IMPERVA INC
Form 10-Q
November 13, 2012
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the Quarterly Period Ended September 30, 2012

OR

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

For the Transition Period from to

Commission File Number 001-35338

Imperva, Inc.

(Exact name of the Registrant as Specified in its Charter)

Delaware	**03-0460133**
(State or Other Jurisdiction of Incorporation or Organization)	**(I.R.S. Employer Identification No.)**

3400 Bridge Parkway, Suite 200

Redwood Shores, California 94065

(Address of Principal Executive Offices, including Zip Code)

(650) 345-9000

(Registrant s Telephone Number, including Area Code)

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See 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	¨	Accelerated filer	¨
Non-accelerated filer	x (Do not check if a smaller reporting company)	Smaller reporting company	¨

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

Shares of Imperva, Inc. common stock, $0.0001 par value per share, outstanding as of November 1, 2012: 24,046,130 shares.

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IMPERVA, INC.

FORM 10-Q

Quarterly Period Ended September 30, 2012

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

IMPERVA, INC. AND SUBSIDIARIES

Condensed Consolidated Balance Sheets

(In thousands, except share and per share data)

	September 30, 2012 Unaudited	December 31, 2011 *
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 56,468	$ 96,025
Short-term investments	45,212	1,587
Restricted cash	591	687
Accounts receivable, net of allowance for doubtful accounts of $327 and $225 as of September 30, 2012 and December 31, 2011, respectively	26,719	25,736
Inventory	313	442
Deferred tax assets	250	246
Prepaid expenses and other current assets	2,624	1,352
Total current assets	132,177	126,075
Property and equipment, net	4,457	4,026
Severance pay fund	2,825	2,652
Restricted cash	666	666
Deferred tax assets	46	46
Other assets	608	77
TOTAL ASSETS	$ 140,779	$ 133,542
LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES:		
Accounts payable	$ 3,730	$ 3,534
Accrued compensation and benefits	10,107	7,491
Accrued and other current liabilities	3,848	4,408
Deferred revenue	26,430	21,982
Total current liabilities	44,115	37,415
Other liabilities	1,955	2,856
Deferred revenue	11,868	10,943
Accrued severance pay	3,238	2,760
TOTAL LIABILITIES	61,176	53,974
Commitments and Contingencies (Note 7)		
STOCKHOLDERS EQUITY:		
Preferred stock, $0.0001 par value - 5,000,000 shares authorized, no shares issued and outstanding as of September 30, 2012 and December 31, 2011		
Common stock, $0.0001 par value - 145,000,000 shares authorized, 24,037,971 and 22,978,166 shares issued and outstanding as of September 30, 2012 and December 31, 2011, respectively	2	2
Additional paid-in capital	153,328	147,085

Accumulated deficit	(72,793)	(66,130)
Accumulated other comprehensive income (loss)	32	(616)
TOTAL IMPERVA, INC. STOCKHOLDERS EQUITY	80,569	80,341
Noncontrolling interest	(966)	(773)
TOTAL STOCKHOLDERS EQUITY	79,603	79,568
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$ 140,779	$ 133,542

(*) The Condensed Consolidated Balance Sheet as of December 31, 2011 has been derived from the audited consolidated financial statements at that date but does not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements.

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

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IMPERVA, INC. AND SUBSIDIARIES

Condensed Consolidated Statements of Operations

(In thousands, except share and per share data)

(Unaudited)

	Three months ended September 30, 2012	Three months ended September 30, 2011	Nine months ended September 30, 2012	Nine months ended September 30, 2011
Net revenue:				
Products and license	$ 14,677	$ 11,464	$ 40,773	$ 32,821
Services	11,667	8,274	31,643	22,166
Total net revenue	26,344	19,738	72,416	54,987
Cost of revenue:				
Products and license	2,064	1,357	6,192	4,433
Services	3,466	2,893	9,338	7,062
Total cost of revenue	5,530	4,250	15,530	11,495
Gross profit	20,814	15,488	56,886	43,492
Operating expenses:				
Research and development	5,154	4,615	15,072	12,858
Sales and marketing	13,218	10,411	36,740	30,970
General and administrative	4,104	3,063	11,336	8,186
Total operating expenses	22,476	18,089	63,148	52,014
Loss from operations	(1,662)	(2,601)	(6,262)	(8,522)
Other income (expense), net	(67)	(63)	(126)	(238)
Loss before provision for income taxes	(1,729)	(2,664)	(6,388)	(8,760)
Provision for income taxes	262	205	642	471
Net loss	(1,991)	(2,869)	(7,030)	(9,231)
Loss attributable to noncontrolling interest	132	178	367	458
Net loss attributable to Imperva, Inc. stockholders	$ (1,859)	$ (2,691)	$ (6,663)	$ (8,773)
Net loss per share of common stock attributable to Imperva, Inc. stockholders, basic and diluted	$ (0.08)	$ (0.48)	$ (0.29)	$ (1.64)
Shares used in computing net loss per share of common stock, basic and diluted	23,159,742	5,553,912	22,683,810	5,334,581

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

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IMPERVA, INC. AND SUBSIDIARIES

Condensed Consolidated Statements of Comprehensive Loss

(in thousands)

(Unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2012	**2011**	**2012**	**2011**
Net loss	$ (1,991)	$ (2,869)	$ (7,030)	$ (9,231)
Other comprehensive loss (net of tax):				
Change in unrealized gain (loss) on investments.	151	(4)	186	(2)
Change in unrealized gain (loss) on derivatives	391	(339)	462	(810)
Comprehensive loss	(1,449)	(3,212)	(6,382)	(10,043)
Comprehensive loss attributable to noncontrolling interest	132	178	367	458
Comprehensive loss attributable to Imperva, Inc. stockholders	$ (1,317)	$ (3,034)	$ (6,015)	$ (9,585)

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IMPERVA, INC. AND SUBSIDIARIES

Condensed Consolidated Statements of Convertible Preferred Stock and Stockholders Equity (Deficit)

(In thousands, except share data)

(Unaudited)

For the nine months ended September 30, 2012

	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Noncontrolling Interest	Total Stockholders Equity
Balance as of January 1, 2012	22,978,166	$ 2	$ 147,085	$ (66,130)	$ (616)	$ (773)	$ 79,568
Issuance of common stock upon exercise of stock options	1,059,805		2,140				2,140
Vesting of restricted stock			681				681
Stock-based compensation			3,596				3,596
Purchase of additional ownership interest in Incapsula, Inc			(174)			174	
Components of other comprehensive income (loss), net of tax:							
Change in unrealized gain (loss) on investments					186		186
Change in unrealized gain (loss) on derivatives					462		462
Net loss				(6,663)		(367)	(7,030)
Comprehensive loss							(6,382)
Balance as of September 30, 2012	24,037,971	$ 2	$ 153,328	$ (72,793)	$ 32	$ (966)	$ 79,603

For the nine months ended September 30, 2011

	Convertible Preferred Stock Shares	Convertible Preferred Stock Amount	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Noncontrolling Interest	Total Stockholders Equity (Deficit)
Balance as of January 1, 2011	10,761,511	$ 53,442	6,143,018	$ 1	$ 3,340	$ (55,861)	$ 452	$ (351)	$ (52,419)
Issuance of common stock upon exercise of stock options			357,166		542				542
Issuance of common stock upon early exercise of stock awards			90,000						
Vesting of restricted stock					708				708
Stock-based compensation					1,154				1,154
Purchase of additional ownership interest in Incapsula, Inc					(167)			167	

Change in unrealized gain (loss) on investments							(2)		(2)
Change in unrealized gain (loss) on derivatives							(810)		(810)
Net loss						(8,773)		(458)	(9,231)
Comprehensive loss									(10,043)
Balance as of September 30, 2011	10,761,511	$ 53,442	6,590,184	$ 1	$ 5,577	$ (64,634)	$ (360)	$ (642)	$ (60,058)

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IMPERVA, INC. AND SUBSIDIARIES

Condensed Consolidated Statements of Cash Flows

(In thousands)

(Unaudited)

	Nine months ended September 30, 2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	$ (7,030)	$ (9,231)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	1,312	1,123
Stock-based compensation	3,596	1,154
Revaluation of convertible preferred stock warrant liability		154
Amortization of premiums/accretion of discounts on short-term investments	337	
Changes in operating assets and liabilities:		
Accounts receivable, net	(983)	(2,289)
Inventory	129	(100)
Prepaid expenses and other assets	(1,134)	(159)
Accounts payable	196	59
Accrued compensation and benefits	2,616	728
Accrued and other liabilities	(587)	(963)
Severance pay (net)	305	44
Deferred revenue	5,373	4,343
Deferred tax assets	(4)	2
Other	15	79
Net cash provided by (used in) operating activities	4,141	(5,056)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of short-term investments	(50,744)	(988)
Proceeds from sales/maturities of short-term investments	6,928	2,266
Purchase of property and equipment	(1,758)	(1,036)
Purchase of other assets	(400)	
Change in restricted cash	96	159
Net cash provided by (used in) investing activities	(45,878)	401
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from exercise of stock options	2,140	542
Initial public offering costs paid		(2,802)
Proceeds from issuance of restricted stock		963
Borrowings on revolving credit facility		3,000
Repayments of revolving credit facility		(501)
Net cash provided by financing activities	2,140	1,202
Effect of exchange rate changes on cash and cash equivalents	40	68
NET DECREASE IN CASH AND CASH EQUIVALENTS	(39,557)	(3,385)
CASH AND CASH EQUIVALENTS - Beginning of period	96,025	16,410

CASH AND CASH EQUIVALENTS - End of period		56,468		13,025
NONCASH INVESTING AND FINANCING ACTIVITIES:				
Vesting of restricted and early exercised stock options	$	681	$	708

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

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IMPERVA, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Basis of Presentation and Summary of Significant Accounting Policies

Business

Imperva, Inc. (together with its subsidiaries, the Company) was incorporated in April 2002 in Delaware. The Company is headquartered in Redwood Shores, California and has subsidiaries located throughout the world including Israel, Asia and Europe. The Company is engaged in the development, marketing, sales, service and support of data security solutions that provide visibility and control over high value business data across critical systems within the data center.

Basis of Presentation

The Company has prepared the accompanying unaudited Condensed Consolidated Financial Statements in accordance with Article 10 of Regulation S-X and pursuant to the rules and regulations of the Securities and Exchange Commission (the SEC). Pursuant to those rules and regulations, the Company has condensed or omitted certain information and footnote disclosure it normally includes in its annual consolidated financial statements prepared in accordance with generally accepted accounting principles (GAAP). In management s opinion, the Company has made all adjustments (consisting only of normal, recurring adjustments, except as otherwise indicated) necessary to fairly present its consolidated financial position, results of operations, and cash flows. The Company s interim period operating results do not necessarily indicate the results that may be expected for any other interim period or for the full fiscal year. These financial statements and accompanying notes should be read in conjunction with the consolidated financial statements and notes thereto in the Company s Annual Report on Form 10-K for the year ended December 31, 2011, which was filed with the SEC on March 28, 2012 (the Annual Report).

Basis of Consolidation

The condensed consolidated financial statements include the accounts of the Company and its wholly-owned and majority-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation. For its majority-owned subsidiary, Incapsula, Inc. (Incapsula), the Company separately presents the non-controlling interest on its Condensed Consolidated Balance Sheets in Total Stockholders Equity and in its Condensed Consolidated Statements of Operations.

Concentration of Revenue and Accounts Receivable

Significant customers are those which represent more than 10% of the Company s total revenue or gross accounts receivable at each respective balance sheet date. For the three months ended September 30, 2012, the Company had one customer that represented 11% of the Company s total revenue. For the three months ended September 30, 2011, the Company had one customer that represented 15% of the Company s total revenue. For the nine months ended September 30, 2012 and 2011, the Company did not have any customers that represented more than 10% of the Company s total revenue. There was one customer who represented 11% of gross accounts receivable as of September 30, 2012 and there was no such customer as of December 31, 2011.

Significant Accounting Policies

There have been no material changes to the Company s significant accounting policies as compared to the significant accounting policies described in the Company s Annual Report on Form 10-K for the year ended December 31, 2011.

Recent Accounting Pronouncements

There have been no new accounting pronouncements during the nine months ended September 30, 2012, as compared to the recent accounting pronouncements described in the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2011, that are of significance, or potential significance, to the Company.

Reverse Stock Split

In September 2011, the Company s board of directors approved an amended and restated certificate of incorporation effecting a 1-for-2 reverse stock split of the Company s issued and outstanding shares of common stock and convertible preferred stock. An amendment to the amended and restated certificate of incorporation was filed on November 7, 2011 effecting the 1-for-2 reverse stock split. The par value of the common and convertible preferred stock was not adjusted as a result of the reverse stock split. All issued and outstanding common stock, convertible preferred stock, warrants for preferred stock, and per share amounts contained in the Company s condensed consolidated financial statements have been retroactively adjusted to reflect this reverse stock split for all periods presented.

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2. Incapsula

On November 5, 2009, the Company entered into a license agreement for Incapsula to use certain developed technology of the Company. In lieu of any other fee or royalty under the license agreement, Incapsula issued to the Company 5,000,000 shares of its Series A Convertible Preferred Stock representing a 58% ownership interest at the date of issuance. The transaction was accounted for as a business combination. No value was assigned to the license on the acquisition date as the use of the license will stay within the control of the Company. Therefore, the Company s historical carrying value of the developed technology immediately prior to the acquisition was used to determine the value of the purchase consideration exchanged in the transaction. As Incapsula was a newly-formed entity with no net assets on the acquisition date and the value of the license was determined to be zero, no goodwill was recorded by the Company on the acquisition.

On March 9, 2010, the Company entered into a Series A and Series A-1 Purchase Agreement whereby Incapsula issued 6,666,666 shares of its Series A Convertible Preferred Stock to the Company in exchange for cash consideration of $3.0 million. As a result of this transaction, the Company increased its ownership interest in Incapsula to 76% at the date of issuance. The purchase of the additional ownership interest in Incapsula was treated as an equity transaction. Under the terms of the Series A and Series A-1 Purchase Agreement, the Company entered into a forward contract with Incapsula to purchase 8,750,000 shares of Incapsula s Series A-1 Convertible Preferred Stock in exchange for $7.0 million in cash consideration if certain milestones were achieved no later than September 2011. On the transaction date, no value was assigned to the forward contract as the option did not meet the definition of a derivative instrument as it did not contain a net settlement feature. Specifically, the forward contract could only be gross physically settled as Incapsula is a non-publicly traded company whose stock was not readily convertible to cash.

In July 2011, Incapsula achieved the respective performance milestones. As a result, the Company purchased 4,375,000 shares of Incapsula s Series A-1 Preferred Stock for $3.5 million thereby increasing its ownership interest to 82%. In January 2012, the Company purchased the remaining 4,375,000 shares of Incapsula s Series A-1 Preferred Stock for $3.5 million thereby increasing its ownership interest in Incapsula to 85%.

Under the terms of the agreements between the Company and Incapsula, the Company has the right, but not the obligation, to purchase the remaining ownership interest in Incapsula commencing on November 5, 2013 and ending on November 5, 2018 (the Purchase Right). Exercise of the Purchase Right is solely within the Company s control and the price for the remaining ownership interest will be based on an Incapsula enterprise valuation calculated as the greater of (i) eight times Incapsula s prior 12 months trailing revenues or (ii) seven times the aggregate amount Incapsula has raised in connection with its Series A Convertible Preferred Stock financings. On the acquisition date, no value was assigned to this Purchase Right as the option does not meet the definition of a derivative instrument as it does not contain a net settlement feature. Specifically, the Purchase Right can only be gross physically settled as Incapsula is a non-publicly traded company whose stock is not readily convertible to cash.

As of September 30, 2012 and December 31, 2011, all of the outstanding shares of Incapsula s Series A and A-1 Convertible Preferred Stock are held by the Company.

In March 2010, the board of directors of Incapsula adopted the Incapsula 2010 Share Incentive Plan pursuant to which Incapsula may grant to its employees options to purchase shares of Incapsula s common stock or restricted shares. If the Company exercises the Purchase Right option discussed above, awards under the Incapsula 2010 Share Incentive Plan would be assumed by the Company, substituted with Company stock options or cashed out, and all outstanding awards and the Incapsula 2010 Share Plan would terminate.

3. Cash, Cash Equivalents, and Short-Term Investments

The Company considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents. Cash and cash equivalents consist of cash on hand, highly liquid investments in commercial paper, money market funds and various deposit accounts.

The Company considers all high quality investments purchased with original maturities at the date of purchase greater than three months to be short-term investments. Investments are available to be used for current operations and are, therefore, classified as current assets even though maturities may extend beyond one year. Cash equivalents and short-term investments are classified as available-for-sale and are, therefore, recorded at fair value on the condensed consolidated balance sheets, with any unrealized gains and losses reported in accumulated other comprehensive income (loss), which is reflected as a separate component of stockholders equity in its condensed consolidated balance sheets, until realized. The Company uses the specific-identification method to compute gains and losses on the investments. The amortized cost of securities is adjusted for amortization of premiums and accretion of discounts to maturity. Such amortization and accretion is included as a component of other income (expense), net in the condensed consolidated statements of operations.

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Cash, cash equivalents and short-term investments consist of the following (in thousands):

	As of September 30, 2012			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Cash and cash equivalents:				
Cash	$ 23,766	$	$	$ 23,766
Bank deposits	12,519			12,519
Commercial paper	16,999		2	16,997
Money market funds	3,186			3,186
Total	$ 56,470	$	$ 2	$ 56,468
Short-term investments:				
Commercial paper	$ 9,518	$ 2	$	$ 9,520
Corporate debt obligations	20,830	47		20,877
Bank deposits	10,063			10,063
US agency securities	2,003		1	2,002
Mutual funds	2,667	83		2,750
Total	$ 45,081	$ 132	$ 1	$ 45,212

	As of December 31, 2011			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Cash and cash equivalents:				
Cash	$ 26,023	$	$	$ 26,023
Bank deposits	20,000			20,000
Money market funds	50,002			50,002
Total	$ 96,025			$ 96,025
Short-term investments - Mutual funds	$ 1,644	$	$ 57	$ 1,587

None of the Company s short-term investments have been in an unrealized loss position for more than twelve months as of September 30, 2012 and December 31, 2011.

The following table summarizes the cost and estimated fair value of short-term investments based on stated effective maturities as of September 30, 2012 (in thousands):

	As of September 30, 2012	
	Amortized Cost	Estimated Fair Value
Short-term investments:		
Due within one year	$ 38,772	$ 38,934
Due within two years	6,254	6,278

Total	$ 45,026	$ 45,212

The Company reviews its short-term investments on a regular basis to evaluate whether or not any security has experienced an other-than-temporary decline in fair value. The Company considers factors such as the length of time and extent to which the market value has been less than the cost, the financial condition and near-term prospects of the issuer and its intent to sell, or whether it is more likely than not the Company will be required to sell, the investment before recovery of the investment s amortized cost basis. If the Company believes that an other-than-temporary decline exists in one of these securities, the Company writes down these investments to fair value. For debt securities, the portion of the write-down related to credit loss would be recorded to other income (expense), net, in the Company s condensed consolidated statements of operations. Any portion not related to credit loss would be recorded to accumulated other comprehensive income (loss), which is reflected as a separate component of stockholders equity in the Company s condensed consolidated balance sheets. During the nine months ended September 30, 2012, the Company did not consider any of its investments to be other-than-temporarily impaired.

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4. Fair Value of Financial Instruments

The Company evaluates assets and liabilities subject to fair value measurements on a recurring basis to determine the appropriate level to classify them for each reporting period. There have been no transfers between fair value measurement levels during the nine months ended September 30, 2012.

