SolarWinds, Inc.
Form 10-K
February 14, 2014

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

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

For the fiscal year ended: December 31, 2013
Commission file number: 001-34358
SOLARWINDS, INC.
(Exact name of registrant as specified in its charter)

Delaware	73-1559348
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
3711 S. MoPac Expressway Austin, Texas	78746
(address of principal executive offices)	(zip code)

Registrant's telephone number, including area code: (512) 682-9300
Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, $0.001 par value	New York Stock Exchange

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ý No ¨
Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ¨ No ý
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 ý 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 ý No ¨
Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer x	Accelerated filer ¨	Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No ý
Based on the closing price of the registrant's common stock on the last business day of the registrant's most recently completed second fiscal quarter, which was June 28, 2013, the aggregate market value of its shares held by non-affiliates on that date was approximately $2,532,978,272.
On February 12, 2014, 75,133,750 shares of common stock were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Part III of this Annual Report on Form 10-K incorporates certain information by reference from the definitive proxy statement for the registrant's 2014 Annual Meeting of Stockholders to be filed within 120 days of the registrant's fiscal year ended December 31, 2013 (the "Proxy Statement"). Except with respect to information specifically incorporated by reference in this Form 10-K, the Proxy Statement is not deemed to be filed as part of this Form 10-K.

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Safe Harbor Cautionary Statement

This Annual Report on Form 10-K contains forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, and the Private Securities Litigation Reform Act of 1995. Such statements may be signified by terms such as “anticipates,” “believes,” “seeks,” “estimates,” “expects,” “intends,” “plans,” “pr “projects,” “may,” “should,” “will,” “would,” “could” or similar expressions and the negatives of those terms. In this report, forward-looking statements include statements regarding our financial projections, future financial performance and plans and objectives for future operations including, without limitation, the following:

- expectations regarding our plans and strategies to grow our business and expand our market presence, including internationally;
- expectations concerning our product offerings and the expansion of our product offerings into new areas of software;
- expectations regarding our financial condition and results of operations, including revenue, operating expenses and effective income tax rate;
- expectations regarding our non-U.S. earnings in foreign operations;
- expectations concerning potential acquisitions and the anticipated benefits of acquisitions;
- competitive conditions and our relative position in the industry;
- our market opportunities and our ability to take advantage of such market opportunities, the demand for IT management products in various markets and factors contributing to such demand;
- our sales and marketing efforts and our expectations about the results of those efforts;
- expectations about our ability to generate and maintain customer loyalty, including our maintenance customers;
- expectations regarding investment plans and our capital expenditures;
- our research and development plans;
- our dividend policy;
- our share repurchase program;
- our equity compensation plans and practices;
- our future borrowings and our beliefs regarding the sufficiency of our cash and cash equivalents, cash flows from operating activities and borrowing capacity;
- expectations regarding the leases for our current and future corporate headquarters and our beliefs regarding the adequacy of our current facilities and planned expansions to our facilities; and
- expectations regarding the outcome of legal proceedings in which we are involved.

Forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements to be materially and adversely different from any future results, performance or achievements expressed or implied by the forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those discussed under the heading “Risk Factors” in this report and in other documents we file with the Securities and Exchange Commission, or the SEC. Given these risks and uncertainties, you should not place undue reliance on these forward-looking statements. Also, forward-looking statements represent our management’s beliefs and assumptions only as of the date of this report. Except as required by law, we assume no obligation to update these forward-looking statements publicly, or to update the reasons actual results could differ materially and adversely from those anticipated in these forward-looking statements, even if new information becomes available in the future.

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PART I

ITEM 1. BUSINESS

Overview

SolarWinds, Inc. and its subsidiaries ("SolarWinds," the "Company," "we," "us" or "our") design, develop, market, sell and support enterprise-class information technology, or IT, infrastructure management software to IT professionals in organizations of all sizes. Our product offerings range from individual software tools to more comprehensive software products that solve problems encountered every day by IT professionals and help to enable efficient and effective management of their network, systems and application infrastructure. We also provide remote monitoring and management, or RMM, tools that allow managed service providers, or MSPs, to deliver IT management services to their clients. Our products are ready-to-use, featuring intuitive and easily customized user interfaces and built-in workflows. Our products can be downloaded directly from our websites and installed and configured by our end-users in a matter of hours. Our customers include small- and mid-size businesses, large enterprises, managed service providers, and local, state and federal government entities.

As a core part of our strategy, we utilize a differentiated business model for providing enterprise-class software to IT professionals within organizations of all sizes worldwide. Key differentiating elements of our business model include powerful and scalable, yet easy-to-use and affordable IT management software that is produced utilizing a highly efficient product development and engineering process, a scalable marketing model and a high-volume, transaction-oriented inside sales model that have allowed us to drive and support rapid growth in our business at high operating margins while offering our products at prices that are typically lower than competing vendors.

We manage our business with a culture and systems that are focused on metrics, helping us to achieve consistency in our execution. We design our products to be easy-to-install and easy-to-evaluate, allowing potential buyers of our software to see the value that the products provide after downloading a free version of the software from our website for evaluation. We design our marketing programs to drive visitors to our websites in order to generate large volumes of highly qualified leads. We are committed to an inside sales model which we call "selling from the inside." This approach utilizes a disciplined, transaction-oriented process to convert these leads into paying customers at a higher level of productivity at a lower cost than is typically achieved with a traditional outside sales force that travels and incurs higher costs.

SolarWinds, Inc. is a holding company whose principal operating subsidiary is SolarWinds Worldwide, LLC, or SolarWinds Worldwide. SolarWinds, Inc. was incorporated in the State of Oklahoma in 1999 and reincorporated in the State of Delaware in 2008. SolarWinds Worldwide was formed in the State of Delaware in 2005. Our principal executive offices are located at 3711 South MoPac Expressway, Building Two, Austin, Texas 78746, and our telephone number is (512) 682-9300.

Acquisitions

We have made multiple acquisitions of businesses as part of our growth strategy, including two acquisitions during 2013. In May 2013, we acquired N-able Technologies International, Inc., or N-able. Through our acquisition of N-able, we enhanced our RMM offerings and added MSP service automation to the broad range of management challenges that we address for the IT industry. In October 2013, we acquired Confio Corporation, or Confio, a database performance management company. By acquiring Confio, we added database performance management solutions to our product portfolio.

Our Growth Strategy

Our differentiated business model of providing low-cost, easy-to-install and easy-to-use software marketed and sold directly to IT professionals through a highly productive and efficient inside sales force is the core of our strategy. We also sell our software through distributors and resellers to supplement our sales force, expand our global presence, reach various market segments and help us to initiate and fulfill sales orders from state, local and federal governments and those commercial customers that prefer to make purchases through a particular reseller or distributor. We evaluate all of our strategic opportunities to ensure that they are compatible with our model for providing cost-efficient, downloadable enterprise-class software that can be marketed and sold through a high volume, transaction-oriented model.

We plan to continue to focus on growth opportunities within our existing customer base and IT infrastructure management markets through increased brand awareness and product depth and breadth, through expansion into adjacent areas of IT infrastructure management and by expanding our business globally. Our objective is to extend our market presence by providing IT professionals with easy-to-use and affordable enterprise-class software that solves their specific needs. The following are key elements of our growth strategy:

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- Continue to Add New Customers in Under-penetrated Markets. We believe that the opportunity to provide in-house IT management and cloud-based IT management products for use by MSPs throughout North America and the rest of the world remains significantly under-penetrated and represent a significant opportunity to continue our growth. We intend to penetrate these markets further by leveraging our customer base and end-user community and by using our strategic marketing programs to identify and obtain new customers.
- Expand Our Business in International Markets. We believe a substantial opportunity exists for sales of our software in the Europe, Middle East and Africa region ("EMEA"), the Asian-Pacific region and the Latin America region and we intend to increase our sales, marketing and support operations in these regions. We believe our market penetration is low in many geographic and end user markets in which we sell products. We anticipate continuing our international expansion to further market, sell and develop our products. In addition, we plan to continue to scale and develop our existing group of international distributors and resellers. In the new markets we enter, we plan to continue our strategy of delivering powerful, easy-to-use and affordable software while leveraging the web as the primary method to reach potential customers.
- Cross-Sell and Up-Sell Existing Products into Our Growing Customer Base. Our customers are generally IT professionals in small- and mid-size businesses, enterprises, and local, state and federal government entities that have purchased one or more of our products. We have an active, loyal end-user community that is built from our customers and end-users who have downloaded our free tools. We seek to expand, and generate loyalty from, our customer base and our end-user community by providing a variety of free tools for IT professionals, by hosting our online community website, thwack®, and through other marketing programs. We believe our customers are highly satisfied users of our products and that there is a significant opportunity for follow-on sales of both incremental capacity and additional products and modules to these customers.
- Selectively Expand Our Product Portfolio by Pursuing Strategic Acquisitions and Product Development. We expect to continue to pursue product-oriented acquisitions that will enable us to utilize our go-to-market strategy and enter new markets or new segments of our existing markets by bringing new product offerings to market more quickly than we can develop them. In addition, we plan to continue to develop new software products and modules that enhance and expand our current offerings. We also intend to continue to expand our product offerings into new areas of software in which we can provide differentiated, easy-to-use enterprise-class software products that are marketed and sold directly to end-users.

Our Products

We offer a broad portfolio of IT infrastructure management products that are powerful, yet easy-to-use and affordable. Our products are classified into the following categories: network management, systems and application management, managed service provider, or MSP, products and free tools.

Our network and systems and application management products consist of enterprise-class IT management products that are used by IT professionals and teams in companies of all sizes to configure, monitor, and report on the health and performance of their network, systems, and application infrastructure. These products provide advanced IT management functionality and are capable of scaling from simple to complex environments. Our products are priced affordably so that individual IT professionals can typically purchase them with one or two levels of or, in some cases, no management approval.

