LogMeIn, Inc.
Form 10-Q
July 26, 2012
**Table of Contents**

# UNITED STATES

# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# FORM 10-Q

(Mark One)

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

**For the quarterly period ended June 30, 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: 001-34391**

# LOGMEIN, INC.

**(Exact name of registrant as specified in its charter)**

| | |
|---|---|
| **Delaware** | **20-1515952** |
| **(State or other jurisdiction of incorporation or organization)** | **(I.R.S. Employer Identification No.)** |
| **500 Unicorn Park Drive Woburn, Massachusetts** | **01801** |
| **(Address of principal executive offices)** | **(Zip Code)** |

**781-638-9050**

**(Registrant s telephone number, including area code)**

**(Former name, former address and former fiscal year, if changed since last report)**

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). 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 | x |
| Non-accelerated filer | ¨ (Do not check if a smaller reporting company) | Smaller reporting company | ¨ |

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

As of July 20, 2012, there were 24,746,745 shares of the registrant s Common Stock, par value $0.01 per share, outstanding.

Table of Contents

**LOGMEIN, INC.**

**INDEX**

Table of Contents

**Part I. Financial Information**

**Item 1. Financial Statements**

**LogMeIn, Inc.**

**Condensed Consolidated Balance Sheets**

| | December 31, 2011 | June 30, 2012 |
|---|---|---|
| **ASSETS** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 103,603,684 | $ 98,443,541 |
| Marketable securities | 95,040,045 | 100,015,400 |
| Accounts receivable (net of allowance for doubtful accounts of $109,000 and $142,000 as of December 31, 2011 and June 30, 2012, respectively) | 8,747,104 | 8,363,433 |
| Prepaid expenses and other current assets | 2,411,640 | 2,938,152 |
| Deferred income tax assets | 1,980,342 | 1,976,028 |
| Total current assets | 211,782,815 | 211,736,554 |
| Property and equipment, net | 5,202,721 | 5,884,674 |
| Restricted cash | 369,792 | 3,909,611 |
| Intangibles, net | 3,260,612 | 6,861,150 |
| Goodwill | 7,258,743 | 18,440,492 |
| Other assets | 242,122 | 230,767 |
| Deferred income tax assets | 3,940,312 | 3,940,312 |
| Total assets | $ 232,057,117 | $ 251,003,560 |
| **LIABILITIES AND EQUITY** | | |
| Current liabilities: | | |
| Accounts payable | $ 6,275,163 | $ 5,554,634 |
| Accrued liabilities | 10,472,805 | 13,096,744 |
| Deferred revenue, current portion | 55,961,859 | 59,702,020 |
| Total current liabilities | 72,709,827 | 78,353,398 |
| Deferred revenue, net of current portion | 2,302,465 | 3,125,276 |
| Other long-term liabilities | 1,239,136 | 2,292,857 |
| Total liabilities | 76,251,428 | 83,771,531 |
| Commitments and contingencies (Note 9) | | |
| Preferred stock, $0.01 par value 5,000,000 shares authorized, 0 shares outstanding as of December 31, 2011 and June 30, 2012 | | |
| Equity: | | |
| Common stock, $0.01 par value 75,000,000 shares authorized as of December 31, 2011 and June 30, 2012; 24,551,641 and 24,733,520 shares issued and outstanding as of December 31, 2011 and June 30, 2012, respectively | 245,516 | 247,335 |
| Additional paid-in capital | 154,440,369 | 165,076,334 |
| Retained earnings | 2,677,128 | 3,329,045 |
| Accumulated other comprehensive loss | (1,557,324) | (1,420,685) |
| Total equity | 155,805,689 | 167,232,029 |

| | | |
|---|---|---|
| Total liabilities and equity | $ 232,057,117 | $ 251,003,560 |

See notes to condensed consolidated financial statements.

2

Table of Contents

**LogMeIn, Inc.**

**Condensed Consolidated Statements of Income**

| | Three Months Ended June 30, 2011 | Three Months Ended June 30, 2012 | Six Months Ended June 30, 2011 | Six Months Ended June 30, 2012 |
|---|---|---|---|---|
| Revenue | $ 29,097,956 | $ 33,796,581 | $ 56,136,735 | $ 66,484,512 |
| Cost of revenue | 2,445,765 | 3,424,728 | 4,981,901 | 6,842,046 |
| Gross profit | 26,652,191 | 30,371,853 | 51,154,834 | 59,642,466 |
| Operating expenses | | | | |
| Research and development | 4,661,979 | 6,696,432 | 8,979,758 | 12,916,403 |
| Sales and marketing | 14,056,128 | 16,474,132 | 27,042,237 | 33,319,955 |
| General and administrative | 3,836,955 | 4,799,987 | 9,895,645 | 9,705,251 |
| Legal settlement | | | 1,250,000 | |
| Amortization of acquired intangibles | 92,048 | 145,680 | 184,082 | 272,945 |
| Total operating expenses | 22,647,110 | 28,116,231 | 47,351,722 | 56,214,554 |
| Income from operations | 4,005,081 | 2,255,622 | 3,803,112 | 3,427,912 |
| Interest income, net | 239,958 | 217,977 | 450,670 | 433,467 |
| Other expense | (151,872) | (269,325) | (260,683) | (505,590) |
| Income before income taxes | 4,093,167 | 2,204,274 | 3,993,099 | 3,355,789 |
| Provision for income taxes | (1,410,843) | (1,628,597) | (1,376,022) | (2,703,872) |
| Net income | $ 2,682,324 | $ 575,677 | $ 2,617,077 | $ 651,917 |
| Net income per share: | | | | |
| Basic | $ 0.11 | $ 0.02 | $ 0.11 | $ 0.03 |
| Diluted | $ 0.11 | $ 0.02 | $ 0.10 | $ 0.03 |
| Weighted average shares outstanding: | | | | |
| Basic | 24,116,686 | 24,677,893 | 24,023,018 | 24,625,851 |
| Diluted | 25,169,689 | 25,367,227 | 25,118,423 | 25,360,950 |

See notes to condensed consolidated financial statements.