The Company s cash equivalents and short-term investment instruments are classified within Level 1 or Level 2 of the fair value hierarchy because they are valued using quoted market prices, broker or dealer quotations, or alternative pricing sources with reasonable levels of price transparency. The types of instruments valued based on quoted market prices in active markets include mutual funds and money market securities, and are generally classified within Level 1 of the fair value hierarchy.

The types of instruments that are valued based on other observable inputs include investment-grade corporate bonds, commercial paper, bank deposits and United States government agency securities. Such instruments are generally classified within Level 2 of the fair value hierarchy.

The Company executes its foreign currency contracts primarily in the retail market in an over-the-counter environment with a relatively high level of price transparency. The market participants usually are large multi-national and regional banks. The Company s foreign currency contracts valuation inputs are based on quoted prices and quoted pricing intervals from public data sources and do not involve management judgment. These contracts are typically classified within Level 2 of the fair value hierarchy.

The following table sets forth the Company s assets and liabilities that were measured at fair value as of September 30, 2012 and December 31, 2011, by level within the fair value hierarchy (in thousands):

	As of September 30, 2012			
	Level I	**Level II**	**Level III**	**Fair Value**
Financial Assets:				
Cash and cash equivalents:				
Bank deposits	$	$ 12,519	$	$ 12,519
Commercial paper		16,997		16,997
Money market funds	3,186			3,186
Short-term investments:				
Corporate debt obligations		20,877		20,877
Bank deposits		10,063		10,063
Commercial paper		9,520		9,520
US agency securities		2,002		2,002
Mutual funds	2,750			2,750
Prepaid expenses and other current assets - Forward foreign exchange contracts		269		269
Total financial assets	$ 5,936	$ 72,247	$	$ 78,183
Financial Liability -				
Accrued and other current liabilities - Forward foreign exchange contracts	$	$ 350	$	$ 350

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	As of December 31, 2011			
	Level I	Level II	Level III	Fair Value
Financial Assets:				
Cash and cash equivalents:				
Bank deposits	$	$ 20,000	$	$ 20,000
Money market funds	50,002			50,002
Short-term investments - Mutual funds	1,587			1,587
Total financial assets	$ 51,589	$ 20,000	$	$ 71,589
Financial Liability -				
Accrued and other current liabilities - Forward foreign exchange contracts	$	$ 631	$	$ 631

In addition to the amounts disclosed in the above table, the fair value of the Company s Israeli severance pay assets, which were comprised of Level II assets, was $2.8 million and $2.7 million as of September 30, 2012 and December 31, 2011, respectively.

5. Derivative Instruments

The Company s primary objective for holding derivative instruments is to reduce its exposure to foreign currency rate changes. The Company reduces its exposure by entering into forward foreign exchange contracts with respect to operating expenses that are forecast to be incurred in currencies other than U.S. dollars. Substantially all of the Company s revenue and capital purchasing activities and a majority of its operating expenditures are transacted in U.S. dollars. However, certain operating expenditures are incurred in or exposed to other currencies, primarily the Israeli shekel and the Euro.

The Company has established forecasted transaction currency risk management programs to protect against fluctuations in fair value and the volatility of future cash flows caused by changes in exchange rates. The Company s currency risk management program includes forward foreign exchange contracts designated as cash flow hedges. These forward foreign exchange contracts generally mature within 12 months. The Company does not enter into derivative financial instruments for trading purposes.

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Derivative instruments measured at fair value and their classification on the condensed consolidated balance sheets are presented in the following tables (in thousands):

	Asset (Liability) as of September 30, 2012		(Liability) as of December 31, 2011 (unaudited)	
	Notional Amount	Fair Value	Notional Amount	Fair Value
Forward foreign exchange contracts included in accrued and other current liabilities	$ 15,378	$ (350)	$ 20,135	$ (631)
Forward foreign exchange contracts included in prepaid expenses and other current assets	$ 12,446	$ 269		

Gains (losses) on derivative instruments and their classification on the condensed consolidated statement of operations are presented in the following table (in thousands):

	For the three months ended September 30,		For the nine months ended September 30,	
	2012	2011	2012	2011
Foreign Exchange Forward Contract Derivatives in cash flow hedging relationships:				
Gains recognized in OCI (a)	$ 223	$	223	$
Losses recognized in OCI (a)	(115)	(204)	(225)	(138)
Gains recognized from accumulated OCI into net loss (b)		139		674
Losses recognized from accumulated OCI into net loss (b)	(283)		(464)	
Gains recognized in net loss (c)				49
Losses recognized in net loss (c)		(6)	(5)	
Foreign Exchange Forward Contract Derivatives not designated as hedging relationships:				
Gains recognized in net loss (d)	47		117	
Losses recognized in net loss (d)	$	$	$ (17)	$

(a) Net change in the fair value of the effective portion classified in other comprehensive income (loss) (OCI).

(b) Effective portion of cash flow hedges reclassified from accumulated other comprehensive income (loss) into net loss, of which $(17) and $(266) were recognized within cost of sales and operating expenses, respectively, for the three months ended September 30, 2012 and $(31) and $(433) were recognized within cost of sales and operating expenses for the nine months ended September 30, 2012. $11 and $128 were recognized within cost of sales and operating expenses, respectively for the three months ended September 30, 2011 and $53 and $621 were recognized within cost of sales and operating expenses, respectively, for the nine months ended September 30, 2011. All amounts are reflected with the respective condensed consolidated statement of operations.

(c) Ineffective portion and amount excluded from effectiveness testing classified in other income (expense), net.

(d) Classified in other income (expense), net.

6. Revolving Credit Facility

In September 2010, the Company entered into a revolving credit facility of up to $6.0 million with a financial institution. As of September 30, 2012 and December 31, 2011, there was no balance outstanding on the credit facility. The credit facility originally provided for an expiration on October 15, 2012, which has since been extended through December 17, 2012. The Company expects to enter into a one-year extension to the credit facility on substantially similar terms prior to its expiration. The credit facility, is secured by the assets of the Company, and contains a restrictive covenant that requires the Company to maintain a minimum cash and cash equivalents balance of $3.0 million. The terms of this agreement requires payment of an unused line fee of 0.25% per quarter of the unused portion and bears interest at LIBOR plus 2.75%. As of September 30, 2012 and December 31, 2011, the Company was compliant with the covenant of the credit facility.

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7. Commitments and Contingencies

(a) Operating Leases

The Company rents its facilities under operating leases with lease periods expiring from 2013 to 2018. Future minimum payments under these facility operating leases are as follows as of September 30, 2012 (in thousands):

Year Ending December 31:	
2012 (remaining 3 months)	$ 662
2013	3,359
2014	2,617
2015	2,271
2016	2,131
Thereafter	1,513
Total	$ 12,553

Rent expense for the Company s operating leases is recognized on a straight-line basis over the lease term. Rent expense for the nine months ended September 30, 2012 and 2011 was $1.5 million and $1.7 million, respectively.

In connection with a lease of office space, the Company received a tenant improvement allowance of $639,000 during the year ended December 31, 2010 from the lessor for certain improvements made to the leased property. The Company has recorded the tenant improvement allowance as a leasehold improvement within property and equipment, net, and a deferred rent within other liabilities on the condensed consolidated balance sheets. The deferred rent liability is amortized to rent expense over the term of the lease on a straight-line basis. The leasehold improvements are being amortized to expense over the period from when the improvements were placed into service until the end of their useful life, which is the end of the lease term.

In addition, certain of the Company s operating lease agreements for office space also include rent holidays and scheduled rent escalations during the initial lease term. The Company has recorded the rent holidays as a deferred rent within other liabilities on the condensed consolidated balance sheets. The Company recognizes the deferred rent liability and scheduled rent increase on a straight-line basis into rent expense over the lease term commencing on the date the Company takes possession of the lease space.

As of September 30, 2012 the Company has $666,000 in restricted deposits to secure bank guarantees provided to the lessor.

(b) Cancelable Lease Agreement

The Company leases motor vehicles under a cancelable operating lease agreement. The Company has an option to cancel the lease agreement, which may result in penalties in a maximum amount of $78,000 as of September 30, 2012. Motor vehicle lease expenses for the nine months ended September 30, 2012, and 2011 were $1.5 million, and $1.4 million, respectively.

(c) Purchase Commitments

As of September 30, 2012 and December 31, 2011, the Company had purchase commitments of $3.5 million and $3.0 million, respectively, to purchase inventory, trial units, and research and development equipment from its vendors. The purchase commitments result from the Company s contractual obligation to order or build inventory in advance of anticipated sales. According to the Company s agreements with its vendors, the Company committed to purchase inventory within nine months from the date the inventory arrived at the vendor s warehouse.

The Company also provided stand-by letters of credit to its vendors to secure its obligation to purchase the inventory. As of September 30, 2012, the Company had $562,000 of restricted deposits to secure the stand-by letters of credit provided.

(d) Litigation

From time to time, the Company may be subject to legal proceedings and claims in the ordinary course of business. The Company does not believe that it is currently a party to any material litigation; however, the Company has received, and may in the future continue to receive, claims from third parties. Future litigation may be necessary to defend the Company, its channel partners and its customers by determining the scope, enforceability and validity of third-party proprietary rights or to establish the Company s proprietary rights. Further, the ultimate outcome of any litigation is uncertain and, regardless of outcome, litigation can have an adverse impact on the Company because of defense costs, potential negative publicity, diversion of management resources and other factors. Accordingly, there can be no assurance that existing or future legal proceedings arising in the ordinary course of business or otherwise will not have a material adverse effect on the Company s business, consolidated financial position, results of operations or cash flows.

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(e) Indemnification

The Company from time to time enters into certain types of contracts that contingently require it to indemnify various parties against claims from third parties. These contracts primarily relate to (i) the Company s bylaws, under which it must indemnify directors and executive officers, and may indemnify other officers and employees, for liabilities arising out of their relationship, (ii) contracts under which the Company must indemnify directors and certain officers for liabilities arising out of their relationship, (iii) contracts under which the Company may be required to indemnify customers or resellers against certain claims, including claims that a Company product infringes a patent, copyright or other intellectual property right, and (iv) procurement, consulting, or license agreements under which the Company may be required to indemnify vendors, consultants or licensors for certain claims, including claims that may be brought against them arising from the Company s acts or omissions with respect to the supplied products or technology.

In the event that one or more of these matters were to result in a claim against the Company, an adverse outcome, including a judgment or settlement, may cause a material adverse effect on the Company s future business, operating results or financial condition. It is not possible to determine the maximum potential amount under these indemnification agreements due to the limited history of prior indemnification claims and the unique facts and circumstances involved in each particular agreement.

The Company maintains director and officer insurance, which may cover certain liabilities arising from its obligation to indemnify its directors and officers.

From time to time, the Company may receive indemnification claims in the normal course of business. The Company does not believe it is party to any currently pending claims the outcome of which will have a material adverse effect on its operations or financial position.

8. Stock Plans

(a) 2003 Stock Plan

During 2003, the Board of Directors adopted the 2003 Stock Plan (the 2003 Plan), which allows for the granting of both incentive stock options and non-qualified stock options and the direct award or sale of shares of the Company s common stock (including restricted common stock) to officers, employees, directors, consultants and other key persons. Incentive stock options may be granted to employees with exercise prices of no less than the fair value of the common stock on the grant date, and non-statutory options may be granted to employees, directors, or consultants at exercise prices of no less than 85% of the fair value of the common stock on the grant date, as determined by the Board of Directors. If, at the time the Company grants an option, the optionee directly or by attribution owns stock possessing more than 10% of the total combined voting power of all classes of stock of the Company, the option price shall be at least 110% of the fair value. Options granted under the Plan generally expire no later than ten years and in general vest four years from the date of grant.

(b) 2011 Stock Option and Incentive Plan

On September 9, 2011, the Board of Directors adopted the 2011 Stock Option and Incentive Plan (the 2011 Plan) which was subsequently approved by the Company s stockholders. The 2011 Plan replaces the 2003 Plan as the Board has decided not to grant any additional awards under that plan. The Company has reserved a total of 1,000,000 shares of common stock for issuance under the 2011 Plan. In addition, any reserved but unissued shares under the 2003 Stock Plan will be added to the number of shares reserved for issuance under the 2011 Plan. The 2011 Plan also provides that the number of shares reserved and available for issuance under the plan will automatically increase each January 1, beginning in 2012 and ending in 2015, by 4% of the outstanding number of shares of common stock on the immediately preceding December 31. The Board of Directors or compensation committee may reduce the amount of the increase in any particular year. As of December 31, 2011, there were 1,886,296 shares available for grant under the 2011 Plan. On January 1, 2012, the share reserve under the 2011 Plan was automatically increased by 919,127 shares.

The 2011 Plan permits the granting of incentive stock options, non-qualified stock options, restricted stock units, stock appreciation rights, restricted shares of common stock and performance share awards. The exercise price of stock options may not be less than the 100% of the fair market value of the common stock on the date of grant. Options granted pursuant to the 2011 Plan generally expire no later than ten years.

(c) 2011 Employee Stock Purchase Plan

On September 9, 2011, the Board of Directors adopted the 2011 Employee Stock Purchase Plan (the ESPP) which was subsequently approved by the Company s stockholders. The ESPP took effect on the effective date of the registration statement for the Company s IPO. The ESPP permits eligible employees to acquire shares of the Company s common stock by accumulating funds through periodic payroll deductions of up to 15% of base salary. Each offering period may run for no more than 24 months and consist of no more than five purchase periods. The purchase price for shares of the Company s common stock purchased under the ESPP will be 85% of the lesser of the fair market value of the Company s common stock on the first day of the offering period or the last trading day of the applicable purchase period within that offering period.

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The Company has initially reserved a total of 500,000 shares of common stock for future issuance under the ESPP. The number of shares reserved for issuance under the ESPP will increase automatically on January 1 of each of the first eight years commencing in 2012 by the number of shares equal to 1% of the Company s total outstanding shares as of the immediately preceding December 31. The Board of Directors or compensation committee may reduce the amount of the increase in any particular year. No more than 20,000,000 shares of common stock may be issued under the ESPP and no other shares may be added to the ESPP without the approval of the Company s stockholders. On January 1, 2012, the share reserve under the 2011 Employee Stock Purchase Plan was automatically increased by 229,782 shares.

(d) Incapsula 2010 Share Incentive Plan

In March 2010, Incapsula s board of directors adopted the Incapsula 2010 Share Incentive Plan (the Incapsula Plan), pursuant to which Incapsula may grant to its employees and service providers options to purchase shares of its common stock, restricted shares, or restricted share units. The total number of shares of common stock that may be granted under the Incapsula Plan shall not exceed 4,733,333 in the aggregate, subject to certain adjustments.

The following table summarizes option activity under the Incapsula Plan and related information for the nine months ended September 30, 2012:

	Shares Available for Grant	Number of Stock Options Outstanding	Weighted Average Exercise Price
Outstanding - January 1, 2012	2,921,833	1,774,000	$ 0.08
Granted	(232,500)	232,500	0.25
Exercised		(90,000)	0.15
Forfeited	50,000	(50,000)	0.19
Outstanding - September 30, 2012	2,739,333	1,866,500	$ 0.10

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(e) Stock Compensation Expense

The Company recognized stock-based compensation expense under the 2011 Stock Option and Incentive Plan, 2003 Stock Plan, 2011 Employee Stock Purchase Plan, and the Incapsula 2010 Share Incentive Plan in the condensed consolidated statements of operations as follows (in thousands):

	For the three months ended September 30,		For the nine months ended September 30,	
	2012	2011	2012	2011
Cost of revenues	$ 143	$ 29	$ 302	$ 73
Research and development	372	35	759	83
Sales and marketing	665	102	1,365	245
General and administrative	582	412	1,170	753
Total stock-based compensation expense	$ 1,762	$ 578	$ 3,596	$ 1,154

The fair value of stock option and ESPP grants to employees for the three and nine months ended September 30, 2012 and 2011 was estimated using the following weighted average assumptions:

	For the three months ended September 30,		For the nine months ended September 30,	
	2012	2011	2012	2011
Stock option grants:				
Dividend rate	0%	0%	0%	0%
Risk-free interest rate	0.8%	1.1%	1.0%	0.9%
Expected term (in years)	6.1	5.3	6.0	4.2
Expected volatility	46%	49%	48%	59%
ESPP grants:				
Dividend rate			0%	
Risk-free interest rate			0.2%	
Expected term (in years)			0.5	
Expected volatility			38%	

The fair value of the RSUs is determined using the closing price of the Company s common stock on the date of the grant. Compensation is recognized on a straight-line basis over the requisite service period of each grant adjusted for estimated forfeitures.

The following table summarizes share-based award activity under the 2011 Plan:

	Shares Available for Grant	Number of Stock Options Outstanding	Weighted Average Exercise Price	Number of Restricted Stock Units Outstanding	Weighted Average Grant Date Fair Value
Balances - January 1, 2012	1,886,296	2,871,005	$ 4.15		$
Additional shares added to the pool	919,127				
Granted	(965,952)	580,184	31.79	385,768	31.14
Exercised or released		(1,059,806)	2.00		
Cancelled or forfeited	183,229	(177,854)	9.91	(5,375)	34.02

Balances - September 30, 2012	2,022,700	2,213,529	$	11.97	380,393	$	31.10

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Supplemental disclosure information about our stock options outstanding as of September 30, 2012 is as follows:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (Years)	Aggregate Intrinsic Value (in thousands)
Options exercisable	639,185	$ 3.42	6.95	$ 21,460
Options outstanding	2,213,529	$ 11.97	8.18	$ 55,431

The aggregate intrinsic value of options exercised under the Plan was $29.0 million for the nine months ended September 30, 2012. The aggregate intrinsic value is calculated as the difference between the per-share exercise price and the market value of the Company s common stock for each share subject to an option multiplied by the number of shares subject to options. As reported in the Wall Street Journal, the market value as of September 30, 2012 was $36.99 per share. As of September 30, 2012, total compensation cost related to unvested stock-based awards granted to employees under the Plan, but not yet recognized, was $16.4 million, net of estimated forfeitures. As of September 30, 2012, this cost will be amortized to expense over a weighted-average remaining period of 2.4 years, and will be adjusted for subsequent changes in estimated forfeitures. Future stock-based award grants will increase the amount of compensation expense to be recorded in these periods.

There was no capitalized stock-based compensation cost and there were no recognized stock-based compensation tax benefits during the nine months ended September 30, 2012 and 2011.

(f) Common Stock Subject to Repurchase

Pursuant to restricted stock agreements with the Company s CEO, the Company has the right, but not the obligation, to repurchase the unvested shares of common stock upon termination of employment at the original purchase price per share. The repurchase rights with respect to the common stock lapse over the vesting period, which ranges from 48 months to 60 months. The amounts received in exchange for these shares have been included in other liabilities in the accompanying condensed consolidated balance sheet and are reclassified to equity as the shares vest. The Company granted 843,819 shares of restricted common stock with a weighted-average grant date fair value per share of $1.94 during the year ended December 31, 2010. There were no grants of shares of restricted common stock during the nine months ended September 30, 2012 and the year ended December 31, 2011. As of September 30, 2012, 487,833 shares of restricted common stock held by the Company s CEO were unvested and subject to repurchase by the Company.

(g) Early Exercise of Stock Options

In 2010 and 2011, the Company s board of directors allowed for the early exercise of stock options granted to certain members of the Company s board of directors. The amounts received in exchange for these shares have been included in other liabilities in the accompanying condensed consolidated balance sheet and are reclassified to equity as the shares vest. As of September 30, 2012, 91,875 shares were unvested.