We also offer a number of network and systems and application management products that we refer to as our transactional products. These are primarily desktop or laptop-based products that are designed for individual IT professionals who need specific solutions for routine, but complicated tasks. This includes individual tools and toolsets, which combine many powerful tools together into a single package, as well as entry-level IT infrastructure monitoring functionality that we sell at a much lower price and higher volume than our other products and represent less than 15% of our total revenue.

Our current network and systems and application management products include:

Network Management. Our enterprise-class network management products allow network administrators and other IT professionals to monitor and manage the performance and configuration of their network infrastructure as well as collect and analyze log data for IT operations, security, and compliance management. Our enterprise-class network management products share integrated components, databases, web servers and user administration and are designed to operate together seamlessly, while still allowing network professionals to purchase and deploy only the products they need.

- SolarWinds Network Performance Monitor. Our flagship product, Network Performance Monitor, is a server-based fault and performance management platform designed to minimize network downtime. Network Performance Monitor monitors and analyzes real-time, in-depth network performance metrics for routers, switches, servers and other Simple Network Management Protocol, or SNMP, enabled devices to provide both current and historical views into the availability and performance of a network and all devices attached to it. Network Performance Monitor is modular and

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has the ability to scale with the growth of a network. It can also be expanded through the use of add-on modules and polling engines. End-users can configure Network Performance Monitor to alert network professionals of network events, including thresholds, correlated events, sustained conditions and complex combinations of device states. Network Performance Monitor drives follow-on sales of related modules and our other products.

- Additional Network Management Products. We offer a number of additional network management products that solve a variety of network management issues and extend the capabilities of Network Performance Monitor. These products are purchased separately and are typically fully integrated with our Network Performance Monitor's web console and database. These additional network management products include:
- SolarWinds Enterprise Operations Console. Enterprise Operations Console is a server-based product that provides summarized web-based views of multiple instances of Network Performance Monitor, Network Performance Monitor modules, and Server & Application Monitor, enabling flexible deployment architectures for large or distributed environments.
- SolarWinds IP Address Manager. IP Address Manager tracks, manages and reports on the use of IP addresses through a web interface. In addition, IP Address Manager provides a single interface for management of third party DHCP and DNS IP infrastructure.
- SolarWinds NetFlow Traffic Analyzer. NetFlow Traffic Analyzer utilizes Cisco Systems' NetFlow protocol and other similar protocols to extract data from network devices to provide an in-depth view of which end-users, protocols and applications are consuming network bandwidth.
- SolarWinds Network Configuration Manager. Network Configuration Manager is a server-based product that automates the processes of network device discovery, network inventory management and network change management.
- SolarWinds Scalability Engines. Scalability engines increase the scale and provide fail-over for a number of our network management and systems and application management products increasing their monitoring capabilities to a larger number of devices by distributing the polling load across additional servers and ensuring up-time.
- SolarWinds User Device Tracker. User Device Tracker is a server-based switch port management tool for tracking and identifying the devices connected to the network, managing network port capacity and responding to network threats posed by rogue devices.
- SolarWinds VoIP & Network Quality Manager. VoIP & Network Quality Manager monitors VoIP and WAN performance from the perspective of multiple remote sites by tracking key edge-to-edge router performance statistics using Cisco IP SLA technology.
- SolarWinds Firewall Security Manager. Firewall Security Manager provides multi-vendor support for firewall analytics and management enabling the automation of firewall security audits, firewall and router analysis, and simplified troubleshooting and change management.
- SolarWinds Log and Event Manager. Log and Event Manager is a server-based product that automates the collection and interpretation of logs from a wide variety of sources including network devices, physical and virtual servers, applications and storage infrastructure, providing IT professionals with real-time availability and performance monitoring of the IT infrastructure. Through log analysis and event correlation provided with approximately 700 built-in correlation rules along with customizable rules, Log and Event Manager supports compliance verification with internal policies and regulatory requirements and SOX and also provides IT professionals with real-time and forensic tools for responding to security threats and events.
- Network Management Transactional Products. Our current network management transactional products include Standard Toolset, Engineer's Toolset, Kiwi Syslog® Server, Kiwi CatTools®, and Kiwi Logviewer, or Kiwi products, ipMonitor® and Network Topology Mapper.

Systems and Application Management. Our enterprise-class systems and application performance management products allow IT professionals such as systems administrators to monitor and manage the performance of physical and virtual servers, applications, databases, and storage devices. This includes products for monitoring end-user application experience, performing patch management, IT help desk ticketing, and mobile device-based IT management capabilities. Many of our systems and application management products are designed to operate together seamlessly, as well as with our network management products.

• SolarWinds Server & Application Monitor. Server & Application Monitor is a server-based availability and performance management system for applications and server infrastructure, both virtual and physical. Server & Application Monitor provides a view of critical IT services and allows system administrators to drill down and view

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application-specific server processes, performance counters, synthetic end-user transactions and custom data collected via scripts. With Server & Application Monitor, end-users can configure customized alerts and reports for tracking and managing application and server performance. These capabilities allow system administrators to monitor, manage and optimize the performance of an increasingly complex and growing number of mission-critical business applications. Server & Application Monitor supports over 200 major applications, with extensibility to support additional applications on both the Windows and Linux operating systems.

- SolarWinds Virtualization Manager. Virtualization Manager is a server-based product that provides virtualization administrators with a single solution to manage all aspects of a virtual server infrastructure, including inventory, sprawl control, performance monitoring, capacity planning, and configuration tracking. Using a multi-dimensional, search-based approach Virtualization Manager combines multiple disparate data points into useable insights, which are presented in management dashboards and reports. Virtualization Manager integrates with other key enterprise applications such as configuration management databases, service desks and enterprise portals.
- SolarWinds Storage Manager, powered by Profiler. Storage Manager is a server-based product that combines reporting, monitoring and notification on the performance of storage resources, including direct-attached storage, or DAS, network-attached storage, or NAS and storage area networks, or SAN, from a wide range of storage hardware vendors. In addition, Storage Manager provides mapping of storage resources to physical and virtual infrastructure to help optimize storage allocation.
- Database Performance Analyzer (formerly Confio Ignite®). Through a unique response time analysis approach to measuring and communicating database application performance, Database Performance Analyzer provides developers, systems administrators, and database administrators with the ability to speed application time-to-market and subsequently monitor and manage database performance for production applications based on Microsoft SQL Server®, Oracle®, IBM® DB2 and SAP® Sybase databases, running on VMware® virtual servers as well as physical servers.
- SolarWinds Patch Manager. Patch Manager is a server-based product that allows Systems Administrators to automate and improve the process of deploying, managing, and reporting on patches and configuration settings of Microsoft Windows servers and workstations.
- SolarWinds Serv-U® Managed File Transfer Server. Serv-U Managed File Transfer Server allows IT professionals to secure, automate, and manage file transfers and workflows. In addition, Serv-U Managed File Transfer Server provides comprehensive enterprise security, tracking and reporting features to demonstrate compliance with SOX, HIPAA, and GLBA regulations, as well as internal corporate standards.
- SolarWinds Web Help Desk®. Web Help Desk provides IT help desk ticketing, change management, IT asset management, and self-resolution of issues using a searchable knowledge base.
- SolarWinds Web Performance Monitor. Web Performance Monitor captures the user steps of any web application through an easy-to-use recorder and continuously monitors the end-user experience of those web applications.
- Systems and Application Management Transactional Products. Our current systems and application management transactional products include DameWare® Remote Support and DameWare Mini Remote Control, or DameWare products, which allow system administrators to remotely manage computers on their networks, as well as SolarWinds Mobile Admin®, which provides secure access to over 40 IT management tools through Android, iOS, and Blackberry mobile devices.

MSP Products

Our MSP products allow remote monitoring and management and add MSP service automation. These products assist MSP's with the adoption of cloud and SaaS-based services among small and medium-sized businesses, or SMBs. Our MSP products were acquired with our acquisition of N-able in May 2013.

- N-Central®. Our flagship MSP product is N-Central, the industry's top RMM and IT service automation solution. N-Central offers Cloud-based, multi-tenant, remote monitoring and management for IT infrastructure such as desktops, servers, applications, and network devices.
- Our MSP product portfolio also includes additional products that address a wide range of IT management capabilities, including bandwidth management, mobile device management, security, backup, patch management and IT service automation.

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Free Tools

Our free tools are desktop, laptop, server-based or internet-based applications designed for use by individual IT professionals, and typically focused on a single network or infrastructure management task or technology. We use free tools primarily to drive awareness of our brand and our paid products within the broader IT management community and to expand and build loyalty among our customers and our end-user community.

Maintenance and Support

Our perpetual license customers generally receive one year of software maintenance and support as part of their initial purchase of our products and have the option to renew their maintenance agreements. These maintenance agreements provide customers the right to receive software updates, maintenance releases and patches, when and if they become available, and access to our world-wide multi-lingual team of internal support representatives.

Our typical customers are network professionals, systems administrators, storage administrators or virtual administrators who are sophisticated users of software and related technologies. We devote significant resources to designing software products that are easy-to-install, configure and use, and to developing extensive, easy-to-understand instruction manuals and online tutorials for our products. We also utilize community websites, such as thwack, as forums for our end-users to share information, tips, tools and other valuable resources. Through these online communities, users of our software are able to find answers for many technical problems, discover new uses for our software, and provide suggestions or feedback to our product development teams. As a result of these efforts, our customers are able to resolve many technical issues without having to contact our support representatives, which significantly reduces our total support expenses.

Research and Development

Our research and development organization is responsible for the design, development and testing of our software. Our current research and development efforts are focused on new releases of existing products, as well as new products and modules.

