranting defined levels of uptime reliability and software performance and permitting those customers to receive service credits or discounted future services, or to terminate their agreements in the event that we fail to meet those levels. The costs incurred in correcting any material defects or errors in our software or in failing to meet any such service levels may be substantial.

Because our long-term success depends, in part, on our ability to expand sales of our software to customers located outside of the United States, our business may be increasingly susceptible to risks associated with international operations.

We have limited experience operating in international jurisdictions. In each of the six month periods ended August 31, 2010 and 2009, 14% of our revenue was attributable to sales to companies located outside the United States. 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 include:

- fluctuations in currency exchange rates;

- unexpected changes in foreign regulatory requirements;

localization of our software, including translation of the interface of our software into foreign languages and creation of localized agreements;

longer accounts receivable payment cycles and difficulties in collecting accounts receivable;

tariffs and trade barriers and other regulatory or contractual limitations on our ability to sell or develop our software in certain international markets;

difficulties in managing and staffing international operations;

potentially adverse tax consequences, including the complexities of international value added tax systems and restrictions on the repatriation of earnings;

the burdens of complying with a wide variety of international laws and different legal standards, including local data privacy laws and local consumer protection laws that could regulate retailers permitted pricing and promotion practices;

political, social and economic instability abroad, terrorist attacks and security concerns in general; and

reduced or varied protection of intellectual property rights in some countries.

The occurrence of any of these risks could negatively affect our international business and, consequently, our results of operations.

Because portions of our software development, sustaining engineering, quality assurance and testing, operations and customer support are provided by a third party in China, our business is susceptible to risks associated with having substantial operations overseas.

Portions of our software development, sustaining engineering, quality assurance and testing, operations and customer support are provided by Sonata Services Limited, or Sonata, a third party located in Shanghai, China. As of August 31, 2010, in addition to our 147 employees in our operations, customer support, science, product management and engineering groups located in the United States, an additional 70 Sonata personnel were dedicated to our projects. Remotely coordinating a third party in China requires significant management attention and substantial resources, and there can be no assurance that we will be successful in coordinating these activities. Furthermore, if there is a disruption to these operations in China, it will require that substantial management attention and time be devoted to achieving resolution. If Sonata were to stop providing these services or if there was widespread departure of trained Sonata personnel, this could cause a disruption in our product development process, quality assurance and product release cycles and customer support organizations and require us to incur additional costs to replace and train new personnel.

Enforcement of intellectual property rights and contractual rights may be more difficult in China. China has not developed a fully integrated legal system, and the array of new laws and regulations may not be sufficient to cover all aspects of economic activities in China. In particular, because these laws and regulations are relatively new, and because of the limited volume of published decisions and their non-binding nature, the interpretation and enforcement of these laws and regulations involve uncertainties. Accordingly, the enforcement of our contractual arrangements with Sonata, our confidentiality agreements with each Sonata employee dedicated to our work, and the interpretation of the laws governing this relationship are subject to uncertainty.

If we fail to maintain proper and effective internal controls, our ability to produce accurate financial statements could be impaired, which could adversely affect our operating results, our ability to operate our business and investors views of us.

Ensuring that we have internal financial and accounting controls and procedures adequate to produce accurate financial statements on a timely basis is a costly and time-consuming effort that needs to be re-evaluated frequently. The Sarbanes-Oxley Act requires, among other things, that we maintain effective internal control over financial reporting and disclosure controls and procedures. In particular, we are required to perform annual system and process evaluation and testing of our internal control over financial reporting to allow management and our independent registered public accounting firm to report on the effectiveness of our internal control over financial reporting, as required by Section 404 of the Sarbanes-Oxley Act. In the future, our testing, or the subsequent testing by our independent registered public accounting firm, may reveal deficiencies in our internal control over financial reporting that are deemed to be material weaknesses. Our compliance with Section 404 requires that we incur substantial accounting expense and expend significant management time on compliance-related issues. Moreover, if we are not able to comply with the requirements of Section 404 in the future, or if we or our independent registered public accounting firm identifies deficiencies in our internal control over financial reporting that are deemed to be material weaknesses, the market price of our common stock could decline and we could be subject to sanctions or investigations by the NASDAQ Stock Market, the Securities and Exchange Commission, or SEC, or other regulatory authorities, which would require additional financial and management resources.