9. Income Taxes

The Company is subject to income tax in the United States as well as other tax jurisdictions in which it conducts business. Earnings from non-U.S. activities are subject to local country income tax. The Company does not provide for federal income taxes on the undistributed earnings of its foreign subsidiaries as such earnings are to be reinvested indefinitely. The Company recorded income tax expense of $0.3 million and $0.2 million for the three months ended September 30, 2012 and 2011, respectively, and $0.6 million and $0.5 million for the nine months ended September 30, 2012 and 2011, respectively. These income tax expense amounts were primarily attributable to foreign taxes.

Factors that impact the income tax provision include, but are not limited to, stock-based compensation expense, permanent tax adjustments, foreign operations and a valuation allowance against the Company s deferred tax assets.

10. Segment Information

The Company has two operating segments which are also both reportable business segments: (i) Imperva, which is comprised of Imperva s and its wholly-owned subsidiaries financial position and results of operations; and (ii) Incapsula, which is comprised entirely of the financial position and results from operations of the Company s majority-owned subsidiary, which commenced operations in late 2009.

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The following table presents a summary of the Company s operating segments (in thousands):

	For the three months ended September 30,		For the nine months ended September 30,	
	2012	2011	2012	2011
Imperva:				
Net revenue	$ 26,122	$ 19,711	$ 71,941	$ 54,952
Operating loss	(957)	(1,884)	(4,238)	(6,617)
Provision for income tax	224	199	597	443
Net loss	(1,134)	(2,073)	(4,783)	(7,254)
Depreciation and amortization	427	394	1,237	1,101
Stock-based compensation	1,755	567	3,575	1,137
Total assets	$ 136,401	$ 39,028	$ 136,401	$ 39,028
Incapsula:				
Net revenue	$ 222	$ 27	$ 475	$ 35
Operating loss	(705)	(717)	(2,024)	(1,905)
Provision for income tax	38	6	45	28
Net loss	(857)	(796)	(2,247)	(1,977)
Depreciation and amortization	35	9	75	22
Stock-based compensation	7	11	21	17
Total assets	$ 4,378	$ 3,437	$ 4,378	$ 3,437

The Company s net services revenue is comprised of the following (in thousands):

	For the three months ended September 30,		For the nine months ended September 30,	
	2012	2011	2012	2011
Maintenance and support	$ 8,582	$ 6,452	$ 24,072	$ 17,766
Professional services and training	1,749	1,418	4,589	3,478
Subscriptions	1,336	404	2,982	922
Total net services revenue	$ 11,667	$ 8,274	$ 31,643	$ 22,166

The Company s net revenue by geographic region, based on the customer s location, is summarized as follows (in thousands):

	For the three months ended September 30,		For the nine months ended September 30,	
	2012	2011	2012	2011
Americas	$ 16,226	$ 12,115	$ 43,341	$ 34,316
EMEA	5,623	4,284	16,412	12,805
APAC	4,495	3,339	12,663	7,866
Total net revenue	$ 26,344	$ 19,738	$ 72,416	$ 54,987

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The following table presents long-lived assets by location (in thousands):

	As of September 30, 2012	As of December 31, 2011
United States	$ 1,852	$ 1,815
Israel	2,584	2,196
Other	21	15
Total long-lived assets	$ 4,457	$ 4,026

11. Net Loss per Share

The following outstanding shares of common stock and potential common shares were excluded from the computation of diluted net loss per share of common stock for the periods presented because including them would have been antidilutive:

	For the three months and nine months ended September 30, 2012	2011
Convertible preferred stock		10,761,524
Stock options to purchase common stock	2,213,529	2,944,899
Restricted stock units for common stock	380,393	
Restricted shares of common stock subject to repurchase	579,708	1,011,878
Common stock warrants	8,333	
Convertible preferred stock warrants		19,999

12. Related Party Transaction

The Company indirectly sells its products, licenses and services through a third party to Seagate Technology, the Executive Vice President of which is also director of the Company. Net revenues recorded from indirect sales to Seagate Technology were approximately $0.3 million for the nine months ended September 30, 2012. Net revenues for the three months ended September 30, 2012 were not significant. As of September 30, 2012, Imperva had no accounts receivable from the reseller for the indirect sales to Seagate.

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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the (1) unaudited condensed consolidated financial statements and the related notes thereto included elsewhere in this Quarterly Report on Form 10-Q, and (2) the audited consolidated financial statements and notes thereto and management s discussion and analysis of financial condition and results of operations for the year ended December 31, 2011 included in our Annual Report on Form 10-K filed with the Securities and Exchange Commission, or the SEC, on March 28, 2012. This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. 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. Such forward-looking statements are subject to risks, uncertainties and other factors that could cause actual results and the timing of certain events to differ materially from future results expressed or implied by such forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those identified herein, and those discussed in the section titled Risk Factors, set forth in Part II, Item 1A of this Form 10-Q and in our other SEC filings, including our Annual Report on Form 10-K for the year ended December 31, 2011. We disclaim any obligation to update any forward-looking statements to reflect events or circumstances after the date of such statements.

Overview

We are a pioneer and leader of a new category of data security solutions focused on providing visibility and control over high-value business data across critical business systems within the data center. Our SecureSphere Data Security Suite is a broad solution designed to prioritize and mitigate risks to high-value business data, protect against hackers and malicious insiders, and address and streamline regulatory compliance. SecureSphere is an integrated, modular suite, which provides database, file and web application security, and secures business data across various systems in data centers, including traditional on-premise data centers as well as private, public and hybrid cloud computing environments. We also offer cloud-based security services that deliver on-demand and cost effective web application security.

We were founded in 2002 with the vision of protecting high-value business data within the enterprise. Since that time we have been investing in our data security products to meet the rapidly evolving demands of customers. We shipped our initial web application security and data security products in 2002; in 2006, we expanded our database security product to include compliance features; and in 2010, we launched our file security offering. In addition, in 2010, we launched our cloud-based initiatives with ThreatRadar and, in 2011, we introduced our cloud-based offering for mid-market enterprises and small and medium-sized businesses (SMB) that we provide through Incapsula, Inc., our majority-owned subsidiary.

Our research and development efforts are focused primarily on improving and enhancing our existing data security products and services, as well as developing new products and services and conducting advanced security research. We conduct our research and development activities in Israel, and we believe this provides us with access to some of the best engineering talent in the security industry. As of September 30, 2012, we had 149 employees dedicated to research and development, including our advanced security research group, the Application Defense Center (ADC). Our research and development expense was $5.2 million and $15.1 million for the three and nine months ended September 30, 2012, respectively, as compared to $4.6 million and $12.9 million for the same periods in 2011, respectively.

We derive our revenue from sales and licenses of our products and sales of our services. Products and license revenue is generated primarily from sales of perpetual software licenses installed on hardware appliances or virtual appliances for our SecureSphere Data Security Suite. Services revenue consists of maintenance and support, professional services and training and subscriptions. A majority of our revenue is derived from customers in the Americas region. In the nine months ended September 30, 2012, 60% of our total revenue was generated from the Americas, 23% from Europe, Middle East and Africa (EMEA) and 17% from Asia Pacific.

We market and sell our products through a hybrid sales model, which combines a direct touch sales organization and an overlay channel sales team that actively assist our extensive network of channel partners throughout the sales process. We also provide our channel partners with marketing assistance, technical training and support. We primarily sell our products and services through our channel partners, including distributors and resellers, which sell to end-user customers, who we refer to in this Quarterly Report on Form 10-Q as our customers. We have a network of over 550 channel partners worldwide, including both resellers and distributors. Historically, our channel partners originated over 55% and fulfilled almost 90% of our sales. We work with many of the world s leading security value-added resellers, and our partners include some of the largest hosting companies for cloud-based deployments.

As of September 30, 2012, we had over 2,000 customers in more than 60 countries. In addition, our solutions are used to protect thousands of organizations through cloud-based deployments with our Software-as-a-Service (SaaS) customers and our managed security service provider (MSSP) and hosting partners. Our customers include top telecommunications companies, commercial banks in the United States, financial data service firms, computer hardware companies and food and drug store companies in the United States, as well as over 150 government agencies around the world and more than 100 Fortune 1000 companies.

Our net revenue has increased in each of the last three years, growing from $39.3 million in 2009 to $78.3 million in 2011. We have incurred net losses attributable to our stockholders of $6.7 million and $10.3 million in the nine months ended September 30, 2012 and the year ended December 31, 2011, respectively. As of September 30, 2012, we had an accumulated deficit of $72.8 million.

Opportunities, Challenges and Risks

We believe that the growth of our business and our future success are dependent upon many factors, including our ability to maintain our technology leadership, improve our sales and marketing, address the needs of smaller enterprises and compete effectively in the marketplace for data security solutions. While each of these areas presents significant opportunities for us, they also pose important challenges and risks that we must successfully address in order to sustain the growth of our business and improve our results of operations.

Maintain Technology Leadership. As a result of the rise in sophisticated attacks by hackers and malicious insiders, the difficulty in complying with regulations governing business data and the growing complexity of, and open access to, data centers, we believe that enterprises are struggling to provide visibility and control over business data that they need to protect. We believe these challenges are driving the need for a new protection layer positioned closely around business data and systems in the data center. We expect that as enterprises recognize the growing risk to high-value business data and the need to comply with increasing regulatory compliance mandates, their spending will increase on solutions designed to control and protect such data. We believe that traditional security and compliance products do not address the evolving needs of enterprises or do not do so adequately, and that this presents us with a large market opportunity. To capitalize on this opportunity, we have introduced and expect that in the future we will need to continue to introduce innovations to our broad data security solutions. We cannot assure you that our products will achieve widespread market acceptance or that we will properly anticipate future customer needs. Moreover, if our products do not satisfy evolving customer requirements, we will not capture the increase in spending that we expect will result from enterprises seeking to secure business data and systems.

Invest in Sales and Marketing. In order to capitalize on the anticipated increase in spending in the data security market, we will need to continue to invest significant resources to further strengthen our existing relationships with channel partners, extend our global network by adding new channel partners and grow our sales and marketing team. Any investments that we make in our sales and marketing will occur in advance of our experiencing any benefits from such investments, and so it may be difficult for us to determine if we are efficiently allocating our resources in this area. We cannot assure you that the investments that we intend to make to strengthen our sales and marketing efforts will enable us to capitalize on the expected increase in spending in the data security market or result in an increase in revenue or an improvement in our results of operations.

Address Needs of Smaller Enterprises. As market awareness of the benefits of a broad data security solution increases, we believe there is a significant opportunity to provide data security solutions to smaller enterprises as they confront increasing security threats and compliance mandates. To capitalize on this opportunity, we intend to increase our business with mid-market enterprises and SMBs by expanding our cloud-based service offerings and our distribution channel. We have made, and may in the future continue to make, significant investments in our cloud-based security products to address the data security needs of mid-market enterprises and SMBs. If our cloud-based security products, which are relatively new, fail to gain broad acceptance with mid-market enterprises and SMBs, our revenue growth, results of operations and competitive position in our industry could suffer.

Compete Effectively. We operate in an intensely competitive market that has witnessed significant consolidation in recent years with large companies acquiring many of our competitors. We track our success rate in competitive sales opportunities against certain competitors, some of which generate higher revenues and have greater market capitalizations than we do, and many of which are more established or have greater name recognition within our industry. Based upon our internal tracking of the results of such competitive sales opportunities, we believe that we have historically competed favorably against our larger competitors, and that we have a proven track record of successfully competing against such larger competitors. Nonetheless, some of our larger competitors have numerous advantages, including, but not limited to, greater financial resources, broader product offerings and more established relationships with channel partners and customers. If we are unable to compete effectively for a share of the data security market, our business, results of operations and financial condition could be materially and adversely affected.

To date, we have incurred, and continue to incur, losses from operations and net losses. However, we believe that our existing cash, cash equivalents and short-term investments will be sufficient to meet our working capital and capital expenditure needs for at least the next 12 months. Further, we expect that, if we successfully execute our business plan and strategy, our loss from operations and our net losses will continue to decline, and that we will reach profitability. Should we need additional cash in the future, we may utilize existing lines of credit, enter into additional lines of credit or raise funds through the sale of equity securities.

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Key Metrics of Our Business

We monitor the key financial metrics discussed below to help us evaluate growth trends, establish budgets, measure the effectiveness of our sales and marketing efforts and assess operational efficiencies.

Net Revenue. We measure our net revenue to assess the acceptance of our products from our customers, our growth in the markets we serve and to help us establish our strategic and operating plans for future periods. We discuss the components of our net revenue in Financial Overview Net Revenue below.

Gross Margin. We monitor our gross margin to assess the impact on our current and forecasted financial results from any changes to the pricing and mix of products we are selling to our customers.

Loss from Operations. We track our loss from operations to assess how effectively we are planning and monitoring our operations as well as controlling our operational costs, which are primarily driven by headcount.

Cash, Cash Equivalents and Short-term Investments. We evaluate the level of our cash, cash equivalents and short-term investments to ensure we have sufficient liquidity to fund our operations, including the development of future products and product enhancements and the expansion into new sales channels and territories.

Number of Customers. We believe our customer count is a key indicator of our market penetration, the productivity of our sales organization and the value that our products bring to our customer base. We also believe our existing customers represent significant future revenue opportunities for us.

We discuss for the periods presented revenue, gross margin, the components of loss from operations and number of customers further below under Segments and Results of Operations , as applicable, and we discuss our cash and cash equivalents under Liquidity and Capital Resources.

We also believe that deferred revenue and cash flow from operations are key financial metrics for our business. The components of deferred revenue and cash flow from operations, as well as our rationale for monitoring these metrics, are discussed immediately below this table:

	For the three months ended or As of September 30,		**For the nine months ended or As of September 30,**	
	2012	2011	2012	2011
	(in thousands, except number of customers and percentages)			
Net revenue	$ 26,344	$ 19,738	$ 72,416	$ 54,987
Gross margin	79.0%	78.5%	78.6%	79.1%
Loss from operations	$ (1,662)	$ (2,601)	$ (6,262)	$ (8,522)
Total deferred revenue	$ 38,298	$ 25,560	$ 38,298	$ 25,560
Cash, cash equivalents and short-term investments	$ 101,680	$ 13,025	$ 101,680	$ 13,025
Net cash provided by (used in) operations	$ 1,284	$ (2,160)	$ 4,141	$ (5,056)
Number of customers	2,094	1,584	2,094	1,584

Deferred Revenue

Our deferred revenue consists of amounts that have been invoiced but that have not yet been recognized as revenue. The majority of our deferred revenue balance consists of the unamortized portion of services revenue from maintenance and support contracts. We monitor our deferred revenue balance because it represents a significant portion of revenue to be recognized in future periods. We also assess the increase in our deferred revenue balance plus revenue we recognized in a particular period as a measure of our sales activity for that period. While the change in our deferred revenue and revenue recognized in a given period comprise the majority of our sales activity during that period, they do not constitute the entire sales activity during the period. Our total sales activity also includes sales of products and services for which we have not yet met the criteria to recognize revenue or add such amounts to our deferred revenue balance. Revenue and deferred revenue from these transactions is recognized or recorded in future periods when we have met the required criteria. We discuss for the periods presented deferred revenue further below under Results of Operations.

Net Cash Flow Provided By Operations

We monitor cash flow from operations as a measure of our overall business performance. Our cash flow from operations is driven primarily by sales of our products and licenses and, to a lesser extent, from up-front payments from customers under maintenance and support contracts. Our primary uses of cash in operating activities are for personnel-related expenditures, costs of acquiring the hardware used for our appliances, marketing and promotional expenses and costs related to our facilities. Monitoring cash flow from operations enables us to analyze our financial performance without the non-cash effects of certain items such as depreciation and amortization and stock-based compensation expenses, thereby allowing us to better understand and manage the cash needs of our business.

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Segments

For financial reporting purposes, we operate as two reportable business segments: (i) Imperva, which is comprised of our financial position and results of operations and those of our wholly-owned subsidiaries; and (ii) Incapsula, which is comprised entirely of the financial position and results of operations of our majority-owned subsidiary. Our Incapsula segment commenced operations in November 2009 and has not generated any significant revenue since inception. In discussing our results of operations, we have provided a consolidated discussion and analysis of the revenues from our two segments and, where significant, provided a separate discussion and analysis of the operating expenses of our two segments. See Note 10 of Notes to Condensed Consolidated Financial Statements for a discussion of our financial information by segment.

Financial Overview

Net Revenue

We derive our revenue from sales and licenses of our products and sales of our services.

Our net revenue is comprised of the following:

Products and License Revenue Product and license revenue is generated from sales of perpetual software licenses installed on hardware appliances or virtual appliances for our SecureSphere Data Security Suite. Our SecureSphere Data Security Suite consists of database security, file security and web application security. We offer multiple hardware appliance versions that accompany our software, each with different throughput capacities. Perpetual software license revenue is generated from sales of our appliances, licenses for additional users and add-on software modules. We also generate a small amount of hardware revenue from sales of spares or replacement appliances, demonstration units and accessories.

Services Revenue Services revenue consists of maintenance and support, professional services and training and subscriptions. Maintenance and support revenue is generated from support services that are bundled with appliances and add-on software modules. There are three levels of maintenance and support Standard, Enhanced and Premium and these are offered through agreements for one to five-year terms. Maintenance and support includes major and minor if-and-when available software updates; customer care, which includes our designated support engineer program; content updates from our advanced security research group, the ADC, and hardware replacement. Subscription revenue is generated from sales of our cloud-based services. Professional services revenue consists of fees we earn related to implementation and consulting services we provide our customers. Training services revenue consists of fees we earn related to training customers and partners on the use of our products. We expect that the services revenue from maintenance and support contracts will continue to grow along with the increase in the size of our installed base.

Most of our products and services are sold to customers in the Americas, primarily in the U.S., however, a significant portion of our revenue is generated from international sales. See Note 10 of Notes to Condensed Consolidated Financial Statements for a discussion of our financial information by geographic region. Our revenue by geographic region is as follows:

	For the three months ended September 30,		For the nine months ended September 30,	
	2012	**2011**	**2012**	**2011**
Americas	$ 16,226	$ 12,115	$ 43,341	$ 34,316
EMEA	5,623	4,284	16,412	12,805
APAC	4,495	3,339	12,663	7,866
Total net revenue	$ 26,344	$ 19,738	$ 72,416	$ 54,987

Cost of Revenue

Our total cost of revenue is comprised of the following:

Cost of Products and License Revenue Cost of products and license revenue is comprised primarily of third-party hardware costs and royalty fees. Our cost of products and license revenue also includes personnel costs related to our operations team, shipping costs and write-offs for excess and obsolete inventory.

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Cost of Services Revenue Cost of services revenue is primarily comprised of personnel costs of our technical support team, our professional consulting services and training teams and our Security Operations Center (SOC) team. Cost of services revenue also includes facilities costs, subscription fees and depreciation. We expect that our cost of services revenue will increase in absolute dollars as we increase our headcount.

Operating Expenses

Our operating expenses consist of research and development, sales and marketing and general and administrative expenses. Personnel costs are the most significant component of our operating expenses and consist of wages, benefits and bonuses and, with regard to the sales and marketing expense, sales commissions. Personnel costs also include stock-based compensation. We expect personnel costs to continue to increase in absolute dollars as we hire new employees to continue to grow our business. While our operating expenses have grown on an absolute basis each year, they have decreased as a percentage of revenue. As a result, our operating margins have improved.

Research and Development

Our research and development is focused on maintaining and improving our existing products and on new product development. A majority of our research and development expenses are comprised of personnel costs and, to a lesser extent, facility costs, hardware prototype costs, laboratory expenses and depreciation. We expense research and development costs as incurred. We expect our research and development expenses to increase in absolute dollars as we continue to enhance our existing products and develop new products and services that address the emerging market for data security and regulatory compliance.