We work closely with our customers in developing our products and have designed a product development process that is responsive to customer feedback throughout the process. Our customers and end-user community provide extensive input regarding a wide variety of use cases that we incorporate into our product definitions and requirements. A subset of our customers participates in the validation of our product releases by aiding in the identification of issues prior to a product release. Our research and development organization regularly assists sales engineering and customer support personnel with customer inquiries, which provides another mechanism for customer feedback during the development process.

We utilize small development teams. Each of these teams is dedicated to specific products and work according to a structured and repeatable, iterative process. These teams apply a standard architecture to their individual products, and are managed centrally to ensure standardization, efficiency and interoperability. We use a hybrid onshore and offshore development model, wherein product requirements definition and technical design are primarily performed by our technical staff in the United States along with staff in the Czech Republic, who work closely with development teams in our international facilities and with two contract development vendors in Eastern Europe that write code and do testing and quality assurance. Since establishing our research and development centers in the Czech Republic and India, and as a result of our acquisitions, we have significantly increased our research and development employee headcount. We expect to continue to invest in our research and development activities by hiring engineers in all of our global locations. We believe that we have developed a differentiated process that allows us to release new software rapidly, cost effectively and with a high level of quality. Using our development model, we had 64 product releases in 2011, 82 product releases in 2012 and 75 product releases in 2013.

Our research and development costs were $21.3 million, $28.8 million and $37.5 million for the years ended December 31, 2011, 2012 and 2013, respectively.

Marketing and Sales

We have designed our marketing and sales model to be efficient for very high volumes of affordable transactions for customers of all sizes. Our marketing efforts focus on driving traffic to our websites and on generating high quality sales leads, primarily consisting of end-users who download a free evaluation of our software. Our sales efforts focus on converting these leads into paying customers through a high volume, short duration, sales process that we measure

and manage frequently.
Marketing
We use a variety of online marketing programs for lead generation, as well as more traditional direct marketing and indirect channel partner marketing programs to drive awareness of our products and traffic to our websites. These efforts leverage the ubiquity of Internet search engines through search engine marketing and optimization programs. In addition, we

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send a series of targeted emails to end-users who have downloaded free evaluations of one or more of our software products or received our corporate communications or public relations material. Once we drive traffic to our websites, we have a well-defined process that allows us to automatically track visitors' activities, communicate with potential customers, encourage downloads of our software and provide highly qualified leads to our sales organization.

Our historical marketing approach, which continues to be important to us, was based on word-of-mouth and customer references. It allowed us to build a substantial customer base and community of network engineers and IT professionals who use our products and act as advocates for them. We continue to build our customer base and this community through marketing of relevant web-based content and online communications. Examples of our initiatives include thwack, a community website designed for IT professionals that provides our end-users and the broader IT management community with information, tools and valuable resources, several company sponsored blogs in which we provide perspectives and information relevant to the IT management marketplace, network engineering, systems management, virtualization, security and other technical topics, and web-based events designed to train and inform users about deeper aspects of our products. These activities keep us connected to our end-user base and other prospective customers. Other marketing activities include attending IT management related trade shows, social marketing programs, communicating with industry analysts, influential bloggers and trade media, as well as hosting webinars on IT management issues to create awareness of our brand and software products.

Sales

We sell our software to our customers both directly and through partners. The majority of our sales leads come from potential customers or existing customers who have downloaded one of our core products and use that full featured product during a no-charge evaluation period. Therefore, our sales force typically contacts leads that are potential buyers and the potential buyers already understand how our products are used and the value our products provide in solving IT problems. As a result, our sales cycles are not as long as they are for companies making "cold" calls.

We execute all of our direct sales through a sales organization that is physically located in one of our sales offices in the United States, Canada, Europe or Asia. Our efficient and low-cost sales process is predicated on these sales professionals being physically located in one of our offices and having a deep knowledge of our sales model and process. We call this "selling from the inside" as it is different from other companies that simply use personnel that they call "inside sales" to create leads or to sell to only smaller organizations. Our sales teams respond to incoming demand and sell our products to companies of all sizes, from small businesses to Fortune 500 companies. We believe that our selling from the inside process has been one of the keys to our success.

We also sell our software through distributors and resellers to supplement our direct sales force, expand our global presence, reach various market segments and help us to initiate and fulfill sales orders from state, local and federal governments and those commercial customers that prefer to make purchases through a particular reseller. Sales to our channel partners often involve three tiers of distribution: a distributor, a reseller and an end-user customer. Our direct sales force works collaboratively with our channel partners to introduce them to customers and new sales opportunities. We provide licenses directly to the end user in sales of our software through our distributors and resellers. As we expand geographically, we expect to continue to add additional channel partners.

Our sales approach focuses on driving a high volume of relatively standardized transactions. We implement our approach through a disciplined sales process that provides clear guidelines for our sales force, and we actively measure and manage our sales results. We offer our products at low prices and typically using standard contract terms. We enable our customers to buy our products in a manner convenient to them, whether by purchase order, online with a credit card or through our channel partners.

We have experienced, and expect to continue to experience, some seasonality in our new license sales and, consequently, our cash collections. We typically achieve the highest levels of new license sales for the year in the third and fourth quarters. We believe that, in general, historical seasonality results primarily from the budgeting cycles of our customers being typically higher in the third and fourth quarters. New license sales for our U.S. federal business tend to peak in the third quarter of each calendar year as September 30 is the fiscal year end for the U.S. federal government. As a result, cash collections have historically been the highest in the fourth quarter of each calendar year. New license sales for our commercial business tend to peak in the fourth quarter of each calendar year as many companies typically have a December 31 fiscal year end.

We believe we have built a sales process and culture that is unique in the software industry, and that our sales force is able to achieve and maintain a higher level of productivity at a lower cost than most other enterprise software companies. Because our sales personnel do not need a professional software sales background, we have been able to keep our personnel costs low and can expand our direct sales force quickly.

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Customers

In 2012 and 2011, we had one distributor that represented 10.2% and 11.9%, respectively, of our consolidated revenue from sales to various end-users. In 2013, this distributor represented less than 10% of our consolidated revenue. We do not believe that our business is substantially dependent on this distributor or that the loss of the relationship would have a material adverse effect on our business, as we are generally directly involved with the end user in all of our sales regardless of whether we make the sale direct or through the reseller channel.

In 2012 and 2011, revenue attributed to the U.S. federal government, including its departments and agencies, represented 10.9% and 12.6%, respectively, of our consolidated revenue. In 2013, consolidated revenue attributable to the U.S. federal government represented less than 10% of our total revenue. Consolidated revenue attributable to the U.S. federal government includes sales that have gone through our distributors and resellers, as well as direct sales. 77.0% and 79.2% of our revenue attributable to the U.S. federal government and its departments and agencies in each of the fiscal years ended December 31, 2012 and 2011, respectively, was made through the distributor noted above.

For further information regarding concentrations of risks, see Note 1, Summary of Significant Accounting Policies, in the Notes to Consolidated Financial Statements in Item 8 of Part II of this Annual Report on Form 10-K.

For information regarding our international operations, see Note 16, Operating Segment and Geographic Information, in the Notes to Consolidated Financial Statements in Item 8 of Part II of this Annual Report on Form 10-K. See also the risk factor “Because our long-term success depends on our ability to operate our business internationally and increase sales of our products to customers located outside of the United States, our business will be susceptible to risks associated with international operations” in Part I, Item 1A under the heading “Risk Factors” for information regarding risks involving our international operations.

Intellectual Property

We rely on a combination of copyright, trademark, trade dress and trade secret laws, as well as confidentiality procedures and contractual restrictions, to establish and protect our proprietary rights. These laws, procedures and restrictions provide only limited protection. We currently have fifteen patents. We have also filed patent applications, but we cannot guarantee that patents will be issued with respect to our current patent applications in a manner that gives us the protection that we seek or at all. Our patents and any future patents issued to us may be challenged, invalidated or circumvented and may not provide sufficiently broad protection or may not prove to be enforceable in actions against alleged infringers.

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

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

Competition

We face competition from both traditional, larger software vendors offering enterprise-wide software frameworks and services and smaller companies offering point solutions for application, database, log and event, network, remote monitoring and management, storage resource or virtualization management. We also compete with network equipment vendors and systems management product providers whose products and services also address network and IT management requirements. Our principal competitors vary depending on the product we offer and include Hewlett Packard, IBM, CA Technologies, Cisco Systems, Inc., VMware, Inc., EMC Corporation, NetApp, Inc., BMC Software, Inc., Quest Software, now a part of Dell Inc., Infoblox Inc., and several smaller vendors.

Competition in our market is based on the level of difficulty in using, maintaining and installing solutions; total cost of ownership, including product price and implementation and support costs; professional services implementation; product performance, functionality, flexibility, scalability and interoperability; brand and reputation; distribution channels; vertical markets or industries; and financial resources of the vendor. We generally compete favorably with respect to these factors; however, many of our actual and potential competitors enjoy substantial competitive advantages over us, such as greater name recognition, more comprehensive and varied products and services and substantially greater financial, technical and other resources. In addition, many of our competitors have established marketing relationships and access to larger customer bases, and have major distribution agreements with consultants, system integrators and resellers. We expect competition to continue to increase both from existing competitors and new market entrants.

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Employees

As of December 31, 2013, we had 1,312 full-time employees, of which 560 were employed in the United States and 752 were employed outside of the United States. We consider our current relationship with our employees to be good. None of our employees is represented by a labor union or is a party to a collective bargaining agreement.