Table of Contents

**LogMeIn, Inc.**

**Condensed Consolidated Statements of Comprehensive Income (Loss)**

| | Three Months Ended June 30, 2011 | Three Months Ended June 30, 2012 | Six Months Ended June 30, 2011 | Six Months Ended June 30, 2012 |
|---|---|---|---|---|
| Net income | $ 2,682,324 | $ 575,677 | $ 2,617,077 | $ 651,917 |
| Other comprehensive income: | | | | |
| Net unrealized gains (losses) on marketable securities, net of tax | 13,720 | (4,295) | (3,423) | 6,438 |
| Net translation gains (losses) | 218,037 | (905,512) | 790,497 | 130,201 |
| Total other comprehensive income (loss) | 231,757 | (909,807) | 787,074 | 136,639 |
| Comprehensive income (loss) | $ 2,914,081 | $ (334,130) | $ 3,404,151 | $ 788,556 |

See notes to condensed consolidated financial statements.

4

Table of Contents

**LogMeIn, Inc.**

**Condensed Consolidated Statements of Cash Flows**

| | Six Months Ended June 30, 2011 | 2012 |
|---|---|---|
| **Cash flows from operating activities** | | |
| Net income | $ 2,617,077 | $ 651,917 |
| Adjustments to reconcile net income to net cash provided by operating activities | | |
| Depreciation and amortization | 2,074,756 | 2,848,825 |
| Amortization of premium on investments | 95,291 | 22,370 |
| Provision for bad debts | 30,000 | 55,000 |
| Provision for deferred income taxes | 1,335,520 | 173 |
| Income tax benefit from the exercise of stock options | (2,028,000) | |
| Stock-based compensation | 3,996,617 | 6,073,007 |
| Gain on disposal of equipment | (396) | (661) |
| Changes in assets and liabilities: | | |
| Accounts receivable | (2,640,416) | 441,348 |
| Prepaid expenses and other current assets | 494,470 | (513,585) |
| Other assets | (163,153) | 11,355 |
| Accounts payable | 645,428 | (871,267) |
| Accrued liabilities | (881,303) | 2,235,628 |
| Deferred revenue | 8,339,473 | 4,138,268 |
| Other long-term liabilities | (93,046) | 1,053,721 |
| Net cash provided by operating activities | 13,822,318 | 16,146,099 |
| **Cash flows from investing activities** | | |
| Purchases of marketable securities | (85,073,350) | (74,987,000) |
| Proceeds from sale or disposal of marketable securities | 85,000,000 | 70,000,000 |
| Purchases of property and equipment | (2,094,569) | (2,284,816) |
| Intangible asset additions | (137,519) | (566,442) |
| Cash paid for acquisition, net of cash acquired | | (14,831,525) |
| Increase in restricted cash and deposits | (25,569) | (3,557,760) |
| Net cash used in investing activities | (2,331,007) | (26,227,543) |
| **Cash flows from financing activities** | | |
| Proceeds from issuance of common stock upon option exercises | 2,432,090 | 2,012,777 |
| Income tax benefit from the exercise of stock options | 2,028,000 | 2,552,000 |
| Net cash provided by financing activities | 4,460,090 | 4,564,777 |
| Effect of exchange rate changes on cash and cash equivalents and restricted cash | 772,196 | 356,524 |
| Net increase (decrease) in cash and cash equivalents | 16,723,597 | (5,160,143) |
| Cash and cash equivalents, beginning of period | 77,279,987 | 103,603,684 |
| Cash and cash equivalents, end of period | $ 94,003,584 | $ 98,443,541 |
| **Supplemental disclosure of cash flow information** | | |
| Cash paid for interest | $ 950 | $ 215 |
| Cash paid for income taxes | $ 175,014 | $ 380,787 |
| **Noncash investing and financing activities** | | |

| | | | | |
|---|---|---|---|---|
| Purchases of property and equipment included in accounts payable and accrued liabilities | $ | 242,494 | $ | 871,749 |
| Fair value of contingent consideration in connection with acquisition included in accrued liabilities and other long-term liabilities | $ | | $ | 234,568 |

See notes to condensed consolidated financial statements.

5

Table of Contents

**LogMeIn, Inc.**

**Notes to Condensed Consolidated Financial Statements**

**1. Nature of the Business**

LogMeIn, Inc. (the Company ) develops and markets a suite of cloud-based remote access, remote IT management, collaboration, data management and customer care solutions that provide instant, secure access to Internet connected devices, data and other people. The Company s product line includes BoldChat®, Cosm™ (formerly known as Pachube), Cubby™, join.me®, LogMeIn Free®, LogMeIn Pro®, LogMeIn® Central™, LogMeIn Rescue®, LogMeIn® Rescue+Mobile™, LogMeIn Backup®, LogMeIn Ignition™, LogMeIn for iOS, LogMeIn Hamachi®, and RemotelyAnywhere®. The Company is based in Woburn, Massachusetts with wholly-owned subsidiaries in Hungary, The Netherlands, Australia, the United Kingdom, Brazil, Japan, India and Ireland.

**2. Summary of Significant Accounting Policies**

*Principles of Consolidation* The accompanying condensed consolidated financial statements include the results of operations of the Company and its wholly-owned subsidiaries. All intercompany transactions and balances have been eliminated in consolidation. The Company has prepared the accompanying consolidated financial statements in conformity with accounting principles generally accepted in the United States of America ( GAAP ).

*Unaudited Interim Condensed Consolidated Financial Statements* The accompanying condensed consolidated financial statements and the related interim information contained within the notes to the condensed consolidated financial statements are unaudited and have been prepared in accordance with GAAP and applicable rules and regulations of the Securities and Exchange Commission for interim financial information. Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. The accompanying unaudited condensed consolidated financial statements should be read along with the Company s audited financial statements included in the Company s Annual Report on Form 10-K, filed with the Securities and Exchange Commission on February 24, 2012. The unaudited interim condensed consolidated financial statements have been prepared on the same basis as the audited consolidated financial statements and in the opinion of management, reflect all adjustments, consisting of normal and recurring adjustments, necessary for the fair presentation of the Company s financial position, results of operations and cash flows for the interim periods presented. The results for the interim periods presented are not necessarily indicative of future results. The Company considers events or transactions that occur after the balance sheet date but before the financial statements are issued to provide additional evidence relative to certain estimates or to identify matters that require additional disclosure.