Sales and Marketing

Sales and marketing expense is the largest component of our operating expenses and consists primarily of personnel costs, including commissions and travel expenses. Sales and marketing expenses also include costs related to marketing and promotional activities, third-party referral fees and, to a lesser extent, facilities costs and depreciation. We expect our sales and marketing expenses to increase in absolute dollars as we expand our sales and marketing efforts worldwide.

General and Administrative

General and administrative expense consists primarily of personnel costs as well as professional fees, facilities costs and depreciation. General and administrative personnel costs include our executive, finance, purchasing, order entry, human resources, information technology and legal functions. Our professional fees consist primarily of accounting, external legal, information technology and other consulting costs. We expect that general and administrative expense will increase in absolute dollars to support our growth, as we expect to incur significant additional legal and accounting costs related to compliance with rules and regulations of the Securities and Exchange Commission, including the additional costs of achieving and maintaining compliance with Section 404 of the Sarbanes-Oxley Act of 2002 and compliance with the rules of the New York Stock Exchange, as well as additional insurance, investor relations and other costs associated with being a public company.

Other Income (Expense), net

Other income (expense), net is comprised of the following items:

Interest Income Interest income consists of interest earned on our cash, cash equivalents and short-term investments. We expect interest income will vary each reporting period depending on our average investment balances during the period and market interest rates.

Interest Expense Interest expense consists of interest accrued or paid on debt obligations and other credit facilities.

Foreign Currency Forward Contract Gains (Losses) Foreign currency forward contract gains and losses pertain to the ineffective portion of derivative instruments that we have entered into primarily to manage our exposure to the variability in expected future expenses resulting from changes in foreign currency exchange rates. We do not use derivative financial instruments for speculative or trading purposes. We expect our foreign currency forward contract gains (losses) to continue to fluctuate in the future due to changes in foreign currency exchange rates.

Foreign Currency Exchange Gains (Losses) Foreign currency exchange gains and losses relate to transactions denominated in currencies other than the U.S. Dollar.

Warrant Liability Gain (Losses) Our outstanding convertible preferred stock warrants were classified as a liability on our consolidated balance sheets and, as such, were remeasured to fair value at each balance sheet date with the corresponding gain or loss from the adjustment recorded as other income (expense), net. Following the completion of our initial public offering in November 2011, outstanding warrants were automatically converted into warrants to purchase common stock and, upon such conversion, are no longer classified as a liability on our consolidated balance sheet.

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Provision for Income Taxes

We operate in several tax jurisdictions and are subject to taxes in each country or jurisdiction in which we conduct business including the United States and Israel. Earnings from our non-U.S. activities are subject to local country income tax and may be subject to U.S. income tax. To date, we have incurred net losses and have not recorded any U.S. federal or state income tax provisions. Our tax expense to date relates to foreign income taxes, mainly from our Israeli activities.

Results of Operations

The following table is a summary of our consolidated statements of operations in dollars and as a percentage of our total revenue. We have derived the data for the three months and nine months ended September 30, 2012 and 2011 from our condensed consolidated financial statements included elsewhere in this Quarterly Report on Form 10-Q.

	For the three months ended September 30,				For the nine months ended September 30,			
	2012		2011		2012		2011	
	Amount	% of Net Revenue	Amount	% of Net Revenue	Amount	% of Net Revenue	Amount	% of Net Revenue
Net revenue:								
Products and license	$ 14,677	55.7%	$ 11,464	58.1%	$ 40,773	56.3%	$ 32,821	59.7%
Services:								
Maintenance and Support	8,582	32.6%	6,452	32.7%	24,072	33.2%	17,766	32.3%
Professional Services and training	1,749	6.6%	1,418	7.2%	4,589	6.3%	3,478	6.3%
Subscriptions	1,336	5.1%	404	2.0%	2,982	4.1%	922	1.7%
Total Services	11,667	44.3%	8,274	41.9%	31,643	43.7%	22,166	40.3%
Total net revenue	26,344	100.0%	19,738	100.0%	72,416	100.0%	54,987	100.0%
Cost of revenue:								
Products and license	2,064	7.8%	1,357	6.9%	6,192	8.6%	4,433	8.1%
Services	3,466	13.2%	2,893	14.7%	9,338	12.9%	7,062	12.8%
Total cost of revenue	5,530	21.0%	4,250	21.5%	15,530	21.4%	11,495	20.9%
Gross profit	20,814	79.0%	15,488	78.5%	56,886	78.6%	43,492	79.1%
Operating expenses:								
Research and development	5,154	19.6%	4,615	23.4%	15,072	20.8%	12,858	23.4%
Sales and marketing	13,218	50.2%	10,411	52.7%	36,740	50.7%	30,970	56.3%
General and administrative	4,104	15.6%	3,063	15.5%	11,336	15.7%	8,186	14.9%
Total operating expenses	22,476	85.3%	18,089	91.6%	63,148	87.2%	52,014	94.6%
Loss from operations	(1,662)	-6.3%	(2,601)	-13.2%	(6,262)	-8.6%	(8,522)	-15.5%
Other income (expense), net	(67)	-0.3%	(63)	-0.3%	(126)	-0.2%	(238)	-0.4%
Loss before provision for income taxes	(1,729)	-6.6%	(2,664)	-13.5%	(6,388)	-8.8%	(8,760)	-15.9%
Provision for income taxes	262	1.0%	205	1.0%	642	0.9%	471	0.9%
Net loss	(1,991)	-7.6%	(2,869)	-14.5%	(7,030)	-9.7%	(9,231)	-16.8%
Loss attributable to noncontrolling interest	132	0.5%	178	0.9%	367	0.5%	458	0.8%
Net loss attributable to Imperva, Inc.stockholders	$ (1,859)	-7.2%	$ (2,691)	-13.6%	$ (6,663)	-9.2%	$ (8,773)	-16.0%

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Comparison of the Three Months and Nine Months Ended September 30, 2012 and 2011

Net Revenue

	For the three months ended September 30, 2012 Amount	For the three months ended September 30, 2011 Amount	Change Amount	Change %	For the nine months ended September 30, 2012 Amount	For the nine months ended September 30, 2011 Amount	Change Amount	Change %
	(dollars in thousands)							
Net revenue:								
Products and license	$ 14,677	$ 11,464	$ 3,213	28.0%	$ 40,773	$ 32,821	$ 7,952	24.2%
Percentage of net revenue	55.7%	58.1%			56.3%	59.7%		
Services:								
Maintenance and Support	8,582	6,452	2,130	33.0%	24,072	17,766	6,306	35.5%
Percentage of net revenue	32.6%	32.7%			33.2%	32.3%		
Professional Services and training	1,749	1,418	331	23.3%	4,589	3,478	1,111	31.9%
Percentage of net revenue	6.6%	7.2%			6.3%	6.3%		
Subscriptions	1,336	404	932	230.7%	2,982	922	2,060	223.4%
Percentage of net revenue	5.1%	2.0%			4.1%	1.7%		
Total Services	11,667	8,274	3,393	41.0%	31,643	22,166	9,477	42.8%
Percentage of net revenue	44.3%	41.9%			43.7%	40.3%		
Total net revenue	$ 26,344	$ 19,738	$ 6,606	33.5%	$ 72,416	$ 54,987	$ 17,429	31.7%
Americas	$ 16,226	$ 12,115	$ 4,111	33.9%	$ 43,341	$ 34,316	$ 9,025	26.3%
Percentage of net revenue	61.6%	61.4%			59.9%	62.4%		
EMEA	5,623	4,284	1,339	31.3%	16,412	12,805	3,607	28.2%
Percentage of net revenue	21.3%	21.7%			22.7%	23.3%		
APAC	4,495	3,339	1,156	34.6%	12,663	7,866	4,797	61.0%
Percentage of net revenue	17.1%	16.9%			17.5%	14.3%		
Total net revenue	$ 26,344	$ 19,738	$ 6,606	33.5%	$ 72,416	$ 54,987	$ 17,429	31.7%

Three Months Ended September 30, 2012 Compared with Three Months Ended September 30, 2011

Our net revenue increased by $6.6 million, or 33.5%, to $26.3 million during the three months ended September 30, 2012 from $19.7 million during the three months ended September 30, 2011 due to growth in products and license revenue and services revenue. This revenue growth reflects the increasing demand for our product and service offerings. The Americas region contributed the largest portion of this growth with a $4.1 million increase over the same period in 2011. The Americas revenue growth in the three months ended September 30, 2012 as compared to the three months ended September 30, 2011 was primarily due to sales of both product and licenses, and, to a lesser extent, increased services revenue as we increased our customer base and continued to renew expiring customer maintenance agreements.

Products and license revenue increased by $3.2 million, or 28.0%, to $14.7 million during the three months ended September 30, 2012 from $11.5 million during the three months ended September 30, 2011. The change in product and license revenue was mostly driven by an increase in the Americas region in the three months ended September 30, 2012 compared to the three months ended September 30, 2011. This increase was due to increased sales volume of our products.

Services revenue increased by $3.4 million, or 41.0%, to $11.7 million during the three months ended September 30, 2012 from $8.3 million during the three months ended September 30, 2011. During the three months ended September 30, 2012, our services revenue was comprised of $8.6 million in maintenance and support, $1.7 million in professional services and training and $1.3 million in subscriptions. The change in services revenue in the three months ended September 30, 2012 from three months ended September 30, 2011 was primarily due to an increase of $2.1 million in maintenance and support revenue resulting from our larger installed base, $0.3 million in professional services and training revenues, and $0.9 million in subscriptions revenue due primarily from our ThreatRadar product, which was launched in the first quarter of 2010.

Nine Months Ended September 30, 2012 Compared with Nine Months Ended September 30, 2011

Our net revenue increased by $17.4 million, or 31.7%, to $72.4 million during the nine months ended September 30, 2012 from $55.0 million during the nine months ended September 30, 2011 due to growth in products and license revenue and services revenue.

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This revenue growth reflects the increasing demand for our product and service offerings. The Americas region contributed the largest portion of this growth increasing by $9.0 million, or 26.3%, growing from $34.3 million for the nine months ended September 30, 2011 to $43.3 million for the 2012 period. In addition, increases in our sales personnel focused on the Asia Pacific region resulted in an increase in revenue in Asia Pacific of $4.8 million, or approximately a 61% change over the same period in 2011.

Products and license revenue increased by $8.0 million, or 24.2%, to $40.8 million during the nine months ended September 30, 2012 from $32.8 million during the nine months ended September 30, 2011. The change in product and license revenue was driven by increases in the Americas and APAC regions in the nine months ended September 30, 2012 compared to the nine months ended September 30, 2011. This increase was due to increased sales volume of our products.

Services revenue increased by $9.5 million, or 42.8%, to $31.6 million during the nine months ended September 30, 2012 from $22.2 million during the nine months ended September 30, 2011. During the nine months ended September 30, 2012, our services revenue was comprised of $24.1 million in maintenance and support, $4.6 million in professional services and training and $3.0 million in subscriptions. The change in services revenue in the nine months ended September 30, 2012 from the nine months ended September 30, 2011 was primarily due to an increase of $6.3 million in maintenance and support revenue resulting from our larger installed base, $2.1 million in subscriptions revenue due primarily from our ThreatRadar product, which was launched in the first quarter of 2010, and $1.1 million in professional services and training revenues.

Gross Profit

	For the three months ended September 30,			For the nine months ended September 30,		
	2012	2011	% Change	2012	2011	% Change
			(dollars in thousands)			
Products and license	$ 12,613	$ 10,107		$ 34,581	$ 28,388	
Gross Margin %	85.9%	88.2%	-2.3%	84.8%	86.5%	-1.7%
Services gross profit	8,201	5,381		22,305	15,104	
Gross Margin %	70.3%	65.0%	5.3%	70.5%	68.1%	2.4%
Total gross profit	$ 20,814	$ 15,488		$ 56,886	$ 43,492	
Gross Margin %	79.0%	78.5%	0.5%	78.6%	79.1%	-0.5%

Three Months Ended September 30, 2012 Compared with Three Months Ended September 30, 2011

Total gross margin increased 0.5 percentage points from 78.5% during the three months ended September 30, 2011 to 79.0% during the three months ended September 30, 2012 primarily due to a increase in services gross margin of 5.3 percentage points in the three months ended September 30, 2012 compared to the same period in 2011. The increased services margin was primarily due to higher maintenance and subscriptions revenue which better leveraged the internal cost structure to support these services during the three months ended September 30, 2012. The decrease in products and license gross margin of 2.3% from 88.2% for the three months ended September 30, 2011 to 85.9% from the comparable 2012 period was attributable to an increase in third party licensing fees for certain products and licenses as well as lower product discounting levels on sales in the Americas and APAC regions during the third quarter of 2011.

Nine Months Ended September 30, 2012 Compared with Nine Months Ended September 30, 2011

Total gross margin decreased 0.5 percentage points from 79.1% during the nine months ended September 30, 2011 to 78.6% during the nine months ended September 30, 2012 primarily due to a decrease in products and license gross margin of 1.7 percentage points in the nine months ended September 30, 2012 compared to the same period in 2011. The change was partially due to an increase in lower margin products sold in the APAC region as compared to the nine months ended September 30, 2011 which was attributable to our efforts to further expand our APAC reseller base and regional coverage. In addition, we incurred an increase in third party license fees from sales of certain products and licenses during the nine months ended September 30, 2012. The 2.4 percentage point increase in services gross margin was mostly due to higher maintenance and subscriptions revenue which better leveraged the internal cost structure to support these services.

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Operating Expenses

	For the three months ended September 30, 2012	For the three months ended September 30, 2011	Change Amount	Change %	For the nine months ended September 30, 2012	For the nine months ended September 30, 2011	Change Amount	Change %
	(dollars in thousands)							
Operating expenses:								
Research and development	$ 5,154	$ 4,615	$ 539	11.7%	$ 15,072	$ 12,858	2,214	17.2%
Percentage of net revenue	21.0%	24.5%			32.7%	36.5%		
Sales and marketing	13,218	10,411	2,807	27.0%	36,740	30,970	5,770	18.6%
Percentage of net revenue	53.8%	55.3%			79.7%	87.9%		
General and administrative	4,104	3,063	1,041	34.0%	11,336	8,186	3,150	38.5%
Percentage of net revenue	16.7%	16.3%			24.6%	23.2%		
Total operating expenses	$ 22,476	$ 18,089	$ 4,387	24.3%	$ 63,148	$ 52,014	$ 11,134	21.4%

Results above include stock-based compensation expense of:

	For the three months ended September 30, 2012	For the three months ended September 30, 2011	Change	For the nine months ended September 30, 2012	For the nine months ended September 30, 2011	Change
	(dollars in thousands)					
Cost of revenues	$ 143	$ 29	$ 114	$ 302	$ 73	$ 229
Research and development	372	35	337	759	83	676
Sales and marketing	665	102	563	1,365	245	1,120
General and administrative	582	412	170	1,170	753	417
	$ 1,762	$ 578	$ 1,184	$ 3,596	$ 1,154	$ 2,442

Three Months Ended September 30, 2012 Compared with Three Months Ended September 30, 2011

Research and development expenses increased by $0.5 million, or 11.7%, to $5.1 million during the three months ended September 30, 2012 from $4.6 million during the three months ended September 30, 2011. The change was primarily attributable to an increase of $0.5 million in personnel costs, including stock-based compensation, due to additional research and development personnel being hired to support our ongoing product development efforts.

Sales and marketing expenses increased by $2.8 million, or 27.0%, to $13.2 million during the three months ended September 30, 2012 from $10.4 million during the three months ended September 30, 2011. The change was principally related to an increase of $2.0 million in personnel costs, including stock-based compensation and contractor costs, due to increased headcount in all regions in an effort to help drive our overall revenue growth, travel costs of $0.3 million, and global marketing program costs of $0.2 million.

General and administrative expenses increased by $1.0 million, or 34%, to $4.1 million during the three months ended September 30, 2012 from $3.1 million during the three months ended September 30, 2011. The change was primarily due to an increase of $0.2 million in personnel costs, including stock-based compensation, to build out our corporate level functions to support anticipated global growth and meet the demands and compliance responsibilities of a U.S. public company, and $0.8 million in professional fees associated with public company costs, such as accounting and legal fees and directors and officers insurance.

Nine Months Ended September 30, 2012 Compared with Nine Months Ended September 30, 2011

For the nine months ended September 30, 2012, research and development expenses increased by $2.2 million, or 17.2%, to $15.1 million from $12.9 million during the nine months ended September 30, 2011. The change was primarily attributable to an increase of $2.0 million in personnel costs, including stock-based compensation, due to additional research and development personnel being hired to support our ongoing product development efforts.

Sales and marketing expenses increased by $5.7 million, or 18.6%, to $36.7 million during the nine months ended September 30, 2012 from $31.0 million during the nine months ended September 30, 2011. The change was due to an increase of $4.4 million in personnel costs, including stock-based compensation, due to increased headcount in all regions in an effort to help drive our overall revenue growth, in addition to $0.8 million in travel expenses and $0.3 million in recruiting costs.

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General and administrative expenses increased by $3.1 million, or 38.5%, to $11.3 million during the nine months ended September 30, 2012 from $8.2 million during the nine months ended September 30, 2011. The change was primarily due to $2.0 million in professional fees associated with public company costs, such as accounting and legal fees and directors and officers insurance. Additionally, there was an increase of $1.0 million in personnel costs, including stock-based compensation, related to increased headcount to support the growth and operations of our business and to meet the demands and compliance responsibilities of a U.S. public company.

Loss from Operations

Three months ended September 30,		Change		Nine months ended September 30,		Change	
2012	2011	Amount	%	2012	2011	Amount	%
(dollars in thousands)							
$ (1,662)	**$ (2,601)**	**$ 939**	**36.1%**	**$ (6,262)**	**$ (8,522)**	**$ 2,260**	**26.5%**

Three Months Ended September 30, 2012 Compared with Three Months Ended September 30, 2011

Our loss from operations decreased by $0.9 million, or 36.1%, from $2.6 million during the three months ended September 30, 2011 to $1.7 million during the three months ended September 30, 2012. Our gross profit increased by $5.3 million during the three months ended September 30, 2012 due to higher net revenues. This gross profit increase was partially offset by increased sales and marketing costs of $2.8 million to expand our global sales efforts, and an increase of $1.0 million of general and administrative costs primarily related to professional fees associated with public company costs, such as accounting and legal fees and directors and officers insurance, and personnel costs related to the increased global scope and operations of our business. In addition, we had increased research and development personnel costs of $0.5 million from hiring to support our ongoing product development efforts. The increase in operating expenses during the three months ended September 30, 2012 was due to the aforementioned headcount increases to support the increase in scope and global reach of our business and additional costs to operate as a public company.

Nine Months Ended September 30, 2012 Compared with Nine Months Ended September 30, 2011

For the nine months ended September 30, 2012, our loss from operations decreased by $2.3 million, or 26.5%, as compared to $8.5 million during the nine months ended September 30, 2011. Our gross profit increased by $13.4 million during the nine months ended September 30, 2012 due to higher net revenues. This gross profit increase was partially offset by increased sales and marketing costs of $5.8 million to expand our global sales efforts, and an increase of $3.1 million of general and administrative costs primarily related to professional fees associated with public company costs, such as accounting and legal fees and directors and officers insurance, and personnel costs related to the increased global scope and operations of our business. In addition, we had increased research and development personnel costs of $2.2 million from hiring to support our ongoing product development efforts. The increase in operating expenses during the nine months ended September 30, 2012 was due to the aforementioned headcount increases to support the increase in scope and global reach of our business and additional costs to operate as a public company.

Other Income (Expense), net

Three months ended September 30,		Change		Nine months ended September 30,		Change	
2012	2011	Amount	%	2012	2011	Amount	%
(dollars in thousands)							
$ (67)	**$ (63)**	**$ (4)**	**-6.3%**	**$ (126)**	**$ (238)**	**$ 112**	**47.1%**

Other income (expense) during the three months ended September 30, 2012 and 2011 was $0.1 million for both periods. There were no significant changes between the two periods.