Additional Information

Our website address is www.solarwinds.com. Our website and the contents therein or connected thereto are not intended to be incorporated into this Annual Report on Form 10-K. Through a link on the Investor Relations section of our website, we make available the following filings as soon as reasonably practicable after they are electronically filed with or furnished to the SEC: our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and any amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act. All such filings are available free of charge. The public may read and copy any materials we file with the SEC at the SEC's Public Reference Room at 100 F Street, NE, Washington, DC 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. In addition, the SEC maintains an Internet site (http://www.sec.gov) that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC.

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ITEM 1A. RISK FACTORS

Risks Related to Our Business and Industry

Our quarterly revenue and operating results have fluctuated in the past and may fluctuate in the future due to a number of factors. As a result, we may fail to meet or exceed the expectations of securities analysts or investors, which could cause our stock price to decline.

We believe our quarterly revenue and operating results may vary significantly in the future. As a result, you should not rely on the results of any one quarter as an indication of future performance and period-to-period comparisons of our revenue and operating results may not be meaningful.

Our quarterly results of operations may fluctuate as a result of a variety of factors, including, but not limited to, those listed below, many of which are outside of our control:

- our ability to maintain and increase sales to existing customers and to attract new customers;
- general economic, industry and market conditions that impact expenditures for enterprise IT management software in the United States and other countries where we sell our software;
- decline in maintenance or subscription renewals;
- our ability to generate a significant volume of qualified sales leads;
- our ability to convert qualified sales leads into new license sales;
- the amount and timing of operating expenses and capital expenditures related to the expansion of our operations and infrastructure and customer acquisition;
- our failure to achieve the growth rate that was anticipated by us in setting our operating and capital expense budgets;
- the timing of revenue and expenses related to the development or acquisition of technologies, products or businesses;
- potential goodwill and intangible asset impairment charges and amortization associated with acquired businesses;
- potential foreign exchange gains and losses related to expenses and sales denominated in currencies other than the functional currency of an associated entity;
- the timing and success of new product introductions by us or our competitors;
- changes in our pricing policies or those of our competitors;
- occasional large customer orders, including in particular those placed by the U.S. federal government;
- unpredictability and timing of buying decisions by the U.S. federal government; and
- changes in tax rates in jurisdictions in which we operate.

Fluctuations in our quarterly operating results might lead analysts to change their models for valuing our common stock. As a result, our stock price could decline rapidly and we could face costly securities class action suits or other unanticipated issues.

Our actual operating results may differ significantly from information we provide regarding our financial outlook.

From time to time, we may provide information regarding our financial outlook in our quarterly earnings releases, quarterly earnings conference calls, or otherwise, that represents our management's estimates as of the date of release. This information regarding our financial outlook, which includes forward-looking statements, will be based on projections, including those related to certain of the factors listed above, prepared by our management. Neither our independent registered public accounting firm nor any other independent expert or outside party will compile or examine the projections nor, accordingly, will any such person express any opinion or any other form of assurance with respect thereto.

These projections will be based upon a number of assumptions and estimates that, while presented with numerical specificity, will be inherently subject to significant business, economic and competitive uncertainties and contingencies, many of which will be beyond our control, and will also be based upon specific assumptions with respect to future business decisions, some of which will change. For example, our management has excluded and currently intends to continue to exclude in their projections the potential revenue associated with certain transactions with U.S. federal government entities that are associated with projects involving larger end user technology implementations that typically involve multiple companies, resellers and/or service providers, or what we refer to as project-based transactions, which are difficult to predict. To the extent we recognize revenue from these project-based transactions during a specific quarter, our actual operating results may differ significantly

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from information we may have provided regarding our financial outlook. We intend to state possible outcomes as high and low ranges, which will be intended to provide a sensitivity analysis as variables are changed but will not be intended to represent that actual results could not fall outside of the suggested ranges. The principal reason that we release such information is to provide a basis for our management to discuss our business outlook with analysts and investors. We do not accept any responsibility for any projections or reports published by analysts.

Information regarding our financial outlook is necessarily speculative in nature, and it can be expected that some or all of the assumptions underlying such information furnished by us will not materialize or will vary significantly from actual results. Accordingly, information that we provide regarding our financial outlook will only be an estimate of what management believes is realizable as of the date of release. Actual results will vary from our financial outlook, and the variations may be material and adverse. In light of the foregoing, investors are urged to consider these factors, not to rely exclusively upon information we provide regarding our financial outlook in making an investment decision regarding our common stock, and to take such information into consideration only in connection with other information included in our filings filed with or furnished to the SEC, including “Risk Factors” such as this one.

Any failure to implement our operating strategy successfully or the occurrence of any of the events or circumstances set forth under “Risk Factors” in this report could result in our actual operating results being different from information we provide regarding our financial outlook, and those differences might be adverse and material.

If we are unable to generate significant volumes of sales leads from Internet search engines, marketing initiatives and traffic to our websites, then our revenue may not grow as expected or may decline.

We generate many of our sales leads through visits to our websites by potential end-users interested in purchasing or downloading evaluations of our products. Many of these potential end-users find our websites by searching for enterprise IT management and monitoring products through Internet search engines, such as Google. A critical factor in attracting potential customers to our websites is how prominently our websites are displayed in response to search inquiries. If we are listed less prominently or fail to appear in search result listings for any reason, visits to our websites by customers and potential customers could decline significantly. We may not be able to replace this traffic and, if we attempt to replace this traffic, we may be required to increase our sales and marketing expenses, which may not be offset by additional revenue and could adversely affect our operating results.

We also generate leads through various other marketing activities such as targeted email campaigns, social marketing programs, attending IT management related trade shows, and hosting webinars on IT management issues. Our marketing efforts may be unsuccessful in generating evaluation downloads, resulting in fewer sales leads. If we fail to generate a sufficient volume of leads from these activities and/or such sales leads do not result in actual sales, our revenue may not grow as expected or could decrease and our operating results could suffer.

If we are unable to sell products to new customers or to sell additional products or upgrades to our existing customers, our revenue growth will be adversely affected and our operating income could decrease.

To increase our revenue, we must regularly add new customers and/or sell additional products or upgrades to existing customers. Even if we generate a significant volume of leads from our marketing activities, we must be able to sell products to a sufficient number of these new sales leads in order to achieve our expected revenue growth. We expect to incur significant additional expenses in expanding our sales personnel and our international operations in order to convert leads into sales of our products. If we are unable to sell products to new customers and additional products or upgrades to our existing customers as a result of these expenditures, we may be unable to grow our revenue and/or our operating results may be adversely affected.

Challenging or uncertain economic conditions could adversely affect our operating results.

Economies in many countries are continuing to experience uncertain and challenging conditions as a result of a multitude of factors, including, but not limited to, sovereign debt levels and threatened defaults, credit downgrades, declines in gross domestic product, increases in unemployment, political uncertainty or unrest and volatility in commodity prices and worldwide stock markets. During these challenging and uncertain economic periods, customers may reduce or delay technology purchases, including purchases of our software products. Our typically short sales cycle may lengthen if purchasing decisions are delayed as a result of uncertain information technology budgets, contract negotiations become more protracted or customers institute additional internal approvals for software purchases. Uncertain and challenging economic conditions could result in reductions in sales of our products, longer sales cycles, difficulties in collecting accounts receivable or delayed payments, slower adoption of new technologies and increased price competition. Any of these events would likely harm our business, financial condition, operating results and cash flows.

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The ability to recruit, retain and develop key employees is critical to our success and growth, and our inability to attract and retain qualified personnel could harm our business.

Our business requires certain expertise and intellectual capital, particularly within our management team. For us to compete successfully and grow, we must retain, recruit and develop key personnel who can provide the needed expertise for our industry and products. As we move into new geographic areas, we will need to attract, recruit and retain qualified personnel in those locations. In addition, acquisitions could cause us to lose key personnel of the acquired businesses. However, the market for qualified personnel is competitive and we may not succeed in recruiting additional key personnel or may fail to effectively replace current key personnel who depart with qualified or effective successors. We believe that replacing our key personnel with qualified successors is particularly challenging as we feel that our business model and approach to marketing and selling our products are unique. Any successors that we hire from outside of the Company would likely be unfamiliar with our business model and may therefore require significant time to understand and appreciate the important aspects of our business or fail to do so altogether. Our effort to retain and develop personnel may also result in significant additional expenses, including stock-based compensation expenses, which could adversely affect our profitability. New regulations and volatility or lack of performance in our stock price could also affect the value of our equity awards, which could affect our ability to attract and retain our key employees. We have made significant changes, and may make additional changes in the future, to our senior management team and other key personnel. We cannot provide assurances that key personnel, including our executive officers, will continue to be employed by us or that we will be able to attract and retain qualified personnel in the future. Failure to retain or attract key personnel could have a material adverse effect on our business.

Failure to expand our sales operations effectively could harm our ability to increase our customer base and achieve broader market acceptance of our products.

Increasing our customer base and achieving broader market acceptance of our products will depend on our ability to expand our sales operations effectively. We are substantially dependent on our direct sales force, and to a significantly lesser extent on certain resellers and distributors, to obtain new customers. We plan to continue to expand our sales force both domestically and internationally. Our ability to achieve significant growth in revenue in the future will depend on our success in recruiting, training and retaining sufficient numbers of sales personnel, and on the productivity of those personnel. Our recent and planned personnel additions may not become as productive as we would like, and we may be unable to hire or retain sufficient numbers of qualified individuals in the future in the markets where we do or plan to do business. Our operating results will be seriously harmed if these expansion efforts do not generate a corresponding significant increase in revenue.

Our business depends on customers renewing their maintenance or subscription agreements. Any decline in customer renewals could harm our future operating results.