*Use of Estimates* The preparation of condensed consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. By their nature, estimates are subject to an inherent degree of uncertainty. Actual results could differ from those estimates.

*Marketable Securities* The Company s marketable securities are classified as available-for-sale and are carried at fair value with the unrealized gains and losses, net of tax, reported as a component of accumulated other comprehensive income in equity. Realized gains and losses and declines in value judged to be other than temporary are included as a component of earnings based on the specific identification method. Fair value is determined based on quoted market prices. At December 31, 2011 and June 30, 2012, marketable securities consisted of U.S. government agency securities that have remaining maturities within two years and have an aggregate amortized cost of $95,051,808 and $100,016,438 and an aggregate fair value of $95,040,045 and $100,015,400, including $102,552 and $67,507 of unrealized gains and $114,315 and $68,545 of unrealized losses, respectively.

*Revenue Recognition* The Company derives revenue primarily from subscription fees related to its LogMeIn premium services, the licensing of its Ignition for iPhone, iPad, and Android software products, and from the licensing of its RemotelyAnywhere software and its related maintenance.

Revenue from the Company s LogMeIn premium services is recognized on a daily basis over the subscription term as the services are delivered, provided that there is persuasive evidence of an arrangement, the fee is fixed or determinable and collectability is deemed reasonably assured. Subscription periods range from monthly to five years, but are generally one year in duration. The Company s software cannot be run on another entity s hardware nor do customers have the right to take possession of the software and use it on their own or another entity s hardware.

Revenue from the sales of the Company s Ignition for iPhone, iPad and Android software products, which are sold as a perpetual license, is recognized when there is persuasive evidence of an arrangement, the product has been provided to the customer, the collection of the fee is probable, and the amount of fees to be paid by the customer is fixed or determinable.

The Company s multi-element arrangements typically include subscription and professional services, which include development services. The Company has determined that the delivered items within its multi-element arrangements do not have value to the customer on a stand-alone basis as the services are not sold by any other vendor and the customer would not be able to resell such services. As a result, the deliverables within these arrangements do not qualify for treatment as separate units of accounting. Accordingly, the Company accounts for fees received under these multi-element arrangements as a single unit of accounting and recognizes the entire arrangement consideration ratably over the term of the related agreement, or the customer life, commencing when all significant performance obligations have been delivered and when all revenue recognition criteria have been met.

Revenues are reported net of applicable sales and use tax, value-added tax, and other transaction taxes imposed on the related transaction.

**Table of Contents**

*Concentrations of Credit Risk and Significant Customers* The Company s principal credit risk relates to its cash, cash equivalents, marketable securities, restricted cash, and accounts receivable. Cash, cash equivalents, and restricted cash are deposited primarily with financial institutions that management believes to be of high-credit quality and custody of its marketable securities is with an accredited financial institution. To manage accounts receivable credit risk, the Company regularly evaluates the creditworthiness of its customers and maintains allowances for potential credit losses. To date, losses resulting from uncollected receivables have not exceeded management s expectations.

As of December 31, 2011, and June 30, 2012, no customers accounted for more than 10% of accounts receivable, and no customers accounted for more than 10% of revenue for the three and six months ended June 30, 2011 or 2012.

*Goodwill* Goodwill is the excess of the acquisition price over the fair value of the tangible and identifiable intangible net assets acquired. The Company does not amortize goodwill, but performs an annual impairment test of goodwill on the last day of its fiscal year and whenever events and circumstances indicate that the carrying amount of goodwill may exceed its fair value. The Company operates as a single operating segment with one reporting unit and consequently evaluates goodwill for impairment based on an evaluation of the fair value of the Company as a whole. Through June 30, 2012, no impairments have occurred.

*Long-Lived Assets and Intangible Assets* The Company records intangible assets at their estimated fair values at the date of acquisition. Intangible assets are amortized based upon the pattern in which their economic benefit will be realized, or if this pattern cannot be reliably determined, using the straight-line method over their estimated useful lives. The Company s intangible assets have estimated useful lives which range from one to seven years.

*Foreign Currency Translation* The functional currency of operations outside the United States of America is deemed to be the currency of the local country. Accordingly, the assets and liabilities of the Company s foreign subsidiaries are translated into United States dollars using the period-end exchange rate, and income and expense items are translated using the average exchange rate during the period. Cumulative translation adjustments are reflected as a separate component of equity. Foreign currency transaction gains and losses are charged to operations. The Company had foreign currency losses of approximately $152,000 and $261,000 for the three and six months ended June 30, 2011, respectively, and foreign currency losses of approximately $269,000 and $506,000 for the three and six months ended June 30, 2012, respectively.

*Stock-Based Compensation* Stock-based compensation is measured based upon the grant date fair value and recognized as an expense on a straight-line basis in the financial statements over the vesting period of the award for those awards expected to vest. The Company uses the Black-Scholes option pricing model to estimate the grant date fair value of stock awards. The Company uses the with-or-without method to determine when it will realize excess tax benefits from stock based compensation. Under this method, the Company will realize these excess tax benefits only after it realizes the tax benefits of net operating losses from operations.

*Income Taxes* Deferred income taxes are provided for the tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes, and operating loss carry-forwards and credits using enacted tax rates expected to be in effect in the years in which the differences are expected to reverse. At each balance sheet date, the Company assesses the likelihood that deferred tax assets will be realized, and recognizes a valuation allowance if it is more likely than not that some portion of the deferred tax assets will not be realized. This assessment requires judgment as to the likelihood and amounts of future taxable income by tax jurisdiction.

