

PROS Holdings, Inc.  
Form 10-K  
February 26, 2009  
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# UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

## Form 10-K

(MARK ONE)

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

For the year ended December 31, 2008

OR

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

For the transition period from        to

Commission File Number 333-141884

**PROS HOLDINGS, INC.**

(Exact name of registrant as specified in its charter)

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**Delaware**

**76-0168604**

(State or other jurisdiction of incorporation or organization)

(I.R.S. Employer Identification No.)

**3100 Main Street, Suite 900**

**Houston, Texas**

(Address of principal executive offices)

**77002**

(Zip code)

Registrant's telephone number, including area code:

**(713) 335-5151**

Securities Registered Pursuant to Section 12(b) of the Act:

<b>Title of Each Class</b>	<b>Name of Each Exchange on Which Registered</b>
Common Stock, par value \$0.001 per share	New York Stock Exchange

Securities Registered Pursuant to Section 12(g) of the Act:

**None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes  No

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  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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.

Accelerated Filer  Non-Accelerated Filer

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Large Accelerated Filer

Smaller Reporting Company

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

The aggregate market value of voting and non-voting common equity held by non-affiliates of the registrant was approximately \$215,126,574 as of June 30, 2008 based upon the closing sale price of the common stock on the New York Stock Exchange reported such date. Shares of common stock held by each officer and director and by each person who owns 5% or more of the outstanding Common Stock have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status was based on publicly filed documents and is not necessarily a conclusive determination for other purposes.

As of February 20, 2009, there were outstanding 25,691,735 shares of common stock, par value \$0.001, of the registrant.

**DOCUMENTS INCORPORATED BY REFERENCE:**

Portions of the registrant's Proxy Statement relating to its 2009 Annual Stockholders Meeting, to be filed subsequently are incorporated by reference into Part III.

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**PROS Holdings, Inc.**

**Annual Report on Form 10-K**

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**SIGNIFICANT RELATIONSHIPS REFERENCED IN THIS ANNUAL REPORT**

The terms *we*, *us*, and *our* refers to PROS Holdings Inc. and all of its subsidiaries that are consolidated in conformity with the accounting principles generally accepted in the United States of America ( *GAAP* ).

**CAUTIONARY STATEMENT REGARDING FORWARD LOOKING STATEMENTS**

This annual report on Form 10-K contains certain statements that may be deemed to be *forward-looking statements* that anticipate results based on our estimates, assumptions and plans that are subject to uncertainty. These statements are made subject to the safe-harbor provisions of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. All statements in this report not dealing with historical results or current facts are forward-looking and are based on estimates, assumptions and projections. Statements which include the words *believes*, *seeks*, *expects*, *may*, *should*, *intends*, *likely*, *targets*, *anticipates*, *estimates*, or the negative version of those words and similar statements of future or forward-looking nature identify forward-looking statements.

Numerous important factors, risks and uncertainties affect our operating results, including, without limitation, those contained in this Report, and could cause our actual results to differ materially, from the results implied by these or any other forward-looking statements made by us or on our behalf. There can be no assurance that future results will meet expectations. You should pay particular attention to the important risk factors and cautionary statements described in the section of this Report entitled *Risk Factors*. You should also carefully review the cautionary statements described in the other documents we file from time to time with the Securities and Exchange Commission ( *SEC* ), specifically all Quarterly Reports on Form 10-Q and Current reports on Form 8-K. Information contained on our website is not part of this report.

**Part I**

**Item 1. *Business***

**Overview**

We are a leading provider of pricing and margin optimization software, an emerging category of enterprise applications designed to allow companies to improve financial performance by implementing pricing excellence best practices through the use of our software products. We were founded in 1985 and initially focused our efforts on providing complex, science-based revenue management solutions to the global airline industry. In 1999, we began to consider ways to diversify our product offering to include a broader suite of pricing and margin optimization functionality. We expanded our focus beyond the airline industry to include other industries that we believed to have similar pricing challenges and a need for advanced pricing and margin optimization solutions. In July 2007, we completed our initial public offering ( *IPO* ) of our common stock in which we sold and issued 5,118,750 shares of common stock and selling stockholders sold an additional 1,706,250 shares of common stock. In addition, in December 2007, we completed a follow on offering of 5,000,000 shares of our common stock in which we sold and issued 65,000 shares of common stock and selling stockholders sold an additional 4,935,000 shares of common stock.