We sell most of our products pursuant to a perpetual license, which ordinarily includes one year of maintenance as part of the initial price. We sell certain of our products pursuant to subscription agreements, which ordinarily have a subscription period of one year. We generally invoice subscription agreements monthly in advance over the subscription period. We introduced our subscription offerings in the second quarter of 2013 as a result of the acquisition of N-able Technologies. Our customers have no obligation to renew their maintenance or subscription agreements after the expiration of the initial period. Additionally, customers could cancel their subscription agreements prior to the expiration of the subscription period, which could result in us recognizing less subscription revenue than expected over the term of the agreement. We may be unable to predict future customer renewal rates accurately. Our customers' renewal rates may decline or fluctuate as a result of a number of factors, including their level of satisfaction with our products, the prices of our products, the prices of products and services offered by our competitors or reductions in our customers' spending levels. If our customers do not renew their maintenance or subscription arrangements or if they renew them on less favorable terms, our revenue may decline and our business will suffer. A substantial portion of our quarterly maintenance and subscription revenue is attributable to agreements entered into during previous quarters. As a result, if there is a decline in renewed maintenance or subscription agreements in any one quarter, only a small portion of the decline will be reflected in our revenue recognized in that quarter and the rest will be reflected in our revenue recognized in the following four quarters or more.

Acquisitions present many risks that could have a material adverse effect on our business and results of operations.
In order to expand our business, we have made several acquisitions and expect to continue making similar acquisitions and possibly larger acquisitions as part of our growth strategy. The success of our future growth strategy will depend on our ability to identify, negotiate, complete and integrate acquisitions and, if necessary, to obtain satisfactory debt or equity financing to fund those acquisitions. Mergers and acquisitions are inherently risky, and any mergers and acquisitions we complete may not be successful. Our past mergers and acquisitions and any mergers and acquisitions that we do in the future involve numerous risks, including, but not limited to, the following:

- difficulties in integrating and managing the operations, personnel, systems, technologies and products of the companies we acquire;

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- diversion of our management's attention from normal daily operations of our business;
- our inability to maintain the key business relationships and the reputations of the businesses we acquire;
- uncertainty of entry into markets in which we have limited or no prior experience and in which competitors have stronger market positions;
- our dependence on unfamiliar affiliates, resellers, distributors and partners of the companies we acquire;
- our inability to increase revenues from an acquisition for a number of reasons, including our failure to drive demand in our existing customer base for acquired products and our failure to obtain maintenance renewals or upgrades and new product sales from customers of the acquired businesses;
- increased costs related to acquired operations and continuing support and development of acquired products;
- our responsibility for the liabilities of the businesses we acquire;
- potential goodwill and intangible asset impairment charges and amortization associated with acquired businesses;
- adverse tax consequences associated with acquisitions;
- changes in how we are required to account for our acquisitions under U.S. generally accepted accounting principles, including arrangements that we assume from an acquisition;
- potential negative perceptions of our acquisitions by customers, financial markets or investors;
- failure to obtain required approvals from governmental authorities under competition and antitrust laws on a timely basis, if at all, which could, among other things, delay or prevent us from completing a transaction, or otherwise restrict our ability to realize the expected financial or strategic goals of an acquisition;
- potential increases in our interest expense, leverage and debt service requirements if we incur additional debt to pay for an acquisition;
- our inability to apply and maintain our internal standards, controls, procedures and policies to acquired businesses; and
- potential loss of key employees of the companies we acquire.

Additionally, acquisitions or asset purchases made entirely or partially for cash may reduce our cash reserves or require us to incur additional debt under our Credit Agreement or otherwise. We may seek to obtain additional cash to fund an acquisition by selling equity or debt securities. We may be unable to secure the equity or debt funding necessary to finance future acquisitions on terms that are acceptable to us. If we finance acquisitions by issuing equity or convertible debt securities, our existing stockholders will experience ownership dilution.

The occurrence of any of these risks could have a material adverse effect on our business, results of operations, financial condition or cash flows, particularly in the case of a larger acquisition or concurrent acquisitions.

Businesses that we acquire may have greater than expected liabilities for which we become responsible.

Businesses that we acquire may have liabilities or adverse operating issues, or both, that we fail to discover through due diligence or the extent of which we underestimate prior to the acquisition. For example, to the extent that any business that we acquire or any prior owners, employees or agents of any acquired businesses or properties: (i) failed to comply with or otherwise violated applicable laws, rules or regulations; (ii) failed to fulfill or disclose their obligations, contractual or otherwise, to applicable government authorities, their customers, suppliers or others; or (iii) incurred tax or other liabilities, we, as the successor owner, may be financially responsible for these violations and failures and may suffer harm to our reputation and otherwise be adversely affected. An acquired business may have problems with internal control over financial reporting, which could be difficult for us to discover during our due diligence process and could in turn lead us to have significant deficiencies or material weaknesses in our own internal control over financial reporting. These and any other costs, liabilities and disruptions associated with any of our past acquisitions and any future acquisitions could harm our operating results.

Charges to earnings resulting from acquisitions may adversely affect our operating results.

When we acquire businesses, we allocate the purchase price to tangible assets and liabilities and identifiable intangible assets acquired at their acquisition date fair values. Any residual purchase price is recorded as goodwill, which is also generally measured at fair value. We also estimate the fair value of any contingent consideration. Our estimates of fair value are based upon assumptions believed to be reasonable but which are uncertain and involve significant judgments by management. After we complete an acquisition, the following factors could result in material charges and adversely affect our operating results and may adversely affect our cash flows:

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- costs incurred to combine the operations of companies we acquire, such as transitional employee expenses and employee retention or relocation expenses;
- impairment of goodwill or intangible assets;
- a reduction in the useful lives of intangible assets acquired;
- impairment of long-lived assets;
- identification of, or changes to, assumed contingent liabilities;
- charges to our operating results due to duplicative pre-merger activities;
- charges to our operating results from expenses incurred to effect the acquisition; and
- charges to our operating results due to the expensing of certain stock awards assumed in an acquisition.

Substantially all of these costs will be accounted for as expenses that will decrease our net income and earnings per share for the periods in which those costs are incurred. Charges to our operating results in any given period could differ substantially from other periods based on the timing and size of our acquisitions and the extent of integration activities. For further information regarding our accounting for acquisitions see “Critical Accounting Policies and Estimates—Acquisitions” under “Management’s Discussion & Analysis of Financial Condition and Results of Operations” and Note 2, Acquisitions, in the Notes to Consolidated Financial Statements in Item 8 of Part II of this Annual Report on Form 10-K.

Our operating income could fluctuate and may continue to decline as a percentage of revenue as we make further expenditures to expand our operations in order to support additional growth in our business.

As a percentage of revenue, our operating income was 36.3%, 42.3% and 42.2% for the years ended December 31, 2013, 2012 and 2011, respectively. We have made significant investments in our operations to support additional growth, such as hiring substantial numbers of new personnel, investing in new facilities, acquiring other companies or their assets and establishing and broadening our international operations in order to expand our business. In 2013, we acquired new operations in Ottawa, Canada and Boulder, Colorado through our acquisitions of N-able and Confio, respectively, which increased our operating expenses in the second half of 2013. We expect these acquisitions will continue to increase our operating expenses in future periods. We also increased our investments in the fourth quarter of 2013 primarily to expand our research and development efforts, increase our sales and marketing activities and broaden our international operations. We expect to continue to make these additional investments to support anticipated future growth in our business. These investments may not yield increased revenue, and even if they do, the increased revenue may not offset the amount of the investments. We also expect to continue to pursue acquisitions in order to expand our presence in current markets or new markets, many or all of which may increase our operating costs more than our revenue. As a result of all of these factors, our operating income could fluctuate and may continue to decline as a percentage of revenue relative to our prior annual periods.

If we are unable to enhance existing products, particularly our core products, or to develop or acquire new products that respond to rapidly changing customer requirements, technological developments or evolving industry standards, our long-term revenue growth will be harmed.

The market for our products is characterized by rapid technological advances, changes in customer requirements, changes in protocols and evolving industry standards. Our long-term growth depends on our ability to enhance and improve our existing products and to introduce or acquire new products that respond to these demands. The success of any enhancement or new product depends on a number of factors, including its timely completion, introduction and market acceptance. New products that we develop or acquire may not be introduced in a timely or cost-effective manner and may not achieve the broad market acceptance necessary to generate significant revenue. Additionally, our existing and prospective customers may develop their own competing technologies, purchase competitive products or services or engage third party providers. If we are unable to develop or acquire enhancements to, and new features for, our existing products or acceptable new products that keep pace with rapid technological developments, our products may become obsolete, less marketable and less competitive, and our business will be harmed.

We operate much of our research and development activities internationally and outsource a portion of the coding and testing of our products and product enhancements to contract development vendors. We believe that performing research and development in our international facilities and supplementing these activities with our contract development vendors enhances the efficiency and cost-effectiveness of our product development. If we experience problems with our workforce or facilities internationally, we may not be able to develop new products or enhance existing products in an alternate manner that may be equally or less efficient and cost-effective.

We depend significantly on our core products, which represent a majority of our revenue in 2013, 2012 and 2011. If we are unable to add products and develop enhancements to our core products that are satisfactory to our customers, or if our customers purchase or develop their own competing products and technologies causing a reduction in demand for our core products, our operating results will be harmed.

We depend on the U.S. federal government for a meaningful portion of our sales, including maintenance renewals, and orders from the U.S. federal government are unpredictable. The delay or loss of these sales may harm our operating results.

A meaningful portion of our sales, including maintenance renewals, are to a number of different departments of the U.S. federal government. Any factors that cause a decline in government expenditures generally or government IT expenditures in particular could cause our revenue to grow less rapidly or even to decline. These factors include, but are not limited to, constraints on the budgetary process, including changes in the policies and priorities of the U.S. federal government, the impact of sequestration under the Budget Control Act of 2011 or other deficit-reduction measures, and any shutdown of the U.S. federal government. Furthermore, sales orders from the U.S. federal government tend to be dependent on many factors and therefore unpredictable in timing. Any sales we expect to make in a fiscal quarter may not be made in that quarter or at all, and our operating results for that quarter may therefore be adversely affected.