The Company evaluates its uncertain tax positions based on a determination of whether and how much of a tax benefit taken by the Company in its tax filings or positions is more likely than not to be realized. Potential interest and penalties associated with any uncertain tax positions are recorded as a component of income tax expense. Through December 31, 2011 and June 30, 2012, the Company has provided a liability for approximately $198,000 and $218,000 for uncertain tax positions, respectively. These uncertain tax positions would impact the Company s effective tax rate if recognized.

*Segment Data* Operating segments are identified as components of an enterprise about which separate discrete financial information is available for evaluation by the chief operating decision-maker, or decision making group, in making decisions regarding resource allocation and assessing performance. The Company, which uses consolidated financial information in determining how to allocate resources and assess performance, has determined that it operates in one segment.

**Table of Contents**

The Company s revenue (based on customer address) by geography is as follows:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2011 | 2012 | 2011 | 2012 |
| Revenues: | | | | |
| United States | $ 18,782,830 | $ 21,887,423 | $ 35,999,433 | $ 43,083,757 |
| United Kingdom | 2,767,445 | 3,086,635 | 5,367,393 | 6,095,188 |
| International - all other | 7,547,681 | 8,822,523 | 14,769,909 | 17,305,567 |
| Total revenue | $ 29,097,956 | $ 33,796,581 | $ 56,136,735 | $ 66,484,512 |

*Guarantees and Indemnification Obligations* As permitted under Delaware law, the Company has agreements whereby the Company indemnifies certain of its officers and directors for certain events or occurrences while the officer or director is, or was, serving at the Company s request in such capacity. The term of the indemnification period is for the officer s or director s lifetime. As permitted under Delaware law, the Company also has similar indemnification obligations under its certificate of incorporation and by-laws. The maximum potential amount of future payments the Company could be required to make under these indemnification agreements is unlimited; however, the Company has director s and officer s insurance coverage that the Company believes limits its exposure and enables it to recover a portion of any future amounts paid.

The Company has entered into agreements with certain customers that require the Company to indemnify the customer against certain claims alleging that the Company s products infringe third-party patents, copyrights, or trademarks. The term of these indemnification obligations is generally perpetual. The maximum potential amount of future payments the Company could be required to make under these indemnification obligations is unlimited. As of the date hereof, the Company does not expect any material claims related to these indemnification obligations.

Through January 1, 2012, the Company had not experienced any losses related to these indemnification obligations, and no claims with respect thereto were outstanding. On March 15, 2012, the Company received an indemnification claim from a customer related to a third-party claim that the customer s use of a LogMeIn service infringes the third party s patent. The Company believes that a risk of material loss related to this indemnification obligation is remote.

*Net Income Per Share* Basic net income per share is computed by dividing net income by the weighted average number of common shares outstanding for the period. Diluted net income per share is computed by dividing net income by the sum of the weighted average number of common shares outstanding during the period and the weighted average number of potential common shares outstanding from the assumed exercise of stock options and the vesting of restricted stock units.

Table of Contents

The Company excluded 795,175 and 1,587,310 of options to purchase common shares as well as 0 and 141,837 of unvested restricted stock units during the three months ended June 30, 2011 and 2012, respectively, and 795,175 and 1,586,910 of options to purchase common shares and 0 and 940 of unvested restricted stock units during the six months ended June 30, 2011 and 2012, respectively, because they had an anti-dilutive impact:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2011 | 2012 | 2011 | 2012 |
| Options to purchase common shares | 795,175 | 1,587,310 | 795,175 | 1,586,910 |
| Unvested restricted stock units | | 141,837 | | 940 |
| Total options and unvested restricted stock units | 795,175 | 1,729,147 | 795,175 | 1,587,850 |

Basic and diluted net income per share was calculated as follows:

| | Three Months Ended June 30, 2011 | Six Months Ended June 30, 2011 |
|---|---|---|
| **Basic:** | | |
| Net income | $ 2,682,324 | $ 2,617,077 |
| Weighted average common shares outstanding, basic | 24,116,686 | 24,023,018 |
| Net income, basic | $ 0.11 | $ 0.11 |
| **Diluted:** | | |
| Net income | $ 2,682,324 | $ 2,617,077 |
| Weighted average common shares outstanding | 24,116,686 | 24,023,018 |
| Add: Options to purchase common shares | 1,053,003 | 1,095,405 |
| Weighted average common shares outstanding, diluted | 25,169,689 | 25,118,423 |
| Net income, diluted | $ 0.11 | $ 0.10 |

| | Three Months Ended June 30, 2012 | Six Months Ended June 30, 2012 |
|---|---|---|
| **Basic:** | | |
| Net income | $ 575,677 | $ 651,917 |
| Weighted average common shares outstanding, basic | 24,677,893 | 24,625,851 |
| Net income, basic | $ 0.02 | $ 0.03 |
| **Diluted:** | | |
| Net income | $ 575,677 | $ 651,917 |
| Weighted average common shares outstanding | 24,677,893 | 24,625,851 |

| | | | | |
|---|---|---|---|---|
| Add: Common stock equivalents | | 689,334 | | 735,099 |
| Weighted average common shares outstanding, diluted | | 25,367,227 | | 25,360,950 |
| Net income, diluted | $ | 0.02 | $ | 0.03 |

*Recently Issued Accounting Pronouncements* In September 2011, the Financial Accounting Standards Board ( FASB ) issued an Accounting Standards Update ( ASU ) which simplifies how companies test goodwill for impairment. The amendment permits an entity to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test described in goodwill accounting standard. The Company adopted this ASU and it did not have a material effect on its financial position, results of operations or cash flows.

In June 2011, the FASB issued ASU No. 2011-05, Comprehensive Income (Topic 220) Presentation of Comprehensive Income (ASU 2011-05), to require an entity to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. ASU 2011-05 eliminates the option to present the components of other comprehensive income as part of the statement of equity. The Company adopted this ASU and it did not have a material effect on its financial position, results of operations or cash flows.