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By using our software products, our customers gain insight into their pricing strategies, identify detrimental pricing practices, optimize their pricing decision-making and improve their business processes and financial performance. Our software products incorporate advanced pricing science, which includes operations research, forecasting and statistics. Our innovative science-based software products analyze, execute and optimize pricing strategies using data from traditional enterprise applications, often augmenting it with real-time and historical data. Our software also uses data elements that are determined using advanced pricing science and are stored in our database. Our high performance software architecture supports real-time high volume transaction processing and allows us to handle the processing and database requirements of the most sophisticated and largest customers, including customers with hundreds of simultaneous users and sub-second electronic transactions. We provide professional services to configure our software products to meet the specific pricing needs of each customer. Our software products have a single code base and a single integrated database.

Many of our customers process large volumes of individually priced business-to-consumer and business-to-business transactions every day. Our high-performance, real-time, dynamic pricing products differ from static retail pricing products by delivering the relevant pricing information at the time the price is quoted, the deal is negotiated and the sale transaction is made. Our software products are also used to provide optimized price lists and goal-driven

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price guidance. While companies in our target industries differ in the wide range of business-to-business and business-to-customer products and services that they provide, many are similar in their need to optimally and dynamically price each individual transaction. We have installed over 200 solutions for over 100 customers across a range of industries in more than 40 countries.

**Industry background**

Pricing is an important component of an enterprise's business processes and financial performance. Companies in the manufacturing, distribution, services, hotel and cruise, and airline industries can face a variety of pricing problems such as unnecessary discounting and quoting prices below breakeven. We believe that improving pricing is one of the most strategic and powerful ways for companies to improve their business and financial performance.

A variety of trends are accelerating the need for better pricing. They include increasingly complex markets and business models as is evidenced through uncertain demand for products and services and volatile costs, greater sophistication of purchasers, proliferation of pricing entities and competitive alternatives, growing quantities of enterprise data and diminishing returns from traditional enterprise applications. One element contributing to pricing problems is the limited visibility into effective prices and margins after accounting for discounts, promotions, rebates and allowances. In addition, a lack of uniform pricing and goals, an unscientific, ad-hoc approach to pricing and a lack of complete, relevant and timely data further add to the pricing problems that we believe most companies in our target industries face. We believe most companies in our target industries have yet to develop or systematically implement pricing technology solutions that can best meet business goals and generate optimal prices.

We believe the market for pricing and margin optimization software is a large and rapidly growing opportunity that spans most major industries. We are a leading provider of pricing and revenue optimization solutions and we implement and support our products on a global basis across multiple industries and in complex and changing information technology and business environments.

**Our solution**

Our software solutions are not like ERP, SCM and CRM which automate a paper intensive current process or a people intensive current process. The goal of a pricing and margin optimization software implementation for analytics, execution, or optimization is to improve pricing processes in an effort to achieve pricing excellence. Our software products currently operate in some of the largest, most complex and demanding information technology environments.

The PROS Pricing Solution Suite is our set of integrated software products that enables enterprises in the manufacturing, distribution, services, hotel and cruise, and airline industries to apply pricing science to determine, analyze and execute optimal pricing strategies. Our software products support pricing decisions through the aggregation and analysis of extensive enterprise application data, transactional data and market information. Our software also uses data elements that are determined using advanced pricing science and are stored in our database. Our high performance software architecture supports real-time high volume transaction processing and allows us to handle the processing and database requirements of the most sophisticated and largest customers, including customers with hundreds of simultaneous users and sub-second

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electronic transactions. We provide professional services to configure our software products to meet the specific pricing needs of each customer. Our software products have a single code base and a single integrated database.

Our PROS Pricing Solution Suite provides science-based software solutions that address three areas necessary to implement and execute an effective pricing solution:

- *Scientific analytics.* Our Scientific Analytics software product provides dynamic visibility into pricing data and performance across pricing the different segments of a business including markets, customers, products, distribution channels, divisions, etc. These analytics help companies understand the pocket margin and its components and locate detrimental pricing trends and underperforming segments of their businesses that might otherwise be hard to identify.
- *Pricing execution.* Our pricing execution software products (Deal Optimizer and Price Optimizer) help companies set and implement pricing policies throughout an enterprise and improve execution through pricing decision and negotiation support. Our software products give our customers the ability to propagate pricing decisions to either users or to another enterprise application, such as a CRM or ERP application. Our execution software products allow our customers to strategically manage a large number of prices, which helps to institutionalize pricing best practices and enforce

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compliance with pricing policies.