Other income (expense), net was $(0.1) million during the nine months ended September 30, 2012 as compared to $(0.2) million for the nine months ended September 30, 2011. The primary change in the components of other income (expense), net, in the three months ended September 30, 2012 compared to the prior year was an increase in interest income of $0.3 million, and a $0.1 million reduction in convertible preferred stock warranty liability losses, partially offset by increased foreign currency exchange losses, net, of $0.2 million and increased forward foreign exchange contracts losses of $0.1 million.

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Provision for Income Taxes

	For the three months ended September 30,		Change		For the nine months ended September 30,		Change	
	2012	2011	Amount	%	2012	2011	Amount	%
	(dollars in thousands)							
Provision for income taxes	$ 262	$ 205	$ 57	27.8%	$ 642	$ 471	$ 171	36.3%

The provision for income taxes for the three months ended September 30, 2012 and 2011 is comprised primarily of foreign income taxes. The increase in the provision for income taxes of $0.1 million in the three months ended September 30, 2012 compared with the three months ended September 30, 2011 was primarily attributable to an increase in income in our foreign operations.

For the nine months ended September 30, 2012 as compared with the nine months ended September 30, 2011, the provision for income taxes increased $0.2 million primarily due to an increase in income in foreign operations.

Deferred Revenue

	As of September 30,		Change	
	2012	2011	Amount	%
	(dollars in thousands)			
Total deferred revenue	$ 38,298	$ 25,560	$ 12,738	49.8%

Deferred revenue increased by $12.7 million, or 49.8%, to $38.3 million as of September 30, 2012 from $25.6 million as of September 30, 2011. The growth in our deferred revenue was primarily attributable to an increase in our installed base of products and licenses worldwide and resulting renewals of maintenance and support agreements, as well as new sales of maintenance and support agreements.

Number of Customers

	As of September 30,		Change	
	2012	2011	Amount	%
	(dollars in thousands)			
Number of customers	2,094	1,584	510	32.2%

Our number of customers increased by 510, or 32.2%, to 2,094 as of September 30, 2012 from 1,584 as of September 30, 2011. Our growth in customer count was driven by increasing market acceptance of our products as well as an increase in our global sales and services and support organizations from 178 people as of September 30, 2011 to 206 as of September 30, 2012. The growth in our sales and services and support organizations was consistent with our plans to continue expanding our global sales and support coverage, in particular for our channel partner sales and support teams. The increase in our services and support organization allowed us to target new customers, particularly in the Asia Pacific region, while continuing to support our existing customers across all of our geographies.

Liquidity and Capital Resources

To date, we have satisfied our capital and liquidity needs through sales of our products and services, private placements of convertible preferred stock, and the sale of common stock, including our initial public offering of common stock in November 2011. We have incurred significant losses as we continue to expand our business. Our cash flow from operating activities will continue to be affected principally by the extent to which our revenue exceeds or does not exceed any increase in spending on personnel to support the growth of our business. Our largest source of operating cash flow is cash collections from our customers.

Capital Resources

As of September 30, 2012, we had $101.7 million of cash, cash equivalents and short-term investments, $3.8 million of which is currently held outside of the United States and not presently available to fund domestic operations and obligations. If we were to repatriate cash held outside of the United States, it could be subject to U.S. income taxes on such amounts, less any previously paid foreign income taxes. Our cash, cash equivalents and short-term investments have increased from $17.7 million as of December 31,

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2010 to $101.7 million as of September 30, 2012. This increase is primarily the result of our initial public offering of common stock in November 2011 in which we raised $86.2 million, after deducting underwriters discounts and offering expenses. This amount was partially offset by our losses from operations as we continued to fund our investments in growth, including the development of future products and product enhancements, and expanded into new sales channels and geographies. We believe our existing cash, cash equivalents and short-term investments will be sufficient to meet our working capital and capital expenditure needs for at least the next 12 months. Our future capital requirements may vary materially from those currently planned and will depend on many factors, including, among other things, market acceptance of our products, the cost of our research and development activities, the acquisition of other businesses and overall economic conditions.

As of September 30, 2012, we had no amounts outstanding under our credit facility agreement which has a maximum borrowing capacity of $6.0 million and a minimum cash and cash equivalents balance covenant of $3.0 million. The agreement originally provided for expiration of the credit facility on October 15, 2012, which has since been extended through December 17, 2012. We expect to enter into a one-year extension to the credit facility on substantially similar terms prior to its expiration. As of September 30, 2012, we were compliant with the covenant of the credit facility.

Since November 2011, we have been incurring costs as a public company that we had not previously incurred, including, but not limited to, costs and expenses for directors fees, increased directors and officers insurance, investor relations fees, expenses for compliance with the Sarbanes-Oxley Act of 2002 and rules implemented by the SEC and New York Stock Exchange, the exchange on which our common stock is listed, and various other costs. The Sarbanes-Oxley Act of 2002 requires annual management assessment of the effectiveness of our internal control over financial reporting.

Cash Flows

The following summary of our cash flows for the periods indicated has been derived from our consolidated financial statements which are included elsewhere in this Quarterly Report on Form 10-Q:

	Nine months ended September 30,	
	2012	**2011**
	(dollars in thousands)	
Net cash provided by (used in) operating activities	$ 4,141	$ (5,056)
Net cash provided by (used in) investing activities	(45,878)	401
Net cash provided by financing activities	2,140	1,202

Our cash, cash equivalents and short-term investments have increased from $13.0 million as of September 30, 2011 to $101.7 million as of September 30, 2012. This increase is primarily the result of our initial public offering of common stock in November 2011 in which we raised $86.2 million, net of underwriters discounts and offering expenses. This amount was partially offset by our losses from operations as we continued to fund our operations, including the development of future products and product enhancements, and expansion into new sales channels and geographies.

Cash Flows from Operating Activities

Our largest uses of cash from operating activities are for employee related expenditures. Our primary source of cash flow from operating activities is cash receipts from customers. Our cash flow from operations will continue to be affected principally by the extent to which we grow our revenues and increase our headcount, primarily in our sales and marketing and research and development functions, in order to grow our business.

Net cash provided by operating activities of $4.1 million for the nine months ended September 30, 2012 reflected a net loss of $7.0 million, adjusted for non-cash charges of $5.2 million, as well as a net change of $5.9 million in our net operating assets and liabilities. The net change in our operating assets and liabilities was the result of an increase in deferred revenue of $5.4 million, which represents unearned amounts billed to our customers, resulting from our larger installed base combined with strong maintenance and support renewal rates from our existing customers, and an increase in accrued compensation and benefits of $2.6 million. These changes were partially offset by an increase in prepaid expenses and other assets of $1.1 million, and an increase in accounts receivable of $1.0 million.

Net cash used in operating activities of $5.1 million for the nine months ended September 30, 2011 reflected a net loss of $9.2 million, partially offset by non-cash charges of $2.4 million, as well as a net change of $1.7 million in our net operating assets and liabilities. The net change in our operating assets and liabilities was the result of a $4.3 million increase in our deferred revenue, and an increase in accrued compensation and benefits of $0.7 million. These amounts were partially offset by an increase in accounts receivable of $2.3 million and a decrease in accrued and other liabilities of $1.0 million.

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Cash Flows from Investing Activities

Our investing activities consist primarily of expenditures to purchase property and equipment and purchases and sales of short-term investments. During the nine months ended September 30, 2012, cash used in investing activities was $45.9 million, primarily as a result of $43.8 million in net purchases of short-term investments in addition to $1.8 million in capital expenditures.

In the nine months ended September 30, 2011, cash provided by investing activities of $0.4 million was primarily attributable to $2.3 million in proceeds from maturities of short-term investments partially offset by $1.0 million in capital expenditures and $1.0 million in purchases of short-term investments.

Cash Flows from Financing Activities

Net cash provided by financing activities was $2.1 million for the nine months ended September 30, 2012 as a result of proceeds from the exercise of stock options.

During the nine months ended September 30, 2011 cash provided by financing activities was $1.2 million. This amount was primarily generated from $2.5 million in net borrowings on our revolving credit facility, $1.0 million in proceeds from the issuance of restricted stock, and $0.5 million in proceeds from the exercise of stock options. These amounts were partially offset by a net increase of $2.8 million in other assets, which consisted of capitalized expenses from our initial public offering.

Contractual Obligations

The following summarizes our contractual obligations as of September 30, 2012:

				Payments Due by Period			
Contractual Obligations:	**2012**	**2013**	**2014**	**2015**	**2016**	**Thereafter**	**Total**
				(in thousands)			
Operating lease obligations(1)	$ 662	$ 3,359	$ 2,617	$ 2,271	$ 2,131	$ 1,513	$ 12,553
Cancelable lease obligations(2)							
Severance Pay Fund(3)							3,238
Purchase commitments(4)	3,549						3,549
Total	$ 4,211	$ 3,359	$ 2,617	$ 2,271	$ 2,131	$ 1,513	$ 19,340

(1) Operating lease agreements represent our obligations to make payments under our non-cancelable lease agreements for our facilities. During the nine months ended September 30, 2012, we made regular lease payments of $1.7 million under the operating lease agreements.

(2) Cancelable lease obligations represent our obligations under our motor vehicle lease agreement. We have the option to cancel the lease at any time which may result in penalties in a maximum amount of $78,000 as of September 30, 2012. During the nine months ended September 30, 2012, we made regular lease payments of $0.5 million under the cancelable lease obligations.

(3) Our consolidated balance sheet as of September 30, 2012 includes $3.2 million of non-current liabilities for our Israeli severance pay fund. The specific timing of any cash payments relating to this obligation cannot be projected with reasonable certainty and, therefore, no amounts for this obligation are included in the annual columns of the table set forth above.

(4) Purchase commitments are contractual obligations to purchase hardware appliances and related component parts from our vendors in advance of anticipated sales.

Off-Balance Sheet Arrangements

Through September 30, 2012, we did not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes.

Critical Accounting Policies and Estimates

The discussion and analysis of our financial condition and results of operations is based upon our Condensed Consolidated Financial Statements, which have been prepared in accordance with U.S. GAAP. The preparation of these financial statements requires us to make estimates, assumptions and judgments that can have significant impact on the reported amounts of assets and liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities at the date of our financial statements. We base our estimates, assumptions and judgments on historical experience and various other factors that we believe to be reasonable under the circumstances. Actual results may differ from these estimates under different assumptions or conditions. On a regular basis we evaluate our estimates, assumptions and judgments and make changes accordingly.

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We believe that the estimates, assumptions and judgments involved in revenue recognition, stock-based compensation, long-lived assets, and accounting for income taxes have the greatest potential impact on our Consolidated Financial Statements, so we consider these to be our critical accounting policies. Historically, our estimates, assumptions and judgments relative to our critical accounting policies have not differed materially from actual results. The critical accounting estimates associated with these policies are described in Part II, Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations of our 2011 Annual Report on Form 10-K for the fiscal year ended December 31, 2011. There have been no material changes to our significant accounting policies as compared to the significant accounting policies described in our Annual Report on Form 10-K for the year ended December 31, 2011.

Recent Accounting Pronouncements

See Note 1 to the unaudited condensed consolidated financial statements in Part I, Item 1 of this Quarterly Report on Form 10-Q.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

There have been no significant changes in our market risk exposures during the nine months ended September 30, 2012 as compared to the market risk exposures disclosed in Management s Discussion and Analysis of Financial Condition and Results of Operations, set forth in Part II, Item 7A, of our Annual Report on Form 10-K for the year ended December 31, 2011.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Our management, with the participation and supervision of our chief executive officer and chief financial officer, evaluated the effectiveness of our disclosure controls and procedures pursuant to Rule 13a-15 under the Exchange Act. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. In addition, the design of disclosure controls and procedures must reflect the fact that there are resource constraints and that management is required to apply its judgment in evaluating the benefits of possible controls and procedures relative to their costs.

Based on the aforementioned evaluation, our chief executive officer and chief financial officer have concluded that as of September 30, 2012, our disclosure controls and procedures are designed at a reasonable assurance level and are effective to provide reasonable assurance that information we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms, and that such information is accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate, to allow timely decisions regarding required disclosure and that such controls and procedures provide reasonable assurance that the financial reporting and the preparation of financial statements for external purposes are reliably prepared and reported in accordance with generally accepted accounting principles.

Changes in Internal Control over Financial Reporting

Regulations under the Exchange Act require public companies, including our company, to evaluate any change in our internal control over financial reporting as such term is defined in Rule 13a-15(f) and Rule 15d-15(f) of the Exchange Act. In connection with their evaluation of our disclosure controls and procedures as of the end of the period covered by this Quarterly Report on Form 10-Q, our chief executive officer and chief financial officer did not identify any changes in our internal control over financial reporting during the three months covered by this Quarterly Report that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

From time to time, we may be subject to legal proceedings and claims in the ordinary course of business. We do not believe we are a party to any currently pending legal proceedings the outcome of which would have a material adverse effect on our operations or financial position. However, we have received, and may in the future continue to receive, claims from third parties asserting, among other things, infringement of their intellectual property rights. Litigation may be necessary to defend ourselves, our channel partners and our customers by determining the scope, enforceability and validity of third-party proprietary rights or to establish our proprietary rights. Further, the ultimate outcome of any litigation is uncertain and, regardless of outcome, litigation can have an adverse impact on us because of defense costs, potential negative publicity, diversion of management resources and other factors. Accordingly, there can be no assurance that existing or future legal proceedings arising in the ordinary course of business or otherwise will not have a material adverse effect on our business, consolidated financial position, results of operations or cash flows.

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Item 1A. Risk Factors

Risks Related to Our Business

We have a history of losses, we may not become profitable and our revenue growth may not continue.

We have incurred net losses in each fiscal year since our inception, including net losses attributable to our stockholders of $12.3 million in 2009, $12.0 million in 2010, $10.3 million in 2011 and $6.7 million in the nine months ended September 30, 2012. As a result, we had an accumulated deficit of $72.8 million at September 30, 2012. We may not become profitable in the future if we fail to increase revenue and manage our expenses, or if we incur unanticipated liabilities. Revenue growth may slow or revenue may decline for a number of possible reasons, including slowing demand for our products or services, increasing competition, a decrease in the growth of, or decline in, our overall market, or our failure to capitalize on growth opportunities or introduce new products and services. In addition, we have incurred, and anticipate that we will continue to incur, significant legal, accounting and other expenses relating to being a public company. If our revenues do not increase at a rate to proportionally offset these expected increases in operating expenses, our operating margins will suffer. Any failure by us to achieve and maintain profitability and continue our revenue growth could cause the price of our common stock to materially decline.

Our limited operating history and the rapidly evolving nature of the markets in which we operate may make it difficult for you to evaluate our business.

We were incorporated in 2002, and since that time have been developing products to meet the rapidly evolving demands of customers in the markets in which we operate. We shipped our initial web application security and data security products in 2002, in 2006, we expanded our database security product to include compliance features and in 2010, we launched our file security offering. In addition, in 2010, we launched our cloud-based services with ThreatRadar and, in 2011, we introduced our cloud-based offerings for mid-market enterprises and small to medium-sized businesses (SMB) through Incapsula, Inc., our majority-owned subsidiary. This limited operating history, as well as the early stage of our relationships with many of our channel partners, makes financial forecasting and evaluation of our business difficult. Furthermore, because we depend in part on the market s acceptance of our products, it is difficult to evaluate trends that may affect our business. Because of our limited historic operating history and rapidly evolving market, any predictions about our future revenue and expenses may not be as accurate as they would be if we had a longer operating history or operated in a more predictable market.

Our quarterly operating results are likely to vary significantly and to be unpredictable, which could cause the trading price of our stock to decline.

Our operating results have historically varied from period to period, and we expect that they will continue to do so as a result of a number of factors, many of which are outside of our control, including:

- the level of demand for our products and services, and the timing of orders from our channel partners and end-user customers, who we refer to in this Quarterly Report on Form 10-Q as our customers;
- the timing of shipments of products, which may depend on many factors such as inventory and logistics and our ability to ship new products on schedule and accurately forecast inventory requirements;
- the mix of products sold, the mix of revenue between products and services and the degree to which products and services are bundled and sold together for a package price;
- seasonal buying patterns of our customers;
- the level of perceived threats to data security, which may fluctuate from period to period;

changes in customer, distributor or reseller requirements or market needs;

changes in the growth rate of the data security market;

the timing and success of new product and service introductions by us or our competitors or any other change in the competitive landscape of our industry, including consolidation among our competitors or customers;

the introduction or adoption of new technologies that compete with our products and services;

deferral of orders from customers in anticipation of new products or product enhancements announced by us or our competitors;

decisions by potential customers to purchase data security solutions from larger, more established security vendors or from their primary network equipment vendors;

the announcement or adoption of new data security compliance regulations or changes to existing compliance regulations;

price competition;

insolvency or credit difficulties confronting our customers, affecting their ability to purchase or pay for our products and services;

insolvency or credit difficulties confronting our key suppliers, which could disrupt our supply chain;

changes in customer renewal rates for our services;

general economic conditions, both domestically and in our foreign markets;

the timing of revenue recognition for our sales, which may be affected by both the mix of sales by our channel partners and the extent to which we bring on new resellers and distributors;

future accounting pronouncements or changes in our accounting policies; and

increases or decreases in our expenses caused by fluctuations in foreign currency exchange rates, particularly the Israeli shekel, since a significant portion of our expenses are incurred and paid in the Israeli shekel and other currencies besides the U.S. dollar.

Further, the purchase of our products is often discretionary and may involve a significant commitment of capital and other resources, which may lead customers to defer or forgo planned purchases, subjecting our results in any particular quarter or the longer term to changes in global economic conditions, reductions in general information technology spending or other factors that affect these decisions. Any one of the factors above or the cumulative effect of some of the factors referred to above may result in significant fluctuations in our quarterly operating results. This variability and unpredictability could result in our failure to meet our revenue or other operating result expectations or those of securities analysts or investors for a particular period. In addition, a significant percentage of our operating expenses are fixed in nature and based on forecasted revenue trends. Accordingly, in the event of revenue shortfalls, we are generally unable to mitigate the negative impact on margins in the short term. If we fail to meet or exceed expectations for our business for these or any other reasons, the market price of our shares could fall substantially and we could face costly lawsuits, including securities class action suits.

We face intense competition, especially from larger, better-known companies and we may lack sufficient financial or other resources to maintain or improve our competitive position.

The market for data security products is intensely competitive and we expect competition to intensify in the future. Our competitors include companies such as Citrix Systems, Inc., F5 Networks, Inc., International Business Machines Corporation (IBM), McAfee, Inc. (a subsidiary of Intel Corporation), Oracle Corporation, Symantec Corporation and other point solution security vendors.

Many of our existing and potential competitors may have substantial competitive advantages such as:

greater name recognition and longer operating histories;

larger sales and marketing budgets and resources;

broader distribution networks and more established relationships with distributors and customers;

access to larger customer bases;

greater customer support resources;

greater resources to make acquisitions;

greater resources to develop and introduce products that compete with our products;

lower labor and development costs; and

substantially greater financial, technical and other resources.

In addition, some of our larger competitors have substantially broader product offerings and leverage their relationships based on other products or incorporate functionality into existing products in a manner that discourages customers from purchasing our products. Customers may elect to accept a bundled product offering from our competitors, even if it has more limited functionality than our product offering, instead of adding the additional appliances required to implement our offering. These larger competitors are also often in a better position to withstand any significant reduction in capital spending, and will therefore not be as susceptible to economic downturns. Also, many of our smaller competitors that specialize in providing protection from a single type of data security threat may deliver these specialized data security products to the market more quickly than we can. Conditions in our markets could change rapidly and significantly as a result of technological advancements or continuing market consolidation.