Furthermore, implementing any appropriate future changes to our internal control over financial reporting may entail substantial costs in order to modify our existing accounting systems, may take a significant period of time to complete and may distract our officers, directors and employees from the operation of our business. These changes, however, may not be effective in maintaining the adequacy of our internal control over financial reporting, and any failure to maintain that adequacy, or consequent inability to produce accurate financial statements on a timely basis, could increase our operating costs and could materially impair our ability to operate our business. In addition, investors perceptions that our internal control over financial reporting is inadequate or that we are unable to produce accurate financial statements may adversely affect our stock price. While neither we nor our independent registered public accounting firm has identified deficiencies in our internal control over financial reporting that are deemed to be material weaknesses, there can be no assurance that material weaknesses will not be subsequently identified.

If one or more of our key strategic relationships were to become impaired or if these third parties were to align with our competitors, our business could be harmed.

We have relationships with a number of third parties whose products, technologies and services complement our software. Many of these third parties also compete with us or work with our competitors. If we are unable to maintain our relationships with the key third parties that currently recommend our software or that provide consulting services on our software implementations or if these third parties were to begin to recommend our competitors products and services, our business could be harmed.

Claims by others that we infringe their proprietary technology could harm our business.

Third parties could claim that our software infringes their proprietary rights. In recent years, there has been significant litigation involving patents and other intellectual property rights, and we expect that infringement claims may increase as the number of products and competitors in our market increases and overlaps occur. In addition, to the extent that we gain greater visibility and market exposure as a public company, we will face a higher risk of being the subject of intellectual property infringement claims. Any claims of infringement by a third party, even those without merit, could cause us to incur substantial defense costs and could distract our management from our business. Furthermore, a party making such a claim, if successful, could secure a judgment that requires us to pay substantial damages. A judgment could also include an injunction or other court order that could prevent us from offering our software. In addition, we might be required to seek a license for the use of the infringed intellectual property, which may not be available on commercially reasonable terms or at all. Alternatively, we might be required to develop non-infringing technology, which could require significant effort and expense and might ultimately not be successful.

Third parties may also assert infringement claims relating to our software against our customers. Any of these claims might require us to initiate or defend potentially protracted and costly litigation on their behalf, regardless of the merits of these claims, because in certain situations we agree to indemnify our customers from claims of infringement of proprietary rights of third parties. If any of these claims succeeds, we might be forced to pay damages on behalf of our customers, which could materially adversely affect our business.

Changes in financial accounting standards or practices may cause adverse, unexpected financial reporting fluctuations and affect our reported results of operations.

A change in accounting standards or practices could have a significant effect on our reported results and might affect our reporting of transactions completed before the change is effective. New accounting pronouncements and varying interpretations of accounting pronouncements have occurred in the past and may occur in the future. Changes to existing rules or the questioning of current practices may adversely affect our reported financial results or the way we conduct our business.

We have expanded our operations in recent periods. If we fail to manage this expansion effectively, we may be unable to execute our business plan, maintain high levels of customer service or address competitive challenges adequately.

We have expanded our overall business, headcount and operations in recent periods. For instance, our headcount grew from 198 employees at February 28, 2007 to 321 employees at August 31, 2010. Headcount in research and development increased from 99 employees at February 28, 2007 to 117 employees at August 31, 2010. We may need to continue to expand our operations in order to increase our customer base and to develop additional software. Increases in our customer base could create challenges in our ability to implement our software and support our customers. In addition, we will be required to continue to improve our operational, financial and management controls and our reporting procedures. As a result, we may be unable to manage our business effectively in the future, which may negatively impact our operating results.

Evolving regulation of the Internet may affect us adversely.

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 our software and restricting our ability to store and process data for our customers. In addition, taxation of software 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 exchange over the Internet could result in a decline in the use of the Internet and the viability of Internet-based software, which could harm our business, financial condition and operating results.

Third-party claims and litigation could seriously harm our business.

We have from time to time become involved in legal matters that arise in the normal course of business and otherwise. For example, we were recently involved in a dispute with a customer relating to certain services. There can be no assurance that third party claims and litigation that may arise in the future will not have a material adverse effect on our business, financial position, results of operations, or cash flows, including a loss of customers, or subject us to significant financial or other remedies.