Because our long-term success depends on our ability to operate our business internationally and increase sales of our products to customers located outside of the United States, our business will be susceptible to risks associated with international operations.

We have international operations in the Republic of Ireland, the Czech Republic, Canada, Australia, India, Singapore, the Philippines and the Netherlands, all of which were established or acquired since 2007. We also expect to continue to expand our international operations for the foreseeable future. The continued international expansion of our operations requires significant management attention and financial resources and results in increased administrative and compliance costs. Our limited experience in operating our business outside the United States increases the risk that our current and future international expansion efforts may not be successful. In particular, our business model may not be successful in particular countries or regions outside the United States for reasons that we currently are unable to anticipate. In addition, conducting international operations subjects us to risks that we have not generally faced in the United States. These include, but are not limited to:

- fluctuations in currency exchange rates (which we only hedge to a limited extent at this time);
- the complexity of, or changes in, foreign regulatory requirements;
- difficulties in managing the staffing of international operations, including compliance with local labor and employment laws and regulations;
- potentially adverse tax consequences, including the complexities of foreign value added tax systems, overlapping tax regimes, restrictions on the repatriation of earnings and changes in tax rates;
- dependence on resellers and distributors to increase customer acquisition or drive localization efforts;
- the burdens of complying with a wide variety of foreign laws and different legal standards;
- increased financial accounting and reporting burdens and complexities;
- longer payment cycles and difficulties in collecting accounts receivable;
- longer sales cycles;
- political, social and economic instability abroad;
- terrorist attacks and security concerns in general;
- reduced or varied protection for intellectual property rights in some countries; and
- the risk of U.S. regulation of foreign operations.

The occurrence of any one of these risks could negatively affect our international business and, consequently, our operating results. We cannot be certain that the investment and additional resources required to establish, acquire or integrate operations in other countries will produce desired levels of revenue or profitability. If we are unable to effectively manage our expansion into additional geographic markets, our financial condition and results of operations could be harmed.

If we fail to develop and maintain our brands cost-effectively, our financial condition and operating results might suffer.

We believe that developing and maintaining awareness and integrity of our brands in a cost-effective manner are important to achieving widespread acceptance of our existing and future products and are important elements in attracting new customers. We believe that the importance of brand recognition will increase as we enter new markets and as competition in our existing markets further intensifies. Successful promotion of our brands will depend on the effectiveness of our marketing efforts and on our ability to provide reliable and useful products at competitive prices. We intend to increase our expenditures on brand promotion. Brand promotion activities may not yield increased revenue, and even if they do, the increased revenue may not offset the expenses we incur in building our brands. We rely on resellers and distributors to some extent in the distribution of our products. We have limited control over these third parties and actions by these third parties could negatively impact our brand. We also rely on our customer base and community of end-users in a variety of ways, including to give us feedback on our products and to provide user-based support to our other customers through thwack, our online community website. If poor advice or misinformation regarding our products is spread among users of thwack, it could adversely affect our reputation, our financial results and our ability to promote and maintain our brands. If we fail to promote and maintain our brands successfully, maintain loyalty among our customers and our end-user community, or incur substantial expenses in an unsuccessful attempt to promote and maintain our brands, we may fail to attract new customers or retain our existing customers and our financial condition and results of operations could be harmed.

We operate in a highly competitive market, which could make it difficult for us to acquire and retain customers.

The market for enterprise IT management solutions is intensely competitive. Competition in our market is based primarily on the level of difficulty in using, maintaining and installing solutions; total cost of ownership, including product price and implementation and support costs; professional services implementation; product performance, functionality, flexibility, scalability and interoperability; brand and reputation; distribution channels; vertical markets or industries; and financial resources of the vendor. We often compete to sell our products against existing products or systems that our potential customers have already made significant expenditures to install. Many of our actual and potential competitors enjoy substantial competitive advantages over us, such as greater name recognition, more comprehensive and varied products and services, and substantially greater financial, technical and other resources. In addition, many of our competitors have established marketing relationships and access to larger customer bases, and have major distribution agreements with consultants, system integrators and resellers. Given their larger size, greater resources and existing customer relationships, our competitors may be able to compete and respond more effectively than we can to new or changing opportunities, technologies, standards or customer requirements.

We face competition from both traditional, larger software vendors offering enterprise-wide software frameworks and services and smaller companies offering point solutions for application, database, log and event, network, remote monitoring and management, storage resource or virtualization management. We also compete with network equipment vendors and systems management product providers whose products and services also address network and IT management requirements. Our principal competitors vary depending on the product we offer and include Hewlett Packard, IBM, CA Technologies, Cisco Systems, Inc., VMware, Inc., EMC Corporation, NetApp, Inc., BMC Software, Inc., Quest Software, now a part of Dell Inc., Infoblox Inc., and several smaller vendors.

Some of our competitors have made acquisitions or entered into strategic relationships with one another to offer more comprehensive or bundled or integrated product offerings. We expect this trend to continue as companies attempt to strengthen or maintain their market positions in an evolving industry and as companies enter into partnerships or are acquired. Companies and alliances resulting from these possible consolidations and partnerships may create more compelling product offerings and be able to offer more attractive pricing, making it more difficult for us to compete effectively.

We have experienced rapid growth in recent periods. If we fail to manage our growth effectively, our financial performance may suffer.

We have substantially expanded our overall business, customer base, headcount and operations since 2006 both domestically and internationally. In 2013, we opened a new facility in Lehi, Utah and acquired new operations in Ottawa, Canada and Boulder, Colorado through our acquisitions of N-able and Confio, respectively. Our expansion has placed, and our expected future growth will continue to place, a significant strain on our managerial, administrative, operational, financial and other resources. As we continue to grow, we must effectively integrate and manage expanded operations and a large number of new employees in geographically distributed locations, while maintaining the effectiveness of our business model and approach to marketing and selling our products. If we are unable to manage our growth effectively, our operating results will suffer.

Interruptions or performance problems associated with our technology and infrastructure, and our reliance on technologies from third parties, may adversely affect our ability to manage our business and meet reporting obligations.

Currently, we use NetSuite to manage our order management and financial processes, salesforce.com to track our sales and marketing efforts and other third party vendors to manage online marketing and web services. We believe the availability of these services is particularly essential to the management of our high-volume, transaction-oriented business model. We also use third party vendors to manage our equity compensation plans and certain aspects of our financial reporting processes. As we expand our operations, we expect to utilize additional systems and service providers that may also be essential to managing our business. Although the systems and services that we require are typically available from a number of providers, it is time consuming and costly to qualify and implement these relationships. Therefore, if one or more of our providers suffer an interruption in their business, or experience delays, disruptions or quality control problems in their operations, or we have to

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change or add additional systems and services, our ability to manage our business and produce timely and accurate financial statements would suffer.

In addition, our continued growth depends in part on the ability of our existing and potential customers to access our website and download our software or encrypted access keys for our software within an acceptable amount of time. We have experienced, and may in the future experience, website disruptions, outages and other performance problems due to a variety of factors, including infrastructure changes, human or software errors, capacity constraints due to an overwhelming number of users accessing our website simultaneously and denial of service or fraud or security attacks. In some instances, we may not be able to identify the cause or causes of these website performance problems within an acceptable period of time. It may become increasingly difficult to maintain and improve our website performance, especially during peak usage times and as our user traffic increases. If our websites are unavailable or if our customers users are unable to download our software or encrypted access keys within a reasonable amount of time or at all, our business would be negatively affected.

Material defects or errors in our products could harm our reputation, result in significant costs to us and impair our ability to sell our products.

Software products are inherently complex and often contain defects and errors when first introduced or when new versions are released. Any defects or errors in our products could result in:

- lost or delayed market acceptance and sales of our products;
- a reduction in maintenance renewals;
- diversion of development resources;
- legal claims; and
- injury to our reputation and our brand.

The costs incurred in correcting or remediating the impact of defects or errors in our products may be substantial and could adversely affect our operating results.

Litigation exposure related to our pending and any future litigation could adversely affect our results of operations, profitability and cash flows.

We have been and may be involved, from time-to-time, in disputes incidental to our business. We are currently the subject of allegations of patent infringement further described under the caption “Legal Proceedings” in Part I, Item 3 of this Annual Report on Form 10-K. We cannot predict when these lawsuits will be completed and are unable to accurately assess the financial outcome that could result from these matters at this time. Pending or future lawsuits may result in a diversion of management’s attention and resources, significant costs, including monetary damages and legal fees, injunctive relief, and may contribute to current and future stock price volatility. No assurance can be made that pending or future litigation will not result in material financial exposure or reputational harm, which could have a material adverse effect upon our results of operations, profitability and cash flows.

In particular, the software and technology industries are characterized by the existence of a large number of patents, copyrights, trademarks and trade secrets and by frequent litigation based on allegations of infringement or other violations of intellectual property rights. We have received, and from time to time may receive, letters claiming that our products infringe or may infringe the patents or other intellectual property rights of others. As we face increasing competition and increasing brand awareness, the possibility of additional intellectual property rights claims against us grows. Our technologies may not be able to withstand any third-party claims or rights against their use. Additionally, we have licensed from other parties proprietary technology covered by patents and other intellectual property rights, and these patents or other intellectual property rights may be challenged, invalidated or circumvented. These types of claims could harm our relationships with our customers, might deter future customers from acquiring our products or could expose us to litigation with respect to these claims. Even if we are not a party to any litigation between a customer and a third party, an adverse outcome in that litigation could make it more difficult for us to defend our intellectual property in any subsequent litigation in which we are a named as a party. Additionally, we use open source software in our products and expect to continue to use open source software in the future. We may face claims from others claiming ownership of, or seeking to enforce the terms of, an open source license, including by demanding release of the open source software, derivative works or our proprietary source code that was developed using such software. Any of these results would have a negative effect on our business and operating results.