Our current and potential competitors may also establish cooperative relationships among themselves or with third parties that may further enhance their resources. Current or potential competitors may be acquired by third parties with greater available resources, such as IBM s acquisition of Guardium, Inc., Oracle s acquisition of Secerno, Ltd. and McAfee s acquisition of Sentrigo, Inc. As a result of such acquisitions, our current or potential competitors might be able to adapt more quickly to new technologies and customer needs, devote greater resources to the promotion or sale of their products and services, initiate or withstand substantial price competition, take advantage of other opportunities more readily or develop and expand their product and service offerings more quickly than we do. Larger competitors with more diverse product offerings may reduce the price of products that compete with ours in order to promote the sale of other products or may bundle them with other products, which would lead to increased pricing pressure on our products and could cause the average sales prices for our products to decline. If we are unable to compete effectively for a share of the data security market, our business, financial condition and results of operations could be materially and adversely affected.

The data security market is rapidly evolving and difficult to predict. If the data security market does not evolve as we anticipate or if customers do not adopt our broad data security solution, our sales will not grow as quickly as anticipated and our stock price could decline.

We are in a new, rapidly evolving category in the security industry that focuses on securing our customers high-value business data. As such, it is difficult to predict important market trends, including how large the data security market will be and what products customers will adopt. For example, organizations that use other security products, such as network firewalls, security information and event management (SIEM) products or data loss prevention (DLP) solutions, may believe that these security solutions sufficiently protect access to sensitive data. Therefore, they may continue spending their IT security budgets on these products and may not adopt our data security solutions in addition to such products.

We offer database, file and web application security in an integrated, modular data security solution. Currently less than 30% of our customers have purchased more than one of our product families. Even if customers purchase our products, they may not make repeat purchases or purchase other elements of our SecureSphere Data Security Suite.

If the market for data security does not evolve in the way we anticipate, if customers do not recognize the benefit our data security solution offers in addition to existing security products, or if we are unable to entice customers to buy products from multiple product families, then our revenue may not grow quickly or may decline, and our stock price could decline.

If we do not successfully anticipate market needs and opportunities and enhance our products and develop new products that meet those needs and opportunities on a timely basis, we may not be able to compete effectively and our ability to generate revenues will suffer.

The data security market is characterized by rapid technological advances, changes in customer requirements, including customer requirements driven by changes to legal, regulatory and self-regulatory compliance mandates, frequent new product introductions and enhancements and evolving industry standards in computer hardware and software technology. As a result, we must continually change and improve our products in response to changes in operating systems, application software, computer and communications hardware, networking software, data center architectures, programming tools and computer language technology. Moreover, the technology in our products is especially complex because it needs to effectively identify and respond to methods of attack and theft, while minimizing the impact on database, file system and web application performance. In addition, our products must successfully interoperate with products from other vendors.

We cannot guarantee that we will be able to anticipate future market needs and opportunities or be able to develop product enhancements or new products to meet such needs or opportunities in a timely manner or at all. Even if we are able to anticipate, develop and commercially introduce enhancements and new products, there can be no assurance that we will be successful in developing sufficient market awareness of them or that such enhancements or new products will achieve widespread market acceptance. For example, while the majority of our current revenues are derived from the sales of our SecureSphere appliances, we are now offering cloud-based data security services through Incapsula. The market for cloud-based data security solutions is relatively new and it is uncertain whether Incapsula s services will gain market acceptance.

Our product enhancements or new products could fail to attain sufficient market acceptance for many reasons, including:

- delays in releasing our enhancements or new products;

- failure to accurately predict market demand in terms of product functionality and to supply products that meet this demand in a timely fashion;

- inability to interoperate effectively with the database technologies, file systems or web applications of our prospective customers;

inability to protect against new types of attacks or techniques used by hackers or other data thieves;

defects, errors or failures;

negative publicity about their performance or effectiveness;

introduction or anticipated introduction of competing products by our competitors;

poor business conditions, causing customers to delay IT purchases;

easing or changing of regulatory requirements related to security; and

reluctance of customers to purchase products incorporating open source software.

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If we fail to anticipate market requirements or fail to develop and introduce product enhancements or new products to meet those needs in a timely manner, it could cause us to lose customers and such failure could substantially decrease or delay market acceptance and sales of our present and future products, which would significantly harm our business, financial condition and results of operations.

New or existing technologies that are perceived to address data security risks or address the risks in different ways could gain wide adoption and supplant our products and services, thereby weakening our sales and our financial results.

The introduction of products and services embodying new technologies could render our existing products and services obsolete or less attractive to customers. Other data security technologies exist or could be developed in the future, and our business could be materially negatively affected if such technologies are widely adopted. We may not be able to successfully anticipate or adapt to changing technology or customer requirements on a timely basis, or at all. If we fail to keep up with technological changes or to convince our customers and potential customers of the value of our solutions even in light of new technologies, our business, financial condition and results of operations could be materially and adversely affected.

If our products fail to protect against malicious attacks and our customers experience security breaches, our reputation and business could be harmed.

Data thieves are sophisticated, often affiliated with organized crime and operate large scale and complex automated attacks. In addition, their techniques change frequently and generally are not recognized until launched against a target. If we fail to identify and respond to new and complex methods of attack and to update our products to detect or prevent such threats in time to protect our customers high-value business data, our business and reputation will suffer.

In addition, an actual or perceived security breach or theft of the sensitive data of one of our customers, regardless of whether the breach is attributable to the failure of our products or services, could adversely affect the market s perception of our security products. Despite our best efforts, there is no guarantee that our products will be free of flaws or vulnerabilities, and even if we discover these weaknesses we may not be able to correct them promptly, if at all. Our customers may also misuse our products, which could result in a breach or theft of business data.

False detection of security breaches or false identification of malicious sources could adversely affect our business.

Our data security products may falsely detect threats that do not actually exist. For example, our ThreatRadar product relies on information on attack sources aggregated from third-party data providers who monitor global malicious activity originating from anonymous proxies, specific IP addresses, botnets and phishing sites. If the information from these data providers is inaccurate, the potential for false positives increases. These false positives, while typical in the industry, may impair the perceived reliability of our products and may therefore adversely impact market acceptance of our products. If our products and services restrict access to important databases, files or applications based on falsely identifying users or traffic as an attack or otherwise unauthorized, this could adversely affect customers businesses. Any such false identification of users or traffic could result in negative publicity, loss of customers and sales, increased costs to remedy any problem and costly litigation.

Defects in our products or services could harm our reputation and business.

Our products and services are very complex and have contained and may contain undetected defects or errors, especially when first introduced or when new versions are released. Defects in our products may impede or block network traffic or cause our products or services to fail to help secure high-value business data. Defects in our products may lead to product returns and require us to implement design changes or software updates.

Any defects or errors in our products, or the perception of such defects or errors, could result in:

- expenditure of significant financial and product development resources in efforts to analyze, correct, eliminate or work around errors or defects;

- loss of existing or potential customers or channel partners;

delayed or lost revenue;

delay or failure to attain market acceptance;

delay in the development or release of new products or services;

negative publicity, which will harm our reputation;

warranty claims against us, which could result in an increase in our provision for doubtful accounts;

an increase in collection cycles for accounts receivable or the expense and risk of litigation; and

harm to our results of operations.

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Although we have limitation of liability provisions in our standard terms and conditions of sale, they may not fully or effectively protect us from claims as a result of federal, state or local laws or ordinances or unfavorable judicial decisions in the United States or other countries. The sale and support of our products also entail the risk of product liability claims. We maintain insurance to protect against certain claims associated with the use of our products, but our insurance coverage may not adequately cover any claim asserted against us. In addition, even claims that ultimately are unsuccessful could result in our expenditure of funds in litigation and divert management s time and other resources.

If our products fail to help our customers achieve and maintain compliance with government regulations and industry standards, our business and results of operations could be materially adversely affected.

We generate a substantial portion of our revenues from our products and services because they help organizations achieve and maintain compliance with government regulations and industry standards, and we expect that will continue for the foreseeable future. For example, many of our customers purchase our web application security products to help them comply with the security standards developed and maintained by the Payment Card Industry (PCI) Security Standards Council (the PCI Council), which apply to companies that process or store credit card information. Industry organizations like the PCI Council may significantly change their security standards with little or no notice, including changes that could make their standards more or less onerous for businesses. Governments may also adopt new laws or regulations, or make changes to existing laws or regulations, that could impact whether our products and services enable our customers to demonstrate, maintain or audit their compliance. If we are unable to adapt our products and services to changing regulatory standards in a timely manner, or if our products fail to expedite our customers compliance initiatives, our customers may lose confidence in our products and could switch to products offered by our competitors. In addition, if regulations and standards related to data security are changed in a manner that makes them less onerous, our customers may view government and industry regulatory compliance as less critical to their businesses, and our customers may be less willing to purchase our products and services. In either case, our sales and financial results would suffer.

Reliance on a concentration of shipments at the end of the quarter could cause our revenue to fall below expected levels, resulting in a decline in our stock price.

Historically, we have received a significant majority of a quarter s sales orders and generated a significant majority of a quarter s revenue during the last two weeks of the quarter. The fact that so many orders arrive at the end of a quarter means that our revenue may move from one quarter to the next if we cannot fulfill all of the orders and satisfy all of the revenue recognition criteria under our accounting policies before the quarter ends.

This pattern is a result of customer buying habits and the efforts of our sales force and channel partners to meet or exceed quarterly quotas. If expected revenue at the end of any quarter is delayed because anticipated purchase orders fail to materialize, our logistics partners fail to ship products on time, we fail to manage our inventory properly, we fail to release new products on schedule, or for any other reason, then our revenue for that quarter could fall below our expectations or those of securities analysts and investors, resulting in a decline in our stock price.

We rely on third party channel partners to generate a majority, and to fulfill, substantially all of our revenue, and if we fail to expand and manage our distribution channels, our revenues could decline and our growth prospects could suffer.

Historically our channel partners have originated more than 55% of our sales and fulfilled almost 90% of our sales, and we expect that channel sales will represent a substantial portion of our revenues for the foreseeable future. Our ability to expand our distribution channels depends in part on our ability to educate our channel partners about our products and services, which are complex. Our agreements with our channel partners are generally non-exclusive and many of our channel partners have more established relationships with our competitors. If our channel partners choose to place greater emphasis on products and services of their own or those offered by our competitors, our ability to grow our business and sell our products may be adversely affected. If our channel partners do not effectively market and sell our products and services, or if they fail to meet the needs of our customers, then our ability to grow our business and sell our products may be adversely affected. The loss of one or more of our larger channel partners, who may cease marketing our products with limited or no notice, and our possible inability to replace them could adversely affect our sales. Our failure to recruit additional channel partners, or any reduction or delay in their sales of our products and services or conflicts between channel sales and our direct sales and marketing activities could materially and adversely affect our results of operations.

Delays or interruptions in the manufacturing and delivery of SecureSphere appliances by our sole source manufacturer may harm our business.

Our hardware appliances are built by a single manufacturer. Our reliance on a sole manufacturer, particularly a foreign manufacturer, involves several risks, including a potential inability to obtain an adequate supply of appliances and limited control over pricing, quality and timely delivery of products. In addition, replacing this manufacturer may be difficult and could result in an inability or delay in obtaining products.

Our manufacturer s ability to timely manufacture and ship our appliances in large quantities depends on a variety of factors. The manufacturer relies on a limited number of sources for the supply of functional components, such as semiconductors, printed circuit boards and hard disk drives. Functional component supply shortages or delays could prevent or delay the manufacture and shipment of appliances and, in the event of shortages or delays, we may not be able to procure alternative functional components on similar pricing terms, if at all. In addition, contractual restrictions or claims for infringement of intellectual property rights may restrict our manufacturer s use of certain components. These restrictions or claims may require our manufacturer to utilize alternative components or obtain additional licenses or technologies, and may impede its ability to manufacture and deliver appliances on a timely or cost-effective basis.

In the event of an interruption from this manufacturer, we may not be able to develop alternate or secondary sources in a timely manner. If we are unable to buy our appliances in quantities sufficient to meet our requirements on a timely basis, we will not be able to deliver products to our channel partners and customers, which would seriously affect present and future sales.

A failure to manage excess inventories or inventory shortages could result in decreased revenue and gross margins and harm our business.

We purchase products from our manufacturing partner outside of and in advance of reseller or customer orders, which we hold in inventory and resell. There is a risk we may be unable to sell excess products ordered from our manufacturing partner. Inventory levels in excess of customer demand may result in inventory write-downs, and the sale of excess inventory at discounted prices could significantly impair our brand image and have an adverse effect on our financial condition and results of operations. Conversely, if we underestimate demand for our products or if our manufacturing partner fails to supply products we require at the time we need them, we may experience inventory shortages. Inventory shortages might delay shipments to resellers, distributors and customers or cause us to lose sales. These shortages may diminish the loyalty of our channel partners or customers.

The difficulty in forecasting demand also makes it difficult to estimate our future financial condition and results of operations from period to period. A failure to accurately predict the level of demand for our products could adversely affect our net revenues and net income, and we are unlikely to forecast such effects with any certainty in advance.

We have operations outside of the United States and a significant portion of our customers and suppliers are located outside of the United States, which subjects us to a number of risks associated with conducting international operations.

We market and sell our products throughout the world and have personnel in many parts of the world. In addition, we have sales offices and research and development facilities outside the United States and we conduct, and expect to continue to conduct, a significant amount of our business with companies that are located outside the United States, particularly in Israel, Asia and Europe. We also source our components for our products from various geographical regions and ship products from a foreign production facility. Therefore, we are subject to risks associated with having international sales and worldwide operations, including:

- trade and foreign exchange restrictions;
- foreign currency exchange fluctuations;
- economic or political instability in foreign markets;
- greater difficulty in enforcing contracts, accounts receivable collection and longer collection periods;
- changes in regulatory requirements;
- difficulties and costs of staffing and managing foreign operations;

the uncertainty and limitation of protection for intellectual property rights in some countries;

costs of compliance with foreign laws and regulations and the risks and costs of non-compliance with such laws and regulations;

costs of complying with U.S. laws and regulations for foreign operations, including import and export control laws, tariffs, trade barriers, economic sanctions and other regulatory or contractual limitations on our ability to sell our products in certain foreign markets, and the risks and costs of non-compliance;

heightened risks of unfair or corrupt business practices in certain geographies and of improper or fraudulent sales arrangements that may impact financial results and result in restatements of, and irregularities in, financial statements;

the potential for political unrest, acts of terrorism, hostilities or war;

management communication and integration problems resulting from cultural differences and geographic dispersion; and

multiple and possibly overlapping tax structures.

Our product and service sales may be subject to foreign governmental regulations, which vary substantially from country to country and change from time to time. Failure to comply with these regulations could adversely affect our business. Further, in many foreign countries it is common for others to engage in business practices that are prohibited by our internal policies and procedures or U.S. regulations applicable to us. Although we implemented policies and procedures designed to ensure compliance with these laws and policies, there can be no assurance that all of our employees, contractors, channel partners and agents will comply with these laws and policies. Violations of laws or key control policies by our employees, contractors, channel partners or agents could result in delays in revenue recognition, financial reporting misstatements, fines, penalties or the prohibition of the importation or exportation of our products and services and could have a material adverse effect on our business and results of operations.

A portion of our revenue is generated by sales to government entities, which are subject to a number of challenges and risks.

Sales to U.S. and foreign federal, state and local governmental agency customers have accounted for approximately 12% of our bookings in each of the years ended December 31, 2011 and 2010 and 11% of our bookings for the nine months ended September 30, 2012 and we may in the future increase sales to government entities. Sales into government entities are subject to a number of risks. Selling to government entities can be highly competitive, expensive and time consuming, often requiring significant upfront time and expense without any assurance that we will complete a sale. Government demand and payment for our products and services may be impacted by public sector budgetary cycles and funding authorizations, with funding reductions or delays adversely affecting public sector demand for our products. Most of our sales to government entities have been made indirectly through our channel partners. Government entities may have contractual or other legal rights to terminate contracts with our distributors and resellers for convenience or due to a default, and any such termination may adversely impact our results of operations.

In addition, for purchases by the U.S. federal government, we must comply with laws and regulations relating to U.S. federal government contracting, which affect how we and our channel partners do business in connection with U.S. federal agencies. These laws and regulations may impose added costs on our business, and failure to comply with these or other applicable regulations and requirements, including non-compliance in the past, could lead to claims for damages from our channel partners, penalties, termination of contracts and suspension or debarment from government contracting for a period of time. Any such damages, penalties, disruption or limitation in our ability to do business with the U.S. federal government may adversely impact our results of operations.

Our business in countries with a history of corruption and transactions with foreign governments increase the risks associated with our international activities.

As we operate and sell internationally, we are subject to the U.S. Foreign Corrupt Practices Act, or the FCPA, and other laws that prohibit improper payments or offers of payments to foreign governments and their officials and political parties by U.S. and other business entities for the purpose of obtaining or retaining business. We have operations, deal with and make sales to governmental customers in countries known to experience corruption, particularly certain emerging countries in Africa, East Asia, Eastern Europe and the Middle East, and further expansion of our international selling efforts may involve additional regions, including South America. Our activities in these countries create the risk of unauthorized payments or offers of payments by one of our employees, consultants, sales agents or channel partners that could be in violation of various laws including the FCPA, even though these parties are not always subject to our control. While we have implemented safeguards to discourage these practices by our employees, consultants, sales agents and channel partners, our existing safeguards and any future improvements may prove to be less than effective, and our employees, consultants, sales agents or channel partners may engage in conduct for which we might be held responsible. Violations of the FCPA may result in severe criminal or civil sanctions, including suspension or debarment from U.S. government contracting, and we may be subject to other liabilities, which could negatively affect our business, operating results and financial condition.

We rely significantly on revenue from services which may decline and, because we recognize revenue from services over the term of the relevant service period, downturns or upturns in sales are not immediately reflected in full in our operating results.

Our services revenue accounted for 34.6% of our total revenue for 2009, 37.7% of our total revenue for 2010, 39.2% of our total revenue for 2011 and 43.7% of our total revenue for the nine months ended September 30, 2012. Sales of new or renewal services contracts may decline or fluctuate as a result of a number of factors, including customers level of satisfaction with our products and services, the prices of our products and services, the prices of products and services offered by our competitors or reductions in our customers spending levels. If our sales of new or renewal services contracts decline, our revenue or revenue growth may decline and our business will suffer. In addition, we recognize service revenue ratably over the term of the relevant service period, which is typically one to three years but has been as long as five years. As a result, much of the revenue we report each quarter is the recognition of deferred revenue from services contracts entered into during previous quarters. Consequently, a decline in new or renewal services contracts in any one quarter will not be fully reflected in revenue in that quarter, but will negatively affect our revenue in future quarters. Accordingly, the effect of significant downturns in new or renewed sales of our services would not be reflected in full in our results of operations until future periods.

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If we are unable to increase sales to larger customers, our results of operations may suffer.

We continuously seek to increase sales of our products to large enterprises, managed security service providers and government entities. Sales to enterprises, service providers and government entities involve risks that may not be present, or are present to a lesser extent, with sales to small to mid-sized entities. These risks include:

- preexisting relationships with larger, entrenched providers of security solutions who have access to key decision makers within the organization and who also have the ability to bundle competing products with a broader product offering;
- increased purchasing power and leverage held by large customers in negotiating contractual arrangements with us;
- more stringent requirements in our support service contracts, including stricter support response times, and increased penalties for any failure to meet support requirements; and
- longer sales cycles and the associated risk that substantial time and resources may be spent on a potential customer who elects not to purchase our products and services.