In May 2011, the FASB issued ASU No. 2011-04, Fair Value Measurement (Topic 820) Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs (ASU 2011-04), to provide a consistent definition of fair value and ensure that the fair value measurement and disclosure requirements are similar between GAAP and International Financial Reporting Standards. ASU 2011-04 changes certain fair value measurement principles and enhances the disclosure requirements particularly for Level 3 fair value measurements (as defined in Note 3). The Company adopted this ASU and it did not have a material effect on its financial position, results of operations or cash flows.

Table of Contents

### 3. Fair Value of Financial Instruments

The carrying value of the Company s financial instruments, including cash equivalents, restricted cash, accounts receivable, and accounts payable, approximate their fair values due to their short maturities. The Company s financial assets and liabilities are measured using inputs from the three levels of the fair value hierarchy. A financial asset or liability s classification within the hierarchy is determined based on the lowest level input that is significant to the fair value measurement. The three levels are as follows:

Level 1: Unadjusted quoted prices for identical assets or liabilities in active markets accessible by the Company at the measurement date.

Level 2: Inputs include quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets and liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability, and inputs that are derived principally from or corroborated by observable market data by correlation or other means.

Level 3: Unobservable inputs that reflect the Company s assumptions about the assumptions that market participants would use in pricing the asset or liability.

The following table summarizes the basis used to measure certain of the Company s financial assets that are carried at fair value:

| | | Basis of Fair Value Measurements | | |
|---|---|---|---|---|
| | Balance | Quoted Prices in Active Markets for Identical Items (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| **Balance at December 31, 2011** | | | | |
| Cash equivalents money market funds | $ 53,839,536 | $ 53,839,536 | $ | $ |
| Cash equivalents bank deposits | 5,032,135 | | 5,032,135 | |
| Short-term marketable securities U.S. government agency securities | 95,040,045 | 85,040,105 | 9,999,940 | |
| Contingent consideration liability | 212,536 | | | 212,536 |
| **Balance at June 30, 2012** | | | | |
| Cash equivalents money market funds | 49,285,842 | 49,285,842 | | |
| Cash equivalents bank deposits | 5,034,637 | | 5,034,637 | |
| Short-term marketable securities U.S. government agency securities | 100,015,400 | 95,014,146 | 5,001,254 | |
| Contingent consideration liability | 234,568 | | | 234,568 |

Bank deposits are classified within the second level of the fair value hierarchy and the fair value of those assets are determined based upon quoted prices for similar assets in active markets.

The Level 3 liability consists of contingent consideration related to the July 19, 2011 acquisition of Cosm. The fair value of the contingent consideration was estimated by applying a probability based model, which utilizes significant inputs that are unobservable in the market. Key assumptions include a 13% discount rate and a 76% weighted-probability of achieving earn-out. The current portion of contingent consideration is included in Accrued liabilities and the non-current portion is included in Other long-term liabilities. A reconciliation of the beginning and ending Level 3 liability is as follows:

| | Six Months Ended June 30, 2012 |
|---|---|

| | |
|---|---|
| Balance beginning of period | $ 212,536 |
| Transfers into Level 3 | |
| Payments | |
| Change in fair value (included within research and development expense) | 22,032 |
| Balance end of period | $ 234,568 |

**4. Acquisitions**

On July 19, 2011, the Company acquired substantially all of the assets of Connected Environments (BVI) Limited, a British Virgin Island limited company and Connected Environments, Limited, a U.K. limited company (collectively Connected Environments ), primarily including their Cosm service, for an initial cash payment of $10 million plus contingent payments totaling up to $5.2 million. The Cosm service is a cloud-based connectivity and data management platform for the Internet of Things. The Company acquired Cosm to expand its capabilities with embedded devices and enter into the Internet of Things market. The operating results of the acquired Cosm service, of which there was no revenue for the three and six months ended June 30, 2012, and $1.7 million and $3.3 million of expenses during the three and six months ended June 30, 2012, respectively, are included in the consolidated financial statements beginning on the acquisition date.

Table of Contents

The Cosm acquisition has been accounted for as a business combination. The assets acquired and the liabilities assumed were recorded at their estimated fair values as of the acquisition date. The Company retained an independent third party valuation firm to calculate the fair value of the intangible assets using the cost method with estimates and assumptions provided by Company management. The excess of the purchase price over the tangible net assets and identifiable intangible assets was recorded as goodwill.

The purchase price was allocated as follows:

| | Amount |
|---|---|
| Tangible assets | $ 7,595 |
| Technology and know-how | 3,250,000 |
| Goodwill | 6,934,966 |
| Total purchase price | 10,192,561 |
| Liability for contingent consideration | (192,561) |
| Cash paid | $ 10,000,000 |

The asset purchase agreement included a contingent payment provision requiring the Company to make additional payments to the shareholders of Connected Environments, as well as certain employees, on the first and second anniversaries of the acquisition, contingent upon the continued employment of certain employees and the achievement of certain product performance metrics. The range of the contingent payments that the Company could pay is between $0 to $4,898,000. The Company has concluded that the arrangement is a compensation arrangement and is accruing the maximum payout ratably over the performance period, as it believes it is probable that the criteria will be met. The Company intends to pay approximately $1.7 million of contingent payments in July 2012.

The asset purchase agreement also includes a contingent payment provision to a non-employee shareholder for an amount between $0 and $267,000, which the Company has concluded is part of the purchase price. This contingent liability was recorded at its fair of $192,561 at the acquisition date. The Company will re-measure the fair value of the consideration at each subsequent reporting period and recognize any adjustment to fair value as part of earnings.

The goodwill recorded in connection with this transaction is primarily related to the expected synergies to be achieved related to Gravity, our service delivery platform, and the ability to leverage existing sales and marketing capacity and customer base with respect to the acquired Cosm service. All goodwill acquired is expected to be deductible for income tax purposes.

The Company incurred approximately $324,000 of acquisition-related costs which are included in general and administrative expense for the year ended December 31, 2011.