Any additional intellectual property rights claim against us or our customers, with or without merit, could be time-consuming, expensive to litigate or settle, and divert management resources and attention. As a result of any successful intellectual property rights claim against us or our customers, we might have to pay damages or stop using technology found to be in violation of a third party's rights, which could prevent us from offering our products to our customers. We could also have to seek a license for the technology, which might not be available on reasonable terms, might significantly increase our cost of

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revenue or might require us to restrict our business activities in one or more respects. The technology also might not be available for license to us at all. As a result, we could also be required to develop alternative non-infringing technology or cease to offer a particular product, which could require significant effort and expense or hurt our revenue and financial results of operations.

Our exposure to risks associated with the use of intellectual property may be increased as a result of our past and any future acquisitions as we have a lower level of visibility into the development process with respect to acquired technology or the care taken to safeguard against infringement risks. Third parties may make infringement and similar or related claims after we have acquired technology that had not been asserted prior to our acquisition.

The success of our business depends on our ability to protect and enforce our intellectual property rights.

We rely primarily on a combination of patent, copyright, trademark, trade dress, unfair competition and trade secret laws, as well as confidentiality procedures and contractual restrictions, to establish and protect our proprietary rights. These laws, procedures and restrictions provide only limited protection. We currently have fifteen patents and have also filed patent applications, but patents may not be issued with respect to these applications. Our patents and any future patents issued to us may be challenged, invalidated or circumvented, and may not provide sufficiently broad protection or may not prove to be enforceable in actions against alleged infringers.

We endeavor to enter into agreements with our employees and contractors and with parties with which we do business in order to limit access to and disclosure of our proprietary information. We cannot be certain that the steps we have taken will prevent unauthorized use, misappropriation or reverse engineering of our technology. Moreover, others may independently develop technologies that are competitive to ours and may infringe our intellectual property. The enforcement of our intellectual property rights also depends on our legal actions against these infringers being successful, but these actions may not be successful, even when our rights have been infringed. Further, any litigation, whether or not resolved in our favor, could be costly and time-consuming.

Our exposure to risks related to the protection of intellectual property may be increased in the context of acquired technologies as we have a lower level of visibility into the development process and the actions taken to establish and protect proprietary rights in the acquired technology. In connection with past acquisitions, we have found that some associated intellectual property rights, such as domain names and trademarks in certain jurisdictions, are owned by resellers, distributors or other third parties. In the past, we have experienced difficulties in obtaining assignments of these associated intellectual property rights from third parties.

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

Our debt obligations contain restrictions that impact our business and expose us to risks that could adversely affect our liquidity and financial condition.

In October 2013, we entered into a Credit Agreement with Wells Fargo Bank, National Association and certain other lenders, which provides for a $125 million revolving credit facility with a $30 million letter of credit sublimit and a $15 million swingline loan sublimit. We have in the past, and may in the future, borrow under the Credit Agreement in order to fund working capital requirements, including, without limitation, to finance acquisitions. In October 2013, we borrowed $40.0 million at an interest rate of approximately 1.4% under a revolving loan pursuant to the Credit Agreement to facilitate our acquisition of Confio.

The Credit Agreement contains customary affirmative and negative covenants. The covenants, among other things, limit or restrict our and our subsidiaries' abilities to incur indebtedness, grant liens, make investments, merge or consolidate, dispose of assets, pay dividends or make distributions, make acquisitions and enter into certain transactions with affiliates, in each case subject to customary exceptions. We are also required to maintain compliance with a consolidated total leverage ratio and a consolidated interest coverage ratio. Our ability to comply with these financial covenants will depend on our future performance, which may be affected by financial, business, economic, regulatory and other factors summarized in this section "Risk Factors," many factors of which are outside of our control.

The Credit Agreement includes customary events of default that include, among other things, non-payment defaults, defaults due to the inaccuracy of representations and warranties, covenant defaults, indebtedness cross default, change of control default, bankruptcy and insolvency defaults, defaults due to invalidity of the documents, material judgment defaults and material adverse effect default. Any default that is not cured or waived could result in the acceleration of the obligations under the Credit Agreement, an increase in the applicable interest rate and a requirement that we pay the obligations in full. Any such default could have a material adverse effect on our liquidity and financial condition.

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In addition, the existence of this indebtedness could adversely affect our liquidity and financial condition by:

- requiring us to dedicate a substantial portion of our cash flow from operations to payments on our indebtedness, thereby reducing the availability of our cash flow to fund acquisitions, working capital, capital expenditures, research and development efforts and other general corporate purposes;
- requiring us under certain circumstances to repatriate earnings from our international operations in order to make payments on our indebtedness, which would require us to incur a U.S. federal income tax liability that is not currently accrued in our financial statements;
- requiring us to liquidate short-term or long-term investments in order to make payments on our indebtedness, which could generate losses;
- exposing us to the risk of increased interest rates as borrowings under the Credit Agreement are subject to variable rates of interest; and
- limiting our ability to borrow additional funds.

Even if we comply with all of the applicable covenants, the restrictions on the conduct of our business could adversely affect our business by, among other things, limiting our ability to take advantage of financings, mergers, acquisitions and other corporate opportunities that may be beneficial to the business. See Note 9, Credit Agreement, in the Notes to the Consolidated Financial Statements in Item 8 of Part II of this Annual Report on Form 10-K, for additional information regarding our Credit Agreement.

Failure to maintain proper and effective internal controls could have a material adverse effect on our business, operating results and stock price.

Section 404 of the Sarbanes-Oxley Act of 2002 (the "Sarbanes-Oxley Act") and related requirements require an annual management assessment of the effectiveness of our internal control over financial reporting and an audit by our independent auditors of our internal control over financial reporting. Ensuring that we have adequate internal financial and accounting controls and procedures in place so that we can produce reliable financial statements on a timely basis is a costly and time-consuming effort that needs to be re-evaluated frequently. Our internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with generally accepted accounting principles. If we fail to maintain proper and effective internal controls, our ability to produce accurate and timely financial statements could be impaired or our operating results could be harmed, either result which could have a material adverse effect on our business and stock price.

We have documented and tested our internal controls over financial reporting for the year ended December 31, 2013. If in the future we are not able to comply with the requirements of Section 404 of the Sarbanes-Oxley Act in a timely manner, or if as part of our process of documenting and testing our internal controls over financial reporting, we or our independent registered public accounting firm identify deficiencies or areas for further attention and improvement, implementing appropriate changes to our internal controls may distract our officers and employees, entail substantial costs to modify our existing processes and take significant time to complete. These changes may not, however, be effective in maintaining the adequacy of our internal controls, and any failure to maintain that adequacy, or consequent inability to produce accurate financial statements on a timely basis, could increase our operating costs and harm our business. In addition, investors' perceptions that our internal controls are inadequate or that we are unable to produce accurate financial statements on a timely basis may harm our stock price and make it more difficult for us to effectively market and sell our services to new and existing customers.

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

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

We may be subject to regulation of our marketing and customer solicitation, which could harm our business.

As part of our product download process and during our sales process, most of our customers agree to receive emails and other communications from us. We also use tracking technologies, including cookies and related technologies, to help us track the activities of the visitors to our websites and to communicate with existing and potential customers. However, we may be subject to restrictions on our ability to collect and use customer data and communicate with customers through email and phone calls. Several jurisdictions have proposed or adopted privacy-related laws that restrict or prohibit unsolicited email or “spam” or regulate the use of cookies. We expect increased regulation related to data privacy to continue. New laws and regulations may impose significant monetary penalties for violations and complex and often burdensome requirements in connection with sending commercial email or other data-driven marketing practices. As a result of such regulation, we may be required to modify or discontinue our existing marketing practices, which could increase our marketing costs.

We offer products to customers in multiple states and foreign jurisdictions and, accordingly, may become subject to laws and regulations of different jurisdictions imposing different standards and requirements related to data privacy. Our business efficiencies and economies of scale depend on generally uniform product offerings and uniform treatment of customers across all jurisdictions in which we operate. Compliance requirements that vary significantly from jurisdiction to jurisdiction would impose added costs on our business and increase liability for compliance deficiencies.

If we fail to protect confidential information against security breaches, or if our customers or potential customers are reluctant to use our websites because of privacy concerns, we might face additional costs and activity in our websites could decline.

Some of our customers pay for our products with credit cards. During the purchasing process and in connection with evaluations of our software, either we or third party providers collect and use personally identifiable information, such as credit card numbers, email addresses and phone numbers. This information could be compromised or accessed as a result of misappropriation or security breaches, and we could be subject to liability as a result. Our policies concerning the collection, use and disclosure of personally identifiable information are described on our websites. We could be subject to legal claims, government action or harm to our reputation if we or our third party service providers fail to comply or are seen as failing to comply with our policies concerning personally identifiable information or if our policies are inadequate. Concern among prospective customers regarding our use of personal information collected on our websites could keep prospective customers from purchasing our products.

Our servers and those of our third party service providers are vulnerable to computer viruses or physical or electronic break-ins. Industry-wide incidents or incidents with respect to our specific websites, including misappropriation of third party information, security breaches, or changes in industry standards, regulations or laws, could deter people from using the Internet or our websites to conduct transactions that involve the transmission of confidential information, which could harm our business.