- *Pricing optimization.* Our pricing optimization software products provide companies with pricing-related predictive analytics in the form of science-based price guidance in order to offer frontline sales representatives easy-to-use guidelines that help them in quoting a profitable price and to optimize their pricing decision-making. Using market and company data, our optimization software products enable our customers to forecast and determine an optimal price within a given set of objectives, such as maximizing market share, revenue or profit.

**Products**

Our software products help our customers improve their business and financial performance through several key benefits, which include:

- *Science-based approach to pricing.* Our software products enable our customers to apply advanced pricing science to identify and address their unique and complex pricing challenges. Our software products include a variety of advanced pricing analytics and forecasting and optimization engines that incorporate our pricing expertise and support real-time, high volume, individually priced transactions with accurate pricing information.
- *Improved business insight.* Our software products enable our customers to gain insight into their business strategy, segment and product profitability and pricing challenges. As a result, our customers can identify and characterize the relative attractiveness of products, customers, geographies and even individual transactions based on sales volume and overall profitability.
- *Enhanced planning and decision making.* Our software products enhance our customers' ability to process and implement pricing policies in a systematic manner. As a result, they are able to pursue more sophisticated and effective pricing strategies and make more informed pricing decisions. Additionally, our software products help companies implement best practices uniformly throughout an enterprise, from sales to marketing to finance.

Our PROS Pricing Solution Suite consists of our scientific pricing analytics, pricing execution and pricing optimization software products. The design of our PROS Pricing Solution Suite allows our customers to deploy all of the products at once or to implement our products incrementally. Our scientific analytics software product is the base product that is present in all implementations. Our pricing execution products, price optimizer and deal optimizer, extend the usability of the base analytics product and provide real-time transaction level optimized prices by customer and product. Our pricing optimization products help companies arrive at an optimal price by analyzing the relationships among demand, price and profit margin to provide pricing-related predictive analytics in the form of science-based price guidance in order to offer frontline sales representatives easy-to-use guidelines that help them in quoting a profitable price and to optimize their pricing decision-making. By deploying multiple products, our customers can analyze their pricing trends, execute consistent pricing policies, effectively negotiate prices and optimize their prices to support organizational goals.



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Our PROS Pricing Solution Suite uses our PROS Database, which includes pricing data elements determined using advanced pricing science, including the pocket price, pocket margin, customer willingness-to-pay, customer cost-to-serve, win-loss ratios, market price, stretch price and other relevant information. Data sources also include our customers' enterprise applications and external market data sources. Our PROS Database uses our internally developed data loaders to import data from these data sources for access by our PROS Pricing Solution Suite. The users of our PROS Pricing Solution Suite include executives, sales and marketing personnel, pricing managers and finance personnel.

Hundreds of man-years of development and science effort are contained in one common set of code, which we believe allows us to configure our software products to meet each of our customer's unique requirements and enables us to effectively support a global customer base. The PROS Configurator allows the PROS Pricing Solution Suite to be configured to meet the specific needs of each customer without writing any customer-specific code. The configuration capabilities include defining business rules, user workflows, executive dashboards, analytic views, approval processes, alerts and data, including hierarchical dimensions and measures.

*Scientific analytics*

Our Scientific Analytics software product helps companies gain insight into their pricing performance, allowing them to take action to correct poor performance and take advantage of time-sensitive opportunities. Our Scientific Analytics software product enables our customers to:

- determine pocket price and pocket margins by discrete metrics, such as by customer, product, channel, plant, sales territory and country;

- understand how various price and cost elements contribute to the pocket margin;
- identify and understand detrimental pricing trends;
- understand the components of margin variance, including price, cost, volume, product mix and exchange rate effects;
- understand differences in segment purchasing behavior;
- proactively monitor pricing performance and market conditions; and
- determine how individual customers contribute to overall revenue and profitability.

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*Pricing execution*

Our pricing execution software products consist of the Price Optimizer and Deal Optimizer products.

Price Optimizer. Our Price Optimizer product allows companies to streamline pricing processes and institute control of pricing policies to support corporate business goals. It allows organizations to create multiple rules-based price lists and quickly modify prices or guidelines in response to changes in business conditions or strategy. Our Price Optimizer product enables our customers to:

- create and manage pricing policies and rules that are aligned with corporate strategies;
- automatically generate mass price updates when pricing inputs change, including costs, competitor prices, market indices, supply availability or demand metrics;
- set up and manage field pricing and discounting guidelines based on pricing policies and benchmarks; and
- manage pricing approval and exception thresholds and the pricing approval workflow to ensure consistency in the pricing process and maintain transaction histories.