On January 6, 2012, the Company acquired substantially all of the assets of Bold Software, LLC ( Bold ), a Wichita, Kansas-based limited liability corporation, for a cash purchase price of approximately $15.3 million plus contingent, retention-based bonuses totaling $1.5 million, which are expected to be paid over a two year period from the date of acquisition. Bold is a leading provider of web chat and customer communications software. Bold s operating results, of which there was approximately $1.1 million and $1.9 million of revenue for the three and six months ended June 30, 2012, respectively, and $1.4 million and $2.5 million of expenses during the three and six months ended June 30, 2012, respectively, are included in the consolidated financial statements beginning on the acquisition date.

The Bold acquisition has been accounted for as a business combination. The assets acquired and the liabilities assumed were recorded at their estimated fair values as of the acquisition date. The Company retained an independent third party valuation firm to calculate the fair value of the intangible assets with estimates and assumptions provided by Company management. The excess of the purchase price over the tangible net assets and identifiable intangible assets was recorded as goodwill.

The purchase price was allocated as follows:

| | Amount |
|---|---|

| | |
|---|---|
| Cash | $ 482,000 |
| Current assets | 126,000 |
| Other assets | 19,000 |
| Deferred revenue | (424,000) |
| Other liabilities | (107,000) |
| Completed technology | 1,090,000 |
| Trade name and trademark | 30,000 |
| Customer relationships | 2,760,000 |
| Non-compete agreements | 160,000 |
| Goodwill | 11,178,000 |
| Total purchase price | $ 15,314,000 |

The asset purchase agreement included a contingent, retention-based bonus program provision requiring the Company to make additional payments to employees, including former Bold owners now employed by the Company, on the first and second anniversaries of the acquisition, contingent upon their continued employment. The range of the contingent, retention-based bonus payments that the Company could pay is between $0 to $1,500,000. The Company has concluded that the arrangement is a compensation arrangement and is accruing the maximum payout ratably over the performance period, as it believes it is probable that the criteria will be met.

Table of Contents

The goodwill recorded in connection with this transaction is primarily related to the expected synergies to be achieved related to the Company s ability to leverage its existing sales and marketing capacity and customer base to accelerate BoldChat sales, and the ability to leverage Bold s technology with the Company s existing support service. All goodwill acquired is expected to be deductible for income tax purposes.

The Company incurred approximately $0.1 million of acquisition-related costs which are included in general and administrative expense for the year ended December 31, 2011, and $0 and $0.1 million of acquisition-related costs in the three and six months ended June 30, 2012, respectively.

**5. Goodwill and Intangible Assets**

The changes in the carry amounts of goodwill for six months ended June 30, 2012 are due to the addition of goodwill resulting from the Bold acquisition and the impact of foreign currency translation adjustments related to asset balances that are recorded in non-U.S. currencies.

Changes in goodwill for the six months ended June 30, 2012, are as follows:

| | |
|---|---|
| Balance, December 31, 2011 | $ 7,258,743 |
| Goodwill related to the acquisition of Bold | 11,178,000 |
| Foreign currency translation adjustments | 3,749 |
| Balance, June 30, 2012 | $ 18,440,492 |

Intangible assets consist of the following:

| | | December 31, 2011 | | | June 30, 2012 | | |
|---|---|---|---|---|---|---|---|
| | Estimated Useful Life | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount |
| Identifiable intangible assets: | | | | | | | |
| Trade name and trademark | 1 -5 years | $ 635,506 | $ 635,506 | $ | $ 665,344 | 651,194 | 14,150 |
| Customer base | 5 -7 years | 1,003,068 | 1,003,068 | | 3,750,573 | 1,219,163 | 2,531,410 |
| Domain names | 5 years | 222,826 | 51,499 | 171,327 | 495,862 | 85,648 | 410,214 |
| Software | 4 years | 298,977 | 298,977 | | 298,977 | 298,977 | |
| Technology | 3 -6 years | 4,475,281 | 1,831,276 | 2,644,005 | 5,592,195 | 2,467,063 | 3,125,132 |
| Non-compete agreements | 5 years | 0 | 0 | | 159,189 | 4,241 | 154,948 |
| Internally developed software | 3 years | 539,612 | 94,332 | 445,280 | 834,496 | 209,200 | 625,296 |
| | | $ 7,175,270 | $ 3,914,658 | $ 3,260,612 | $ 11,796,636 | 4,935,486 | 6,861,150 |

As a result of the Bold acquisition, the Company capitalized $1,090,000 of technology, $30,000 of trade names and trademarks, $2,760,000 of customer base and $160,000 of non-compete agreements as intangible assets. Changes in the gross carrying amount of the intangible assets are due to foreign currency translation adjustments. The Company is amortizing the intangible assets based upon the pattern in which their economic benefit will be realized, or if this pattern cannot be reliably determined, using the straight-line method over their estimated useful lives. The intangible assets have estimated useful lives which range from one to seven years.

The Company capitalized $75,575 and $186,676 during the three months ended June 30, 2011 and 2012, respectively and $137,326 and $294,884 during the six months ended June 30, 2011 and 2012, respectively of costs related to internally developed computer software to be sold as a service incurred during the application development stage and is amortizing these costs over the expected lives of the related services. The Company paid $271,558 to acquire domain names in both the three and six months ended June 30, 2012.

The Company is amortizing its intangible assets based upon the pattern in which their economic benefit will be realized, or if this pattern cannot be reliably determined, using the straight-line method over their estimated useful lives. Amortization expense for intangible assets was $112,658 and $516,787 for the three months ended June 30, 2011 and 2012, respectively, and $220,023 and $1,025,420 for the six months ended June 30, 2011 and 2012, respectively. Amortization relating to software, technology and internally developed software is recorded within cost of revenues and the amortization of trade name and trademark, customer base, domain names, and non-compete agreements is recorded within operating expenses. Future estimated amortization expense for intangible assets is as follows at June 30, 2012:

**Table of Contents**

| Amortization Expense (Years Ending December 31) | Amount |
|---|---|
| 2012 (Six months ending December 31) | $ 1,057,150 |
| 2013 | 2,122,385 |
| 2014 | 1,596,018 |
| 2015 | 803,342 |
| 2016 | 585,857 |
| Thereafter | 696,398 |
| Total | $ 6,861,150 |