We incur significant costs as a result of operating as a public company, and our management is required to devote substantial time to compliance efforts.

As a public company, we incur significant legal, accounting and other expenses. The Sarbanes-Oxley Act and rules subsequently implemented by the SEC and the NASDAQ Global Market impose additional requirements on public companies, including enhanced corporate governance practices. For example, the listing requirements for the NASDAQ Global Market provide that listed companies satisfy certain corporate governance requirements relating to independent directors, audit committees, distribution of annual and interim reports, stockholder meetings, stockholder approvals, solicitation of proxies, conflicts of interest, stockholder voting rights and codes of business conduct. Our management and other personnel need to devote a substantial amount of time to complying with these requirements. Moreover, these rules and regulations have increased our legal and financial compliance costs and make some activities more time-consuming and costly. These rules and regulations could also make it more difficult for us to attract and retain qualified persons to serve on our board of directors and board committees or as executive officers and more expensive for us to obtain or maintain director and officer liability insurance.

Risks Related to Ownership of Our Common Stock

The trading price of our common stock has been volatile in the past, may continue to be volatile, and may decline.

The trading price of our common stock has fluctuated widely in the past and may do so in the future. Further, our common stock has limited trading history. Factors affecting the trading price of our common stock, many of which are beyond our control, could include:

- variations in our operating results, including any decline in our revenues;
- announcements of technological innovations, new products and services, acquisitions, strategic alliances or significant agreements by us or by our competitors;
- recruitment or departure of key personnel;
- the financial projections we may provide to the public, any changes in these projections or our failure to meet these projections;

changes in the estimates of our operating results or changes in recommendations by any securities analysts that elect to follow our common stock;

market conditions in our industry, the retail industry and the economy as a whole;

price and volume fluctuations in the overall stock market;

lawsuits threatened or filed against us or other disputes;

adoption or modification of regulations, policies, procedures or programs applicable to our business; and

the volume of trading in our common stock, including sales upon exercise of outstanding options.

In addition, if the market for technology stocks or the stock market in general experiences loss of investor confidence as has happened in recent periods, the trading price of our common stock could decline for reasons unrelated to our business, operating results, or financial condition. The trading price of our common stock might also decline in reaction to events that affect other companies in our industry even if these events do not directly affect us. Some companies that have had volatile market prices for their securities have had securities class actions filed against them. A suit filed against us, regardless of its merits or outcome, could cause us to incur substantial costs and could divert management s attention.

Future sales of shares by existing stockholders, or the perception that such sales may occur, could cause our stock price to decline.

If our existing stockholders, particularly our directors and executive officers and other significant stockholders, sell substantial amounts of our common stock in the public market, or are perceived by the public market as intending to sell, the trading price of our common stock could decline. During fiscal 2010 Crosspoint Venture Partners, previously our largest stockholder, distributed all of the shares of our common stock held by them to their limited partners, which may have impacted our stock price adversely.

If securities analysts do not publish research or publish unfavorable research about our business, our stock price and trading volume could decline.

The trading market for our common stock depends in part on the research and reports that securities analysts publish about us or our business. We have limited research coverage by securities analysts. If we do not obtain further securities analyst coverage, or if one or more of the analysts who cover us downgrade our stock or publish unfavorable research about our business, our stock price would likely decline. If one or more of these analysts cease coverage of our company or fail to publish reports on us regularly, demand for our stock could decrease, which could cause our stock price and trading volume to decline.

Insiders and other significant stockholders have substantial control over us and will be able to influence corporate matters.

At August 31, 2010, our directors, executive officers and holders of ten percent or more of our common stock beneficially owned, in the aggregate, approximately 38.7% of our outstanding common stock. As a result, these stockholders will be able to exercise significant influence over all matters requiring stockholder approval, including the election of directors and approval of significant corporate transactions, such as a merger or other sale of our company or its assets. This concentration of ownership could limit your ability to influence corporate matters and may have the effect of delaying or preventing a third party from acquiring control over us.

Anti-takeover provisions in our charter documents and Delaware law could discourage, delay or prevent a change in control of our company and may affect the trading price of our common stock.