In addition, product purchases by enterprises, managed security service providers, cloud hosting providers and government entities are frequently subject to budget constraints, multiple approvals, and unplanned administrative, processing and other delays. Large enterprises, managed security service providers, cloud hosting providers and government entities typically have longer implementation cycles; require greater product functionality and scalability and a broader range of services; demand that vendors take on a larger share of risks; sometimes require acceptance provisions that can lead to a delay in revenue recognition; and expect greater payment flexibility from vendors. All these factors can add risk to doing business with these customers. If our sales expectations for a large customer do not materialize in a particular quarter or at all, then our business, financial condition and results of operations could be materially and adversely affected.

If our existing and potential customers migrate to hosted, cloud-based data centers that do not deploy our products, our revenues could suffer.

The majority of our current sales are made through a model in which our channel partners sell our data security solutions to large enterprise customers that operate their own data centers and have the ability to choose the data security solutions and configurations to fit their environment. If our large enterprise customers and potential customers choose to outsource the hosting of their data centers to large, multi-tenancy hosting providers like Rackspace Hosting, Inc. and Amazon.com, Inc., they may not be able to choose what data security solutions are deployed in these hosted environments, and our current sales model may not be effective. Although we work with large hosting services providers, like Rackspace Hosting, Inc. and Savvis, Inc., to integrate our data security solutions into their hosting environments so our solutions may be offered to their hosting customers, we cannot guarantee that all such hosting service providers will adopt our solutions, offer them as a choice to their customers or promote our solutions over those of our competitors. Even if these large hosting services providers integrate our data security solutions into their hosting environments and promote our solutions, they may be able to negotiate larger discounts than individual enterprise customers and, consequently, the average selling price of our products may decrease and our revenue would suffer.

If our customers are not satisfied with our technical support or professional services, they may choose not to purchase our products and services or to renew maintenance contracts, either of which would adversely impact our business and results of operations.

Our business relies on our customers satisfaction with the technical support and professional consulting services we provide to support our products. If we fail to provide technical support services that are responsive, satisfy our customers expectations and resolve issues that they encounter with our products and services, then they may elect not to purchase or renew annual maintenance and support contracts and they may choose not to purchase additional products and services from us. Accordingly, our failure to provide satisfactory technical support or professional services could have a material and adverse effect on our business and results of operations.

We are exposed to fluctuations in currency exchange rates, which could negatively affect our financial condition and results of operations.

Our functional and reporting currency is the U.S. dollar and we generate a majority of our revenue in U.S. dollars. However, in 2011 and the nine months ended September 30, 2012, we incurred approximately 37% and 37%, respectively, of our expenses outside of the United States in foreign currencies, primarily Israeli shekels, principally with respect to salaries and related personnel expenses associated with our Israeli operations. The exchange rate between the U.S. dollar and foreign currencies has fluctuated substantially in recent years and may continue to fluctuate substantially in the future. We expect that a majority of our revenues will continue to be generated in U.S. dollars for the foreseeable future and that a significant portion of our expenses, including personnel costs, as well as capital and operating expenditures, will continue to be denominated in Israeli shekels. The results of our operations may be adversely affected by foreign exchange fluctuations.

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We use forward foreign exchange contracts to hedge or mitigate the effect of changes in foreign exchange rates on our operating expenses denominated in certain foreign currencies. However, we may not be able to purchase derivative instruments that are adequate to insulate ourselves from foreign currency exchange risks. Additionally, our hedging activities may contribute to increased losses as a result of volatility in foreign currency markets.

Our business and operations have experienced rapid growth, and if we do not appropriately manage any future growth, or are unable to improve our systems and processes, our operating results will be negatively affected.

We have experienced rapid growth over the last several years. We rely heavily on information technology systems to help manage critical functions, such as order processing, revenue recognition, financial forecasts and inventory and supply chain management. To manage any future growth effectively, we must continue to improve our information technology and financial infrastructure, operating and administrative systems and controls, and continue to manage headcount, capital and processes in an efficient manner. We may not be able to successfully implement improvements to these systems and processes in a timely or efficient manner. For instance, in the third quarter of 2011, we completed the implementation of NetSuite, an on-demand enterprise resource planning (ERP) system, replacing our prior ERP system. We have a limited operating history using NetSuite and may encounter difficulties using NetSuite to manage critical functions of our business.

In addition, we rely heavily on hosted, Software-as-a-Service (SaaS) technologies from third parties in order to operate critical functions of our business, including ERP services from NetSuite and customer relationship management (CRM) services from salesforce.com, Inc. If these services become unavailable due to extended outages or interruptions or because they are no longer available on commercially reasonable terms or prices, our expenses could increase, our ability to manage our finances could be interrupted and our processes for managing sales of our products and services and supporting our customers could be impaired until equivalent services, if available, are identified, obtained and integrated; all of which could harm our business.

Also, our systems and processes may not prevent or detect all errors, omissions or fraud. Our failure to improve our systems and processes, or their failure to operate in the intended manner, may result in our inability to manage the growth of our business and to accurately forecast our revenue, expenses and earnings, or to prevent certain losses. Our productivity and the quality of our products and services may also be adversely affected if we do not integrate and train our new employees quickly and effectively. Any future growth would add complexity to our organization and require effective coordination across our organization. Failure to manage any future growth effectively could result in increased costs, harm our results of operations and lead to investors losing confidence in our internal systems and processes, any of which could result in a decline in our stock price.

Assertions by third parties of infringement or other violations by us of their intellectual property rights could result in significant costs and substantially harm our business and operating results.

Patent and other intellectual property disputes are common in the IT security industry. Some companies in the IT security industry, including some of our competitors, own large numbers of patents, copyrights, trademarks and trade secrets, which they may use to assert claims against us. Third parties have asserted and may in the future assert claims of infringement, misappropriation or other violations of intellectual property rights against us. For example, in May 2010, F5 Networks, Inc., an IT infrastructure company that competes with us in the web application firewall market, filed a lawsuit against us alleging patent infringement. In June 2010, we filed a counterclaim alleging patent infringement by F5 Networks, Inc. In February 2011, we entered into a settlement and license agreement with F5 Networks, Inc., which dismissed the litigation. Third parties may also assert such claims against our customers or channel partners whom we typically indemnify against claims that our products infringe, misappropriate or otherwise violate the intellectual property rights of third parties. As the numbers of products and competitors in our market increase and overlaps occur, claims of infringement, misappropriation and other violations of intellectual property rights may increase. Also, to the extent we hire personnel from competitors, we may be subject to allegations that they have been improperly solicited or divulged proprietary or other confidential information. Any claim of infringement, misappropriation or other violation of intellectual property rights by a third party, even those without merit, could cause us to incur substantial costs defending against the claim and could distract our management from our business.

The patent portfolios of our most significant competitors are larger than ours. This disparity between our patent portfolio and the patent portfolios of our most significant competitors may increase the risk that they may sue us for patent infringement and may limit our ability to counterclaim for patent infringement or settle through patent cross-licenses. In addition, future assertions of patent rights by third parties, and any resulting litigation, may involve patent holding companies or other adverse patent owners who have no relevant product revenue and against whom our own patents may therefore provide little or no deterrence or protection. We cannot assure you that we are not infringing or otherwise violating any third-party intellectual property rights.

An adverse outcome of a dispute may require us to pay substantial damages, including treble damages, if we are found to have willfully infringed a third party s patents or copyrights; cease making, licensing or using solutions that are alleged to infringe or misappropriate the intellectual property of others; expend additional development resources to attempt to redesign our products or services or otherwise to develop non-infringing technology, which may not be successful; enter into potentially unfavorable royalty or license agreements in order to obtain the right to use necessary technologies or intellectual property rights; and indemnify our partners and other third parties. Royalty or licensing agreements, if required or desirable, may be unavailable on terms acceptable to us, or at all, and may require significant royalty payments and other expenditures. In addition, some licenses may be non-exclusive, and therefore our competitors may have access to the same technology licensed to us. Any of these events could seriously harm our business, financial condition and results of operations.

We have in the past been sued for patent infringement, and we expect that we will be sued for patent infringement in the future, regardless of the merits of any such lawsuits. The cost to defend such lawsuits and any adverse result in such lawsuits could have a material adverse effect on our business, financial condition and results of operations.

We rely on the availability of licenses to third-party software and other intellectual property.

Many of our products and services include software or other intellectual property licensed from third parties, and we otherwise use software and other intellectual property licensed from third parties in our business. This exposes us to risks over which we may have little or no control. For example, a licensor may have difficulties keeping up with technological changes or may stop supporting the software or other intellectual property that it licenses to us. Also, it will be necessary in the future to renew licenses, expand the scope of existing licenses or seek new licenses, relating to various aspects of these products and services, or otherwise relating to our business, which may result in increased license fees. There can be no assurance that the necessary licenses will be available on acceptable terms, if at all. In addition, a third party may assert that we or our customers are in breach of the terms of a license, which could, among other things, give such third party the right to terminate a license or seek damages from us, or both. The inability to obtain or maintain certain licenses or other rights or to obtain or maintain such licenses or rights on favorable terms, or the need to engage in litigation regarding these matters, could result in delays in releases of products and services, and could otherwise disrupt our business, until equivalent technology can be identified, licensed or developed, if at all, and integrated into our products and services or otherwise in the conduct of our business. Any of these events could have a material adverse effect on our business, financial condition and results of operations. Moreover, the inclusion in our products and services of software or other intellectual property licensed from third parties on a nonexclusive basis could limit our ability to differentiate our products from those of our competitors.

Our products contain third-party open source software components, and our failure to comply with the terms of the underlying open source software licenses could negatively affect our business.

Certain of our products are distributed with software licensed by its authors or other third parties under open source licenses, including the GNU Public License, the GNU Lesser Public License, the BSD License, the Apache License and others. Some of these licenses contain requirements that we make available source code for modifications or derivative works we create based upon the open source software, and that we license these modifications or derivative works under the terms of a particular open source license or other license granting third parties certain rights of further use. If we combine our proprietary software with open source software in a certain manner, we could, under certain of the open source licenses, be required to release the source code of our proprietary software. Open source license terms may be ambiguous and many of the risks associated with usage of open source cannot be eliminated, and could, if not properly addressed, negatively affect our business. In addition to risks related to license requirements, usage of open source software can lead to greater risks than use of third-party commercial software, as open source licensors generally do not provide warranties or controls on origin of the software.

If we were found to have inappropriately used open source software, we may be required to re-engineer our products, to release proprietary source code, to discontinue the sale of our products in the event re-engineering could not be accomplished on a timely basis or to take other remedial action that may divert resources away from our development efforts. Disclosing the source code of our proprietary software could make it easier for hackers and other third parties to discover vulnerabilities in or to defeat the protections of our data security products, which could result in our data security products failing to protect our customers business data. Disclosing our proprietary source code also could allow our competitors to create similar products with lower development effort and time and ultimately could result in a loss of product sales for us. Any of these events could have a material adverse effect on our reputation, business, financial condition and results of operations.

Failure to protect our proprietary technology and intellectual property rights could substantially harm our business and operating results.

The success of our business depends on our ability to protect and enforce our trade secrets, trademarks, copyrights, patents and other intellectual property rights. We attempt to protect our intellectual property under patent, trademark, copyright and trade secret laws, and through a combination of confidentiality procedures, contractual provisions and other methods, all of which offer only limited protection.

We have eight issued patents in the United States, but this number is relatively small in comparison to our competitors. We have nine pending U.S. patent applications, and may file additional patent applications in the future. The process of obtaining patent protection is expensive and time-consuming, and we may not be able to prosecute all necessary or desirable patent applications at a reasonable cost or in a timely manner. We may choose not to seek patent protection for certain innovations and may choose not to pursue patent protection in certain jurisdictions. Furthermore, it is possible that our patent applications may not issue as granted patents, that the scope of our issued patents will be insufficient or not have the coverage originally sought, that our issued patents will not provide us with any competitive advantages, and that our patents and other intellectual property rights may be challenged by others or invalidated through administrative process or litigation. In addition, issuance of a patent does not guarantee that we have an absolute right to practice the patented invention. As a result, we may not be able to obtain adequate patent protection or to enforce our issued patents effectively.

In addition to patented technology, we rely on our unpatented proprietary technology and trade secrets. Despite our efforts to protect our proprietary technology and trade secrets, unauthorized parties may attempt to misappropriate, reverse engineer or otherwise obtain and use them. The contractual provisions that we enter into with employees, consultants, partners, vendors and customers may not prevent unauthorized use or disclosure of our proprietary technology or intellectual property rights and may not provide an adequate remedy in the event of unauthorized use or disclosure of our proprietary technology or intellectual property rights. Moreover, policing unauthorized use of our technologies, products and intellectual property is difficult, expensive and time-consuming, particularly in foreign countries where the laws may not be as protective of intellectual property rights as those in the United States and where mechanisms for enforcement of intellectual property rights may be weak. We may be unable to determine the extent of any unauthorized use or infringement of our products, technologies or intellectual property rights.

From time to time, legal action by us may be necessary to enforce our patents and other intellectual property rights, to protect our trade secrets, to determine the validity and scope of the intellectual property rights of others or to defend against claims of infringement or invalidity. Such litigation could result in substantial costs and diversion of resources and could negatively affect our business, financial condition and results of operations. If we are unable to protect our intellectual property rights, we may find ourselves at a competitive disadvantage to others who need not incur the additional expense, time and effort required to create the innovative products that have enabled us to be successful to date.

If we are unable to hire, retain and motivate qualified personnel, our business would suffer.

Our future success depends, in part, on our ability to continue to attract and retain highly skilled personnel. The loss of the services of any of our key personnel, the inability to attract or retain qualified personnel or delays in hiring required personnel, particularly in engineering and sales, may seriously harm our business, financial condition and results of operations. Any of our employees may terminate their employment at any time. Our ability to continue to attract and retain highly skilled personnel will be critical to our future success. Competition for highly skilled personnel is frequently intense, especially in the San Francisco Bay Area and in Tel Aviv, Israel, the locations in which we have a substantial presence and need for highly-skilled personnel. In addition, a large portion of our employee base is substantially vested in significant stock option grants, and the ability to exercise those options and sell their stock in a public market may result in a larger than normal turn-over rate.

We are dependent on the continued services and performance of our senior management and other key employees, the loss of any of whom could adversely affect our business, financial condition and results of operations.

Our future performance depends on the continued services and continuing contributions of our senior management and other key employees to execute on our business plan, and to identify and pursue new opportunities and product innovations. The loss of services of senior management or other key employees, particularly Shlomo Kramer, one of our founders and our President and Chief Executive Officer; Amichai Shulman, one of our founders and our Chief Technology Officer; and Terrence J. Schmid, our Chief Financial Officer and Treasurer, could significantly delay or prevent the achievement of our development and strategic objectives. The loss of the services of our senior management or other key employees for any reason could adversely affect our business, financial condition and results of operations.

Conditions in Israel may limit our ability to develop and sell our products. This could result in a decrease of our revenues.

Our principal research and development facilities are located in Israel. Since the establishment of the State of Israel in 1948, a number of armed conflicts have taken place between Israel and its neighboring countries, as well as incidents of civil unrest. Political, economic and military conditions in Israel could directly affect our operations. We could be adversely affected by any major hostilities involving Israel, including acts of terrorism or any other hostilities involving or threatening Israel, the interruption or curtailment of trade between Israel and its trading partners, a significant increase in inflation or a significant downturn in the economic or financial condition of Israel. Any on-going or future violence between Israel and the Palestinians, armed conflicts, terrorist activities, tension along the Israeli borders or with other countries in the region, including Iran, or political instability in the region could disrupt international trading activities in Israel and may materially and negatively affect our business and could harm our results of operations.

Certain countries, as well as certain companies and organizations, continue to participate in a boycott of Israeli firms, firms with large Israeli operations and others doing business with Israel and Israeli companies. We are also precluded from marketing our products to certain of these countries due to United States and Israeli regulatory restrictions. In addition, such boycott, restrictive laws, policies or practices may change over time and we cannot predict which countries, as well as whether certain companies and organizations, will be subject thereto. The boycott, restrictive laws, policies or practices directed towards Israel, Israeli businesses or Israeli citizens could, individually or in the aggregate, have a material adverse affect on our business in the future.

Some of our executive officers and employees in Israel are obligated to perform annual military reserve duty in the Israel Defense Forces, depending on their age and position in the armed forces. Furthermore, they may be called to active reserve duty at any time under emergency circumstances for extended periods of time. Our operations could be disrupted by the absence, for a significant period, of one or more of our executive officers or key employees due to military service, and any significant disruption in our operations could harm our business.

Our internal network system and website may be subject to intentional disruption that could adversely impact our reputation and future sales.

Because we are a leading provider of data security products, hackers and others may try to access our data or compromise our systems. Similarly, experienced computer programmers may attempt to penetrate our network security or the security of our website and misappropriate proprietary information and/or cause interruptions of our services. Because the techniques used by such computer programmers to access or sabotage networks change frequently and may not be recognized until launched against a target, we may be unable to anticipate these techniques. The theft and/or unauthorized use or publication of our trade secrets and other confidential business information as a result of such an event could adversely affect our competitive position, reputation, brand and future sales of our products, and could impair our ability to operate our business, including our ability to provide subscription or maintenance and support services to our customers. We could suffer monetary and other losses and reputational harm in the event of such incidents.

Outages, interruptions or delays in hosting services could impair the delivery of our cloud-based security services and harm our business.

The cloud-based security services that we provide through our majority owned subsidiary, Incapsula, are operated from a network of third party facilities that host the software and systems that operate these security services. We currently serve our customers from third-party hosting facilities located in the United States and Europe. We have a limited operating history for our cloud-based security services in these third party hosting facilities. In addition, we operate the infrastructure that supports our ThreatRadar and Security Operations Center (SOC) services. Despite precautions taken within our own internal network and at these third party facilities, the occurrence of a natural disaster or an act of terrorism or other unanticipated problems could result in lengthy interruptions in our services.

In addition, any damage to, or failure of, our internal systems or systems at third party hosting facilities could result in outages or interruptions in our cloud-based services. Outages or interruptions in our cloud-based security services may reduce our revenue, cause us to issue credits or pay penalties, cause customers to terminate their subscriptions and adversely affect our renewal rates and our ability to attract new customers. Our business will also be harmed if our customers and potential customers believe our cloud-based security services are unreliable.

Our success in acquiring and integrating other businesses, products or technologies could impact our financial position.

In order to remain competitive, we may seek to acquire additional businesses, products or technologies. The environment for acquisitions in the markets in which we operate is very competitive and acquisition candidate purchase prices will likely exceed what we would prefer to pay, but may choose to pay in order to make an acquisition. Achieving the anticipated benefits of future acquisitions will depend in part upon whether we can integrate acquired operations, products and technology in a timely and cost-effective manner. The acquisition and integration process is complex, expensive and time consuming, and may cause an interruption of, or loss of momentum in, product development and sales activities and operations of both companies. We may not find suitable acquisition candidates, and acquisitions we complete may be unsuccessful. If we consummate a transaction, we may be unable to integrate and manage acquired products and businesses effectively. If we are unable to effectively execute acquisitions, our business, financial condition and results of operations could be adversely affected.

We are subject to governmental export and import controls that could subject us to liability or impair our ability to compete in international markets.

We incorporate encryption technology into our products, and certain of our products are subject to U.S. export controls and may be exported outside the United States only with the required export license through an export license exception or other appropriate government authorizations. If we were to fail to comply with U.S. export control regulations, U.S. Customs regulations, U.S. economic sanctions and other laws, we could be subject to substantial civil and criminal penalties, including fines for our company and incarceration for responsible employees and managers, and the possible loss of export or import privileges. In addition, if our channel partners fail to obtain appropriate import, export or re-export licenses or permits, we may also be adversely affected, through reputational harm and penalties. Complying with export control regulations for a particular sale may be time-consuming and may result in the delay or loss of sales opportunities.