Table of Contents

**6. Accrued Expenses**

Accrued expenses consisted of the following:

| | December 31, 2011 | June 30, 2012 |
|---|---|---|
| Marketing programs | $ 1,770,611 | $ 2,671,289 |
| Payroll and payroll related | 5,333,430 | 6,312,734 |
| Professional fees | 795,720 | 1,071,002 |
| Other accrued expenses | 2,573,044 | 3,041,719 |
| Total accrued expenses | $ 10,472,805 | $ 13,096,744 |

**7. Income Taxes**

The Company recorded a provision for federal, state and foreign income taxes of approximately $1.4 million and $1.6 million for the three months ended June 30, 2011 and 2012, respectively, and $1.4 million and $2.7 million for the six months ended June 30, 2011 and 2012, respectively. The Company s effective tax rate has increased for the three and six months ended June 30, 2012, as compared to the three and six month ending June 30, 2011 as a result of losses generated in its Cosm subsidiary.

Deferred income taxes are provided for the tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes, and operating loss carry-forwards and credits using enacted tax rates expected to be in effect in the years in which the differences are expected to reverse. At each balance sheet date, the Company assesses the likelihood that deferred tax assets will be realized, and recognizes a valuation allowance if it is more likely than not that some portion of the deferred tax assets will not be realized. This assessment requires judgment as to the likelihood and amounts of future taxable income by tax jurisdiction. As of December 31, 2011 and June 30, 2012, the Company maintained a full valuation allowance related to the deferred tax assets of its Hungarian and Cosm subsidiaries. These entities have historical losses and the Company concluded it was not more likely than not that these deferred tax assets are realizable.

The Company files income tax returns in the U.S. federal jurisdiction and various state and foreign jurisdictions. The Company s income tax returns since inception are open to examination by federal, state, and foreign tax authorities. The Company has recorded a liability related to uncertain tax provisions of approximately $198,000 and $218,000 as of December 31, 2011 and June 30, 2012, respectively. The Company s policy is to record estimated interest and penalty related to the underpayment of income taxes or unrecognized tax benefits as a component of its income tax provision. During the three and six months ended June 30, 2011 and 2012, the Company did not recognize any interest or penalties in its statements of operations, and there are no accruals for interest or penalties at December 31, 2011 or June 30, 2012.

The Company has performed an analysis of its ownership changes as defined by Section 382 of the Internal Revenue Code and has determined that an ownership change as defined by Section 382 occurred in October 2004 and March 2010 resulting in approximately $219,000 and $12,800,000, respectively, of net operating losses ( NOLs ) being subject to limitation. As of December 31, 2011 and June 30, 2012, the Company believes all NOLs generated by the Company, including those subject to limitation, are available for utilization given the Company s large annual limitation amount. Subsequent ownership changes as defined by Section 382 could potentially limit the amount of net operating loss carry-forwards that can be utilized annually to offset future taxable income.

**8. Stock Based Awards**

The Company s 2009 Stock Incentive Plan ( 2009 Plan ) is administered by the Board of Directors and Compensation Committee, which have the authority to designate participants and determine the number and type of awards to be granted and any other terms or conditions of the awards. Options generally vest over a four-year period and expire ten years from the date of grant. Restricted stock units generally vest over a three-year period. Certain stock-based awards provide for accelerated vesting if there is a change in control. On May 24, 2012, the Company s stockholders approved an amendment to the 2009 Plan that increased the shares available to grant under the plan by 1,400,000 shares, established a maximum option term, eliminated certain liberal share recycling provisions, set a ratio so that the aggregate number of shares available for issuance under the 2009 Plan will be reduced by one and sixty-two hundredths (1.62) shares for each share delivered in settlement of any award of Restricted

Stock, Restricted Stock Units or other stock based awards and one share for each share delivered in settlement of an Option or a Stock Appreciation Right, and removed the provision that allows our board of directors to re-price underwater awards without stockholder approval. There were 1,743,474 shares available for grant under the 2009 Plan as of June 30, 2012.

The Company uses the Black-Scholes option-pricing model to estimate the grant date fair value of stock awards. The Company estimates the expected volatility of its common stock at the date of grant based on the historical volatility of comparable public companies over the option s expected term as well as its own stock price volatility since the Company s IPO. The Company estimates expected term based on historical exercise activity and giving consideration to the contractual term of the options, vesting schedules, employee turnover, and expectation of employee exercise behavior. The assumed dividend yield is based upon the Company s expectation of not paying dividends in the foreseeable future. The risk-free rate for periods within the estimated life of the stock award is based on the U.S. Treasury yield curve in effect at the time of grant. Historical employee turnover data is used to estimate pre-vesting stock awards forfeiture rates. The compensation expense is amortized on a straight-line basis over the requisite service period of the stock award, which is generally four years for options and three years for restricted stock units.

The Company used the following assumptions to apply the Black-Scholes option-pricing model:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2011 | 2012 | 2011 | 2012 |
| Expected dividend yield | 0.00% | 0.00% | 0.00% | 0.00% |
| Risk-free interest rate | 1.73% | 0.77% | 1.73% - 2.28% | 0.77% - 0.87% |
| Expected term (in years) | 5.56 - 6.25 | 5.56 - 6.25 | 5.56 - 6.25 | 5.56 - 6.25 |
| Volatility | 60% | 55% | 60% | 55% - 60% |

The following table summarizes stock option activity, including performance-based options:

| | Number of Shares | Weighted Average Exercise Price | Weighted Average Remaining Contractual Term (Years) | Aggregate Intrinsic Value |
|---|---|---|---|---|
| Outstanding, January 1, 2012 | 2,626,260 | $ 22.34 | 7.4 | $ 44,093,090 |
| Granted | 668,166 | 36.43 | | |
| Exercised | (181,879) | 11.07 | | $ 1,141,019 |
| Forfeited | (128,770) | 30.46 | | |
| Outstanding, June 30, 2012 | 2,983,777 | $ 25.83 | 7.5 | $ 25,950,580 |
| Exercisable at December 31, 2011 | 1,100,792 | $ 9.54 | 5.5 | $ 32,040,375 |
| Exercisable at June 30, 2012 | 1,310,101 | $ 15.09 | 5.7 | $ 22,454,602 |

The aggregate intrinsic value was calculated based on the positive differences between the fair value of the Company s common stock on December 31, 2011, of $38.55 and $30.52 per share on June 30, 2012, or at time of exercise, and the exercise price of the options.