Deal Optimizer. Our Deal Optimizer product provides a sales force with the guidelines, additional context and information to negotiate better prices over the entire deal horizon. Specifically, the Deal Optimizer product enables our customers to:

- more accurately understand transaction economics including the impact of discounts, rebates, allowances, shipping terms, payment terms, replacement costs and other factors that can influence the profitability of a transaction;
- communicate price targets, price floors and profitability guidelines to appropriate decision-makers within an organization;

- consider important transaction context to aid in better price negotiations, including insight into customer price history and willingness-to-pay, current and planned inventory levels and recent trends in demand, supply, cost or competition; and
- evaluate transaction scenarios and allow comparisons to previous transactions and peer group benchmarks based on relevant metrics.

*Pricing optimization*

Our pricing optimization software products help companies arrive at an optimal price by analyzing the relationships among demand, price and profit margin taking into account operational and financial constraints. Our pricing optimization software products use advanced statistical techniques to determine optimal prices consistent with pricing strategies to provide pricing-related predictive analytics in the form of science-based price guidance. This guidance can be offered frontline sales representatives as easy-to-use guidelines that help them in quoting a profitable price and to optimize their pricing decision. These products utilize optimization and forecasting engines to solve many distinct pricing problems. Our pricing optimization software products enable our customers to:

- analyze and understand factors that influence demand in conjunction with price;
- understand customer or segment price elasticities and customer indifferences which supports the ability to cluster customers into segments based on purchasing behavior;
- construct and execute price testing to systematically manage and evaluate results of price changes;
- forecast demand and response to demand using a library of forecasting algorithms that support a vast number of business scenarios and that consider relevant variables; and
- run optimization algorithms and apply appropriate methodology to recommend optimized prices or other business controls.

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**Technology**

Software architecture. Our software architecture is based on open standards such as Java, XML and HTTP. We have created a component-based design in a service-oriented architecture to develop a flexible, layered framework. This framework supports evolution and innovation in technologies and product features.

Optimization. We have developed robust science-based forecasting and optimization engines, leveraging the deep expertise and research of our science and research group. These engines are industry-independent and are validated using our internally-developed verification and testing processes.

Configuration vs. customization. Rather than developing custom code for each customer, our PROS Pricing Solution Suite can be configured to meet each customer's business needs. The configuration capabilities include defining user workflows, executive dashboards, analytic views, approval processes, alerts and configuring data, including hierarchical dimensions and measures.

Performance and scalability. Our solutions operate in some of the largest and most demanding enterprise environments. The scalability of our technology has been tested at leading vendor benchmark performance centers, which validated the ability of our software products to scale to large data volumes and high request rates. For example, in one implementation of our real-time pricing execution product, our software products handled over 300 requests per second with 250 millisecond average response times. Another implementation of our pricing execution product handles 750 concurrent users. Also, an implementation of our pricing optimization product refreshes and maintains a data set with over one billion forecast entries and 150 million optimization results.

Data integration. The data needed to execute pricing and margin optimization functionality typically resides in a company's ERP, SCM and CRM systems, industry-specific transaction systems, office productivity tools such as spreadsheets and external market data sources. Rarely can the data needed to formulate and execute optimal pricing strategies be found in a single data source within a company. Our data integration capabilities utilize web services and file-based data interfacing to bring data from these disparate sources together into a single cohesive database to support our PROS Pricing Solution Suite. Our data integration capabilities allow us to quickly deploy our solutions to our customers.

User interface. Our technology provides a rich, browser-based interface that supports local and remote users. The user interface supports a wide variety of highly interactive charts and other data views and provides a comprehensive data security model based on user roles and scope of responsibility.

Platform support. Our software products run on most standard information technology platforms including Microsoft SQL Server and Oracle databases, 32-bit and 64-bit processors from HP, SUN, Intel, AMD and IBM, and the HP-UX, Solaris, Linux, Windows and AIX operating systems.

### **Science and research**

We believe that our long-term investment in pricing science differentiates us from our competitors. We are committed to developing high value science-based pricing and margin optimization software products as is evident by our continued investment in research and development. Research and development spending was 27% of total revenue for the year ended December 31, 2008.