Furthermore, U.S. export control laws and economic sanctions prohibit the shipment of certain products to U.S. embargoed or sanctioned countries, governments and persons. Even though we take precautions to prevent our product from being shipped to U.S. sanctions targets, our products could be shipped to those targets by our channel partners despite such precautions. Any such shipment could have negative consequences including government investigations, penalties and reputational harm. In addition, various countries regulate the import of certain encryption technology, including import permitting and licensing requirements, and have enacted laws that could limit our ability to distribute our products or could limit our customers ability to implement our products in those countries. Changes in our products or changes in export and import regulations may create delays in the introduction of our products in international markets, prevent our customers with international operations from deploying our products globally or, in some cases, prevent the export or import of our products to certain countries, governments or persons altogether. Any change in export or import regulations, economic sanctions or related legislation, shift in the enforcement or scope of existing regulations, or change in the countries, governments, persons or technologies targeted by such regulations, could result in decreased use of our products by, or in our decreased ability to export or sell our products to, existing or potential customers with international operations. Any decreased use of our products or limitation on our ability to export or sell our products would likely adversely affect our business, financial condition and results of operations.

If our estimates or judgments relating to our critical accounting policies are based on assumptions that change or prove to be incorrect, our operating results could fall below expectations of securities analysts and investors, resulting in a decline in our stock price.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, as provided in the section entitled Management s Discussion and Analysis of Financial Condition and Results of Operations, the results of which form the basis for making judgments about the carrying values of assets, liabilities, equity, revenue and expenses that are not readily apparent from other sources. Our operating results may be adversely affected if our assumptions change or if actual circumstances differ from those in our assumptions, which could cause our operating results to fall below the expectations of securities analysts and investors, resulting in a decline in our stock price. Significant assumptions and estimates used in preparing our consolidated financial statements include those related to revenue recognition, stock-based compensation, long-lived assets and accounting for income taxes.

If we are unable to establish vendor specific objective evidence of fair value for any undelivered element of a software order from a customer, our revenue relating to the entire software order will be deferred and recognized over future periods, which would prevent us from recognizing revenue on a significant portion of our sales in a particular quarter, which could cause our stock price to decline.

In the course of our selling efforts, we typically enter into arrangements that require us to deliver a combination of products and services. We refer to each individual product or service as an element of the overall arrangement. These arrangements typically require us to deliver particular elements in a future period. Arrangements that are considered software arrangements, such as when there is no hardware component to the arrangement as is the case when we sell virtual products, follow different, more restrictive accounting requirements than non-software arrangements. As we discuss further in the section entitled Management s Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies and Estimates Revenue Recognition, set forth in Part II, Item 7, of our Annual Report on Form 10-K for the year ended December 31, 2011, if we are unable to determine the vendor specific objective evidence of fair value of any undelivered elements in a software arrangement, then we are required by GAAP to defer revenue from the entire software arrangement rather than just the undelivered elements. If we are required to defer revenue from the entire software arrangement for a significant portion of our sales, our revenue for that quarter could fall below our expectations or those of securities analysts and investors, resulting in a decline in our stock price.

If we fail to comply with environmental requirements, our business, financial condition, results of operations and reputation could be adversely affected.

We are subject to various environmental laws and regulations including laws governing the hazardous material content of our products and laws relating to the collection of and recycling of electrical and electronic equipment. Examples of these laws and regulations include the European Union (EU) Restrictions of Hazardous Substances Directive (RoHS) and the EU Waste Electrical and Electronic Equipment Directive, as well as the implementing legislation of the EU member states. Similar laws and regulations have been passed or may be enacted in other regions, including in the United States, and we are, or may in the future be, subject to these laws and regulations. To date, our expenditures for environmental compliance have not had a material impact on our results of operations or cash flows and, although we cannot predict the future impact of such laws or regulations, they may result in additional costs or require us to change the content of our products or how they are manufactured, which could have a material adverse affect on our business, financial condition and results of operations.

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Changes in our provision for income taxes or adverse outcomes resulting from examination of our income tax returns could adversely affect our results.

We are subject to income taxation in the United States and numerous foreign jurisdictions. Determining our provision for income taxes requires significant management judgment. In addition, our provision for income taxes is subject to volatility and could be adversely affected by many factors, including, among other things, changes to our operating or holding structure, changes in the amounts of earnings in jurisdictions with differing statutory tax rates, changes in the valuation of deferred tax assets and liabilities and changes in tax laws. We are subject to ongoing tax examinations in various jurisdictions. Tax authorities may disagree with our intercompany charges, cross-jurisdictional transfer pricing or other matters and assess additional taxes. While we regularly assess the likely outcomes of these examinations to determine the adequacy of our provision for income taxes, there can be no assurance that the outcomes of such examinations will not have a material impact on our operating results and cash flows.

Significant judgment is required to determine the recognition and measurement attributes prescribed in Accounting Standards Codification (ASC) 740-25 (formerly referred to as Financial Interpretation No. 48, Accounting for Uncertainty in Income Taxes-an interpretation of FASB Statement No. 109). In addition, ASC 740-25 applies to all income tax positions, including the potential recovery of previously paid taxes, which if settled unfavorably could adversely impact our provision for income taxes or additional paid-in capital. Further, as a result of certain of our ongoing employment and capital investment actions and commitments, our income in certain countries is subject to reduced tax rates and in some cases is wholly exempt from tax. Our failure to meet these commitments could adversely impact our provision for income taxes. In addition, we are subject to the continuous examination of our income tax returns by the U.S. Internal Revenue Service and other tax authorities. We regularly assess the likelihood of adverse outcomes resulting from these examinations to determine the adequacy of our provision for income taxes. There can be no assurance that the outcomes from these continuous examinations will not have an adverse effect on our results of operations.

Our business is subject to the risks of earthquakes, fire, power outages, floods and other catastrophic events, and to interruption by manmade problems such as terrorism.

A significant natural disaster, such as an earthquake, fire or a flood, or a significant power outage could have a material adverse impact on our business, financial condition and results of operations. Our corporate headquarters are located in the San Francisco Bay Area, a region known for seismic activity. In addition, natural disasters could affect our manufacturing vendors or logistics providers ability to perform services such as manufacturing products on a timely basis and assisting with shipments on a timely basis. In the event our service providers information technology systems or manufacturing or logistics abilities are hindered by any of the events discussed above, shipments could be delayed, resulting in missing financial targets, such as revenue and shipment targets, for a particular quarter. Further, if a natural disaster occurs in a region from which we derive a significant portion of our revenue, customers in that region may delay or forego purchases of our products, which may materially and adversely impact our results of operations for a particular period. In addition, acts of terrorism could cause disruptions in our business or the business of our manufacturer, logistics providers, partners, customers or the economy as a whole. Given our typical concentration of sales at each quarter end, any disruption in the business of our manufacturer, logistics providers, partners or customers that impacts sales at the end of our quarter could have a significant adverse impact on our quarterly results. All of the aforementioned risks may be augmented if the disaster recovery plans for us and our suppliers prove to be inadequate. To the extent that any of the above results in delays or cancellations of customer orders, or the delay in the manufacture, deployment or shipment of our products, our business, financial condition and results of operations would be adversely affected.

Risks Related to Ownership of our Common Stock

Market volatility may affect our stock price and the value of your investment

The trading prices of the securities of technology companies have been highly volatile. The market price of our common stock may fluctuate significantly in response to a number of factors, most of which we cannot predict or control, including:

- announcements of new products, services or technologies, commercial relationships, acquisitions or other events by us or our competitors;

- fluctuations in stock market prices and trading volumes of securities of similar companies;

general market conditions and overall fluctuations in U.S. equity markets;

variations in our operating results, or the operating results of our competitors;

changes in our financial guidance or securities analysts estimates of our financial performance;

changes in accounting principles;

sales of large blocks of our common stock, including sales by our executive officers, directors and significant stockholders;

additions or departures of any of our key personnel;

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announcements related to litigation;

changing legal or regulatory developments in the United States and other countries; and

discussion of us or our stock price by the financial press and in online investor communities.

In addition, the stock market in general, and the New York Stock Exchange in particular, have experienced substantial price and volume volatility that is often seemingly unrelated to the operating performance of particular companies. These broad market fluctuations may cause the trading price of our common stock to decline. In the past, securities class action litigation has often been brought against a company after a period of volatility in the market price of its common stock. We may become involved in this type of litigation in the future. Any securities litigation claims brought against us could result in substantial expenses and the diversion of our management s attention from our business.

If we fail to maintain an effective system of disclosure controls and procedures and internal controls, our ability to produce accurate financial statements or comply with applicable regulations could be impaired.

As a public company, we are subject to the reporting requirements of the Exchange Act, the Sarbanes-Oxley Act of 2002 (the Sarbanes-Oxley Act), and the rules and regulations of the New York Stock Exchange. We expect that the requirements of these rules and regulations will continue to increase our legal, accounting and financial compliance costs, make some activities more difficult, time-consuming and costly and place strain on our personnel, systems and resources.

The Sarbanes-Oxley Act requires, among other things, that we maintain effective disclosure controls and procedures and internal control over financial reporting. We are continuing to develop and refine our disclosure controls and other procedures that are designed to ensure that information required to be disclosed by us in the reports that we file with the SEC is recorded, processed, summarized and reported within the time periods specified in SEC s rules and forms. Our current controls and any new controls that we develop may become inadequate because of changes in conditions, and the degree of compliance with the policies or procedures may deteriorate. Further, weaknesses in our internal controls may be discovered in the future. Any failure to develop or maintain effective controls, or any difficulties encountered in their implementation or improvement, could harm our operating results or cause us to fail to meet our reporting obligations and may result in a restatement of our prior period financial statements. Any failure to implement and maintain effective internal controls also could adversely affect the results of periodic management evaluations and annual independent registered public accounting firm attestation reports regarding the effectiveness of our internal control over financial reporting that we will be required to include in our annual reports filed with the SEC beginning for our fiscal year ending December 31, 2012 under Section 404 of the Sarbanes-Oxley Act. Ineffective disclosure controls and procedures and internal control over financial reporting could also cause investors to lose confidence in our reported financial and other information, which would likely have a negative effect on the trading price of our common stock.

In the event that we are not able to demonstrate compliance with Section 404 of the Sarbanes-Oxley Act in a timely manner, that our internal controls are perceived as inadequate or that we are unable to produce timely or accurate financial statements, investors may lose confidence in our operating results and our stock price could decline.

We also have not yet implemented a complete disaster recovery plan or business continuity plan for our accounting and related information technology systems. Any disaster could therefore materially impair our ability to maintain timely accounting and reporting.

Our failure to raise additional capital or generate the significant capital necessary to expand our operations and invest in new products could reduce our ability to compete and could harm our business.

We expect that our existing cash and cash equivalents will be sufficient to meet our anticipated cash needs for at least the next twelve months. After that, we may need to raise additional funds, and we may not be able to obtain additional debt or equity financing on favorable terms, if at all. If we raise additional equity financing, our stockholders may experience significant dilution of their ownership interests and the per share value of our common stock could decline. Furthermore, if we engage in debt financing, the holders of debt would have priority over the holders of common stock and we may be required to accept terms that restrict our ability to incur additional indebtedness, make capital expenditures and take other actions that would otherwise be in the interests of the stockholders and force us to maintain specified liquidity or other ratios, any of which could harm our business, financial condition and results of operations. Similarly, if we raise additional funds through collaboration, strategic alliance and licensing arrangements with third parties, we may have to relinquish valuable rights to our technologies or grant licenses on terms that are not favorable to us. If we need additional capital and cannot raise it on acceptable terms, we may not be able to, among other things:

develop or enhance our products and services;

continue to expand our sales and marketing and research and development organizations;

acquire complementary technologies, products or businesses;

expand operations, in the United States or internationally;

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hire, train and retain employees; or

respond to competitive pressures or unanticipated working capital requirements.

Our failure to do any of these things could seriously harm our business, financial condition and results of operations.

Concentration of ownership among our existing executive officers, directors and their affiliates may delay or prevent new investors from influencing significant corporate decisions.

Our executive officers and directors and their affiliates beneficially own, in the aggregate, approximately 23.8% of our outstanding common stock as of November 7, 2012. As a result, such persons, acting together, have the ability to control our management and affairs and substantially all matters submitted to our stockholders for approval, including the election and removal of directors and approval of any significant transaction. These persons will also have the ability to control our management and business affairs. This concentration of ownership may have the effect of delaying, deferring or preventing a change in control, impeding a merger, consolidation, takeover or other business combination involving us, or discouraging a potential acquirer from making a tender offer or otherwise attempting to obtain control of our business, even if such a transaction would benefit other stockholders.

If there are substantial sales of shares of our common stock, the price of our common stock could decline.

The price of our common stock could decline if there are substantial sales of our common stock, particularly sales by our directors, executive officers and significant stockholders. Some holders of shares of our common stock have rights, subject to some conditions, to require us to file registration statements covering their shares or to include their shares in registration statements that we may file for ourselves or our stockholders. We also registered shares of common stock that we have issued and may issue under our employee equity incentive plans, and such shares may be sold freely in the public market upon issuance. The market price of the shares of our common stock could decline as a result of sales of a substantial number of our shares in the public market or the perception in the market that the holders of a large number of shares intend to sell their shares.

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

The trading market for our common stock will depend in part on the research and reports that securities or industry analysts publish about us or our business. If we do not establish and maintain adequate research coverage or if one or more of the analysts who covers us downgrades our stock or publishes inaccurate or unfavorable research about our business, our stock price would likely decline. If one or more of these analysts ceases coverage of our company or fails to publish reports on us regularly, demand for our stock could decrease, which could cause our stock price and trading volume to decline.

We do not intend to pay dividends on our common stock so any returns will be limited to the value of our stock.

We have never declared or paid any cash dividend on our common stock. We currently anticipate that we will retain future earnings for the development, operation and expansion of our business and do not anticipate declaring or paying any cash dividends for the foreseeable future. Any return to stockholders will therefore be limited to the value of their stock.

Anti-takeover provisions in our charter documents and under Delaware law could make an acquisition of us, which may be beneficial to our stockholders, more difficult and may prevent attempts by our stockholders to replace or remove our current management.

Provisions in our restated certificate of incorporation and amended and restated bylaws may delay or prevent an acquisition of us or a change in our management. These provisions include:

authorizing blank check preferred stock, which could be issued by the board without stockholder approval and may contain voting, liquidation, dividend and other rights superior to our common stock, which would increase the number of outstanding shares and could thwart a takeover attempt;

a classified board of directors whose members can be dismissed for only cause;

the prohibition on actions by written consent of our stockholders;

the limitation on who may call a special meeting of stockholders;

the establishment of advance notice requirements for nominations for election to our board of directors or for proposing matters that can be acted upon at stockholder meetings; and

the requirement of at least 75% of the outstanding capital stock to amend any of the foregoing second through fifth provisions.

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In addition, because we are incorporated in Delaware, we are governed by the provisions of the anti-takeover provisions of the Delaware General Corporation Law, which 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 of control would be beneficial to our existing stockholders. Although we believe these provisions collectively provide for an opportunity to obtain greater value for stockholders by requiring potential acquirers to negotiate with our board of directors, they would apply even if an offer rejected by our board were considered beneficial by some stockholders. In addition, these provisions may frustrate or prevent any attempts by our stockholders to replace or remove our current management by making it more difficult for stockholders to replace members of our board of directors, which is responsible for appointing the members of our management.

Our ability to use our net operating loss carryforwards may be subject to limitation and may result in increased future tax liability to us.

Generally, a change of more than 50% in the ownership of a corporation s stock, by value, over a three-year period constitutes an ownership change for U.S. federal income tax purposes. An ownership change may limit a company s ability to use its net operating loss carryforwards attributable to the period prior to such change. We have not performed a detailed analysis to determine whether an ownership change under Section 382 of the Internal Revenue Code has occurred after each of our previous private placements of preferred stock or after the issuance of shares of common stock in connection with our initial public offering. In the event we have undergone an ownership change under Section 382, if we earn net taxable income, our ability to use our pre-change net operating loss carryforwards to offset U.S. federal taxable income may become subject to limitations, which could potentially result in increased future tax liability to us.

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

Use of Proceeds from Public Offering of Common Stock

The Form S-1 Registration Statement (Registration No. 333-175008) relating to our IPO was declared effective by the SEC on November 8, 2011, and the offering of our common stock commenced on November 9, 2011. J.P. Morgan Securities LLC and Deutsche Bank Securities Inc. acted as joint book-running managers for the offering, and RBC Capital Markets, LLC, Lazard Capital Markets LLC and Pacific Crest Securities, Inc. acted as co-managers of the offering. The offering has been completed.

The net proceeds to us of our IPO after deducting $6.3 million of underwriters discounts and $6.5 million of offering expenses were $86.2 million. In January 2012, we invested $3.5 million of the net proceeds to us resulting from our IPO in Incapsula, our majority owned subsidiary, and received in exchange an additional 4,375,000 shares of Incapsula s Series A-1 Preferred Stock. We expect to use remaining net proceeds for working capital and general corporate purposes, including acquisitions. Although we may also use a portion of the net proceeds for acquisition of complementary businesses, technologies or other assets, we have no present understandings, commitments or agreements to enter into any acquisitions.

Our management will retain broad discretion in the allocation and use of the net proceeds of our IPO, and investors will be relying on the judgment of our management regarding the application of the net proceeds. Pending specific utilization of the net proceeds as described above, we have invested the net proceeds of the offering in short-term, interest-bearing obligations. The goal with respect to the investment of the net proceeds will be capital preservation and liquidity so that such funds are readily available to fund our operations.

Item 3. Defaults Upon Senior Securities

Not applicable.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

Not applicable.

Item 6. Exhibits

See Exhibit Index.

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SIGNATURES

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

IMPERVA, INC.

Date: November 13, 2012	By: /s/ Shlomo Kramer Shlomo Kramer President and Chief Executive Officer (Principal Executive Officer)
Date: November 13, 2012	By: /s/ Terrence J. Schmid Terrence J. Schmid Chief Financial Officer (Principal Financial Officer)

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EXHIBIT INDEX

Exhibit Number	Exhibit Description	Incorporated by Reference Form	File No.	Exhibit	Filing Date	Provided Herewith
10.1	Third Amendment to Lease Agreement effective as of August 22, 2012 between Westport Office Park, LLC and Imperva, Inc.					X
31.1*	Certification of Principal Executive Officer Pursuant to Securities Exchange Act Rule 13a-14(a).					X
31.2*	Certification of Principal Financial Officer Pursuant to Securities Exchange Act Rule 13a-14(a).					X
32.1*	Certification of Principal Executive Officer Pursuant to 18 U.S.C. Section 1350 and Securities Exchange Act Rule 13a-14(b).					X
32.2*	Certification of Principal Financial Officer Pursuant to 18 U.S.C. Section 1350 and Securities Exchange Act Rule 13a-14(b).					X
101.INS**	XBRL Instance Document					X
101.SCH**	XBRL Taxonomy Extension Schema Document					X
101.DEF**	XBRL Taxonomy Extension Definition Linkbase Document					X
101.CAL**	XBRL Taxonomy Calculation Linkbase Document					X
101.LAB**	XBRL Taxonomy Label Linkbase Document					X
101.PRE**	XBRL Taxonomy Extension Presentation Linkbase Document					X

* This certification is not deemed filed for purposes of Section 18 of the Securities Exchange Act, or otherwise subject to the liability of that section. Such certification will not be deemed to be incorporated by reference into any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934, except to the extent that Imperva, Inc. specifically incorporates it by reference.

** These exhibits are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, are deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and otherwise are not subject to liability under those sections.