The weighted average grant date fair value of stock options issued or modified was $22.42 per share for the year ended December 31, 2011, and $19.80 for the six months ended June 30, 2012.

Of the total stock options issued subject to the plans, certain stock options have performance-based vesting. These performance-based options granted during 2004 and 2007 were granted at-the-money, contingently vest over a period of two to four years depending upon the nature of the performance goal, and have a contractual life of ten years.

15

Table of Contents

The performance-based stock option activity is summarized below:

| | Number of Shares | Weighted Average Exercise Price | Weighted Average Remaining Contractual Term (Years) | Aggregate Intrinsic Value |
|---|---|---|---|---|
| Outstanding, January 1, 2012 | 453,432 | $ 1.25 | 3.6 | $ 16,859,614 |
| Granted | | | | |
| Exercised | 10,000 | | | |
| Forfeited | | | | |
| Outstanding, June 30, 2012 | 443,432 | $ 1.25 | 3.1 | $ 12,979,275 |
| Exercisable at December 31, 2011 | 453,432 | $ 1.25 | 3.6 | $ 16,859,614 |
| Exercisable at June 30, 2012 | 443,432 | $ 1.25 | 3.1 | $ 12,979,275 |

The aggregate intrinsic value was calculated based on the positive differences between the estimated fair value of the Company s common stock on December 31, 2011, of $38.55 per share, and $30.52 per share on June 30, 2012, or at the time of exercise, and the exercise price of the options.

During the three and six months ended June 30, 2012, the Company granted 320,308 and 467,866 restricted stock units, respectively, containing time-based vesting conditions which lapse over a three year period. Upon vesting, the restricted stock units entitle the holder to receive one share of common stock for each restricted stock unit. As of June 30, 2012, the Company estimates that 376,241 shares of restricted stock units with an intrinsic value of approximately $12,457,000 and a weighted average remaining contractual term of 2.9 years will ultimately vest.

The following table summarizes restricted stock unit activity:

| | Number of Shares Underlying Restricted Stock Units | Weighted Average Grant Date Fair Value |
|---|---|---|
| Unvested as of January 1, 2012 | | $ |
| Restricted stock units granted | 467,866 | 33.17 |
| Restricted stock units vested | | |
| Restricted stock units forfeited | (5,721) | 38.02 |
| Unvested as of June 30, 2012 | 462,145 | $ 33.11 |

The Company recognized stock based compensation expense within the accompanying condensed consolidated statements of operations as summarized in the following table:

| | Three Months Ended June 30, 2011 | Three Months Ended June 30, 2012 | Six Months Ended June 30, 2011 | Six Months Ended June 30, 2012 |
|---|---|---|---|---|
| Cost of revenue | $ 82,523 | $ 107,789 | $ 171,575 | $ 214,970 |
| Research and development | 393,511 | 574,452 | 673,628 | 1,156,167 |
| Sales and marketing | 619,508 | 900,724 | 1,182,043 | 1,850,669 |
| General and administrative | 1,155,581 | 1,505,606 | 1,969,371 | 2,851,201 |
| | $ 2,251,123 | $ 3,088,571 | $ 3,996,617 | $ 6,073,007 |

As of June 30, 2012, there was approximately $38,723,000 of total unrecognized share-based compensation cost, net of estimated forfeitures, related to unvested stock awards which are expected to be recognized over a weighted average period of 2.9 years. The total unrecognized share-based compensation cost will be adjusted for future changes in estimated forfeitures.

**9. Commitments and Contingencies**

*Operating Leases* The Company has operating lease agreements for offices in Massachusetts, Hungary, The Netherlands, Australia, the United Kingdom, Japan, and India that expire in 2012 through 2023.

Table of Contents

In April 2012, the Company entered into a lease for a new corporate headquarters located in Boston, Massachusetts. The landlord is obligated to rehabilitate the existing building and the Company expects that the lease term will begin in February 2013 and extend through May 2023. The aggregate amount of minimum lease payments to be made over the term of the lease is approximately $41.3 million. Pursuant to the terms of the lease, the landlord is responsible for making certain improvements to the leased space up to an agreed upon cost to the landlord. Any excess costs for these improvements will be billed by the landlord to the Company as additional rent. The Company estimates these excess costs to be approximately $2.5 million. The lease required a security deposit of approximately $3.3 million in the form of an irrevocable standby letter of credit which is collateralized by a bank deposit in the amount of approximately $3.5 million or 105 percent of the security deposit. The security deposit is classified as restricted cash. The lease includes an option to extend the original term of the lease for two successive five year periods

Rent expense under all leases was approximately $799,000 and $797,000 for the three months ended June 30, 2011 and 2012, respectively, and $1,460,000 and $1,555,000 for the six months ended June 30, 2011 and 2012, respectively. The Company records rent expense on a straight-line basis for leases with scheduled escalation clauses or free rent periods.

The Company also enters into hosting services agreements with third-party data centers and internet service providers that are subject to annual renewal. Hosting fees incurred under these arrangements aggregated approximately $428,000 and $632,000 for the three months ended June 30, 2011 and 2012, respectively and $924,000 and $1,386,000 for the six months ended June 30, 2011 and 2012, respectively.

Future minimum lease payments under non-cancelable operating leases including one year commitments associated with the Company s hosting services arrangements are approximately as follows at June 30, 2012:

| **Years Ending December 31** | |
|---|---|
| 2012 (Six months ending December 31) | $ 2,763,000 |
| 2013 | 3,928,000 |
| 2014 | 5,389,000 |
| 2015 | 5,185,000 |
| 2016 | 5,316,000 |
| Thereafter | 28,395,000 |