We employ 30 scientists, of which 16 are PhDs, and all of whom are engaged to the advancement of pricing and margin optimization technology and its implementation in our software products. These scientists have specialties including but not limited to operations research, management science, statistics, econometrics and computational methods. Our scientists regularly interact with our customers, and our product development, sales and marketing, and professional services staff, to keep our science efforts relevant to real-world demands.

### **Services**

#### ***Pricing and implementation professional services***

Our software product implementations are different from most IT projects. We have developed a standardized and tested implementation process and have experience implementing our software products in global enterprises across multiple industries. We have implemented over 200 solutions across a range of industries in more than 40 countries.

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Our pricing services personnel are responsible for planning the implementations of our software products and they accelerate time to value realization for our customers by starting with industry based pricing best practices already embedded in our products. Our pricing professional services include analyzing a customer's current pricing processes, identifying specific high-value pricing needs and relevant pricing data and initial configuration of our software products to meet the requirements of the customer's specific business. Our implementation services personnel are responsible for the configuration and the technical deployment of our software products. Our implementation professional services include implementing our software products to configuration specifications, assisting customers in loading and validating pricing data and supporting organizational activities to assist our customers' transition from awareness of their pricing challenges to adoption of pricing excellence best practices.

*Customer support*

After our software products are installed and training is complete, our customer support personnel provide ongoing support and maintenance of our software products. Our customer support personnel are responsible for providing product support for our customers through our SupportWeb Portal, a web-based interface for submitting and tracking issues, distributing software releases and bug fixes and hosting our knowledge base. In addition, our customer support personnel respond to customer issues promptly using an escalation process that prioritizes reported issues based on a defined set of severity levels and assist customers in deploying our standard releases for each software product by providing release web seminars and documentation.

**Customers**

We provide our software products to customers in the manufacturing, distribution, services, hotel and cruise, and airline industries. Our customers are generally large global enterprises, although we have customers that are smaller in scope of operations. Approximately 54% of our total revenue came from customers outside the United States for the years ended December 31, 2008 and approximately 63% of our total revenue came from customers outside the United States for the year ended December 31, 2007 and 2006. In 2008, 2007 and 2006, we had no single customer that accounted for 10% or more of revenue.

**Sales and marketing**

We sell and market our software products primarily through our direct sales force from our headquarters in Houston, Texas. Our sales force is organized by our target markets of manufacturing, distribution, services, hotel and cruise, and airline and is responsible for the worldwide sale of our products to new customers. Our sales force works in concert with our pricing solutions personnel for selling and product demonstrations to new customers. Sales to our existing customers are generally the responsibility of our pricing professional services personnel.

Our marketing activities consist of a variety of programs designed to generate sales leads and build awareness of PROS and our pricing and margin optimization software products. We host conferences for pricing and margin optimization professionals, host informational web seminars and we participate in and sponsor other industry conferences and organizations.

**Competition**

The market for price and margin optimization solutions is competitive, fragmented and rapidly evolving. We believe the following factors are the principal basis of competition in the pricing and margin optimization software market:

- ability to offer integrated high-value solutions;
  
- pricing focus and domain expertise;
  
- organizational change management expertise;
  
- product architecture, functionality, performance, reliability and scalability;
  
- breadth and depth of product offerings;
  
- time to value for the customer;
  
- services organization and customer support;

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- existing enterprise relationships;
- large and referenceable customer base;
- vendor viability; and
- price.

We compete with a number of larger and smaller companies and in the future we expect competition will increase as companies come into this market segment. We believe we are able to compete successfully with these vendors due to our long history of providing pricing and margin optimization software products, the scope of our offerings and the flexibility and scalability of our architecture.

There are also several large enterprise application providers, such as JDA Software, Oracle and SAP that have developed offerings that include pricing and margin optimization functionality. JDA Software and Oracle entered the market primarily through their acquisitions of Manugistics and Siebel Systems, respectively, and SAP resells Vendavo's products. We believe these vendors do not provide all of the pricing and margin optimization functionality needed to support a pricing excellence-focused organization. These vendors may seek to compete on price and by bundling their pricing and margin optimization applications with other enterprise applications. We distinguish ourselves from these vendors with the breadth and depth of the functionality of our products and providing high-value pricing and margin optimization software to a global customer base in multiple industries.

In addition, there are a number of vendors that provide pricing and margin optimization software for specific industries. In the hotel industry, we compete with IDEaS and