We are a Delaware corporation and the anti-takeover provisions of the Delaware General Corporation Law may discourage, delay or prevent a change in control by prohibiting us from engaging in a business combination with an interested stockholder for a period of three years after the person becomes an interested stockholder, even if a change in control would be beneficial to our existing stockholders. In addition, our restated certificate of incorporation and amended and restated bylaws may discourage, delay or prevent a change in our management or control over us that stockholders may consider favorable. Our restated certificate of incorporation and amended and restated bylaws:

authorize the issuance of blank check preferred stock that could be issued by our board of directors to thwart a takeover attempt;

establish a classified board of directors, as a result of which the successors to the directors whose terms have expired will be elected to serve from the time of election and qualification until the third annual meeting following their election;

require that directors only be removed from office for cause and only upon a majority stockholder vote;

provide that vacancies on our board of directors, including newly created directorships, may be filled only by a majority vote of directors then in office;

limit who may call special meetings of stockholders;

prohibit stockholder action by written consent, thus requiring all actions to be taken at a meeting of the stockholders;

require supermajority stockholder voting to effect certain amendments to our restated certificate of incorporation and amended and restated bylaws; and

require advance notification of stockholder nominations and proposals.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

(a) Sales of Unregistered Securities

None.

(b) Use of *Proceeds from Public Offering of Common Stock*

In August 2007, we completed our initial public offering, or IPO, pursuant to a registration statement on Form S-1 (Registration No. 333-143248) which the U.S. Securities and Exchange Commission declared effective on August 8, 2007. Under the registration statement, we registered the offering and sale of an aggregate of up to 6,900,000 shares of our common stock. Of the registered shares, 6,000,000 of the shares of common stock issued pursuant to the registration statement were sold at a price to the public of $11.00 per share. As a result of the IPO, we raised a total of $57.6 million in net proceeds after deducting underwriting discounts and commissions and expenses.

In August 2007, we used $3.0 million of our proceeds to settle our credit facility and used $10.2 million of our proceeds to settle our term loan with Silicon Valley Bank and Gold Hill Venture Lending 03, LP. We used approximately $13.4 million of our proceeds in connection with our February 2009 acquisition of Connect3 and $1.3 million cash to pay off short-term notes payable held by a former Connect3 officer and principal shareholder during fiscal 2010 and the six months ended August 31, 2010. Furthermore, in the six months ended August 31, 2010, we used 426,000 of cash in payment of short-term notes payable held by former TradePoint shareholders. As of August 31, 2010, approximately $29.3 million of aggregate net proceeds remained invested in short-term interest-bearing obligations, investment-grade instruments, certificates of deposit or direct or guaranteed obligations of the United States government or in operating cash accounts.

We have used and intend to continue to use the remaining net proceeds from the offering for working capital and other general corporate purposes, including to finance our growth, develop new software and fund capital expenditures. Additionally, we may choose to expand our current business through acquisitions of other complementary businesses, products, services, or technologies. Pending such uses, we plan to invest the net proceeds in short-term, interest-bearing, investment grade securities.

There were no material differences in the actual use of proceeds from our IPO as compared to the planned use of proceeds as described in the final prospectus filed with the Securities and Exchange Commission pursuant to Rule 424(b).

(c) Purchases of Equity Securities by the Issuer and Affiliated Purchasers

None.

Item 3. Defaults Upon Senior Securities

None.

Item 4. ***(Removed and Reserved)***

Not applicable.

Item 5. Other Information

None.

Item 6. Exhibits

Exhibit No.	Description
10.1	Amended and Restated Master Agreement by and between the Registrant and Target Corporation, effective as of June 14, 2010, and Order Form thereunder
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1*	Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

Confidential treatment has been requested with respect to certain portions of this exhibit.

* This certification is not deemed filed with the Securities and Exchange Commission and is not to be incorporated by reference into any filing of DemandTec, Inc. under the Securities Act of 1933 or the Securities Exchange Act of 1934, whether made before or after the date of this Quarterly

Report on Form 10-Q, irrespective of any general incorporation language contained in such filing.

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SIGNATURES

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

Dated: October 1, 2010

DemandTec, Inc.

By: /s/ Mark A. Culhane
Mark A. Culhane
Executive Vice President and Chief Financial Officer
(Principal Financial and Accounting Officer)

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such filing.