The laws of some states and countries require businesses that maintain personal information about their residents in electronic databases to implement reasonable measures to keep that information secure. In addition, under the laws of some states and countries, if there is a breach of our computer systems and we know or suspect that unencrypted personal customer information has been stolen, we are required to inform any customers whose information was stolen, which could harm our reputation and business. Other states and countries have enacted different and often contradictory requirements for protecting personal information collected and maintained electronically. Compliance with numerous and contradictory requirements of the different states and countries is particularly difficult for an online business such as ours that collects personal information from customers in multiple jurisdictions. Failure to comply with these laws could result in legal liability. In addition, we could suffer adverse publicity and loss of customer confidence were it known that we did not take adequate measures to assure the confidentiality of the personally identifiable information that our customers had given to us. This could result in a loss of customers and revenue that could jeopardize our success. We may not be successful in avoiding potential liability or disruption of business resulting from the failure to comply with these laws. If we were required to pay any significant amount of money in satisfaction of claims under these new laws, or any similar laws enacted by other jurisdictions, or if we were forced to cease our business operations for any length of time as a result of our inability to comply fully with any of these laws, our business, operating results and financial condition could be adversely affected. Further, complying with the applicable notice requirements in the event of a security breach could result in significant costs.

If we sustain system failures, cyber attacks to our systems or to our products or other data security breaches, we could suffer a loss of revenue and increased costs, exposure to significant liability, reputational harm and other serious negative consequences.

We are heavily dependent on our technology infrastructure to sell our products and operate our business. Our servers and those of our third party service providers are vulnerable to damage or interruption from natural disasters, power loss, telecommunication failures, cyber attacks such as computer viruses, computer denial-of-service attacks, physical or electronic break-ins and other events. Computer programmers and hackers also may be able to develop and deploy viruses, worms, and other malicious software programs that attack our website or our products or otherwise exploit any security vulnerabilities of our website or our products, including those we distribute of third parties. In addition, sophisticated hardware and operating system software and applications that we procure from third parties may contain defects in design or manufacture, including “bugs” and other problems that could unexpectedly interfere with the operation of our systems.

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The foregoing security problems could result in, among other consequences, loss or theft of, our customers' proprietary or personally identifiable information. The costs to us to eliminate or address the foregoing security problems and security vulnerabilities before or after a cyber incident could be significant. Our remediation efforts may not be successful and could result in interruptions, delays or cessation of service and loss of existing or potential customers that may impede sales of our products or other critical functions. We could lose existing or potential customers in connection with any actual or perceived security vulnerabilities in our websites or our products. In addition, breaches of our security measures and the unapproved dissemination of proprietary information or sensitive or confidential data about us or our customers or other third parties, could expose us, our customers, or other third parties affected to a risk of loss or misuse of this information, result in litigation, damage our brand and reputation, or otherwise harm our business, operating results and financial condition.

Our business and financial performance could be negatively impacted by changes in tax laws or regulations.

New income, sales, use or other tax laws, statutes, rules, regulations or ordinances could be enacted at any time. Further, existing tax laws, statutes, rules, regulations or ordinances could be interpreted, changed, modified or applied adversely to us. Any changes to these existing tax laws could adversely affect our domestic and international business operations, and our business and financial performance. Additionally, these events could require us or our customers to pay additional tax amounts on a prospective or retroactive basis, as well as require us or our customers to pay fines and/or penalties and interest for past amounts deemed to be due. If we raise our product and maintenance prices to offset the costs of these changes, existing customers may elect not to renew their maintenance arrangements and potential customers may elect not to purchase our products. Additionally, new, changed, modified or newly interpreted or applied tax laws could increase our customers' and our compliance, operating and other costs, as well as the costs of our products. Further, these events could decrease the capital we have available to operate our business. Any or all of these events could adversely impact our business and financial performance.

Our results of operations for the years ended December 31, 2013 and 2011 benefit from the tax credit incentives under the U.S. research and experimentation tax credit, or R&E tax credit. Our results of operations for the year ended December 31, 2012 do not reflect an income tax benefit related to the R&E tax credits as the R&E tax credit expired on December 31, 2011. However, the R&E tax credit was extended by the signing of the American Taxpayer Relief Act of 2012, or the Act, on January 2, 2013. The Act retroactively reinstated and extended the R&E tax credit from January 1, 2012 through December 31, 2013. Since the Act was enacted during 2013, the income tax benefit related to the 2012 R&E tax credit was reflected in our results of operations for the year ended December 31, 2013.

The R&E tax credit expired on December 31, 2013, and may not be renewed, or if renewed, it may be renewed on terms significantly less favorable than current tax incentives or on terms resulting in our disqualification from the benefits of the R&E tax credit. The elimination or significant reduction in the tax credit would increase our effective tax rate and would adversely affect our results of operations.

Additional liabilities related to taxes or potential tax adjustments could adversely impact our business and financial performance.

We are subject to tax and related obligations in various federal, state, local and foreign jurisdictions in which we operate or do business. The taxing rules of the various jurisdictions in which we operate or do business are often complex and subject to differing interpretations. Tax authorities could challenge our tax positions we historically have taken, or intend to take in the future, or may audit the tax filings we have made and assess additional taxes. Tax authorities may also assess taxes in jurisdictions where we have not made tax filings. Any assessments incurred could be material, and may also involve the imposition of substantial penalties and interest. Significant judgment is required in evaluating our tax positions and in establishing appropriate reserves, and the resolutions of our tax positions are unpredictable. The payment of additional taxes, penalties or interest resulting from any assessments could adversely impact our business and financial performance.

We intend to invest our non-U.S. earnings permanently in foreign operations. If for some reason our need for U.S. cash changes, and we are unable to remit these foreign earnings to our U.S. entities in a tax-free manner, we could incur material U.S. federal tax liabilities which could adversely impact our business and financial performance.

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

As Internet commerce continues to evolve, increasing regulation by federal, state or foreign agencies becomes more likely. For example, we believe increased regulation is likely in the area of data privacy. Laws and regulations applying to the solicitation, collection, processing or use of personal or consumer information could affect our customers' ability to use and share data, potentially reducing demand for our products. In addition, taxation of products and services provided over the Internet or other charges imposed by government agencies or by private organizations for accessing the Internet may also be imposed. Any regulation imposing greater fees for Internet use or restricting information exchange over the Internet could

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result in a decline in the use of the Internet and the viability of Internet-based services and product offerings, which could harm our business and operating results.

Risks Related to Ownership of Our Common Stock

Our stock price may be volatile.

The market price of our common stock has been and could be subject to wide fluctuations in response to, among other things, the factors described in this “Risk Factors” section or otherwise, and other factors beyond our control, such as fluctuations in the valuations of companies perceived by investors to be comparable to us.

Furthermore, the stock markets have experienced price and volume fluctuations that have affected and continue to affect the market prices of equity securities of many companies. These fluctuations often have been unrelated or disproportionate to the operating performance of those companies. These broad market fluctuations, as well as general economic, political and market conditions, such as sovereign debt issues, interest rate changes and international currency fluctuations, may negatively affect the market price of our common stock.

We and other companies that have experienced volatility in the market price of their stock have become subject to securities class action litigation. We may be the target of additional litigation of this type in the future. Additional securities litigation against us could result in substantial costs and divert our management’s attention from other business concerns, which could seriously harm our business.

Your ownership percentage could be diluted and our stock price could decline due to the issuance of additional shares of stock in connection with acquisitions, our equity incentive plans or otherwise.

We have a number of shares of common stock authorized but unissued and not reserved for issuance under our equity incentive plans or otherwise. As of December 31, 2013, we had 75.0 million shares outstanding, 4.6 million shares subject to issuance upon the exercise of stock options and settlement of restricted stock units, and 12.1 million shares available for issuance under our 2008 equity incentive plan, or 2008 Plan. In addition, our 2008 Plan contains an evergreen provision, which provides for an automatic annual increase in the number of shares available for issuance under the 2008 Plan on the first day of each fiscal year in an amount equal to the lesser of 6.0 million shares, 4.75% of the number of shares outstanding on the last day of the immediately preceding fiscal year or such lesser number of shares as may be determined by our board of directors. For 2014, the amount of the annual increase pursuant to the evergreen provision was 1.8 million shares of common stock. We may issue all of these shares without any action or approval by our stockholders. We intend to continue to pursue strategic acquisitions and may pay for such acquisitions, in part or in full, through the issuance of additional equity. Any issuance of shares in connection with our acquisitions, the exercise of stock options, the settlement of restricted stock units or otherwise would dilute the percentage ownership held by our then existing stockholders and could cause our stock price to decline.

We can issue shares of preferred stock without stockholder approval, which could adversely affect the rights of common stockholders.

Our amended and restated certificate of incorporation permits us to establish the rights, privileges, preferences, and restrictions, including voting rights, of future series of our preferred stock and to issue such stock without approval from our stockholders. The rights of holders of our common stock may suffer as a result of the rights granted to holders of preferred stock that we may issue in the future. In addition, we could issue preferred stock to prevent a change in control of us, depriving common stockholders of an opportunity to sell their stock at a price in excess of the prevailing market price.

Our charter documents and Delaware law could prevent a takeover that stockholders consider favorable and could also reduce the market price of our stock.

Our amended and restated certificate of incorporation and our amended and restated bylaws contain provisions that could delay or prevent a change in control of our Company. These provisions could also make it more difficult for stockholders to elect directors and take other corporate actions. These provisions include:

- a classified board of directors with three-year staggered terms;
- not providing for cumulative voting in the election of directors;
- authorizing the board to issue, without stockholder approval, preferred stock with rights senior to those of our common stock;
- prohibiting stockholder action by written consent; and

- requiring advance notification of stockholder nominations and proposals.

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These and other provisions in our amended and restated certificate of incorporation and our amended and restated bylaws and under Delaware law could discourage potential takeover attempts, reduce the price that investors might be willing to pay in the future for shares of our common stock and result in the market price of our common stock being lower than it would be without these provisions.

If securities analysts do not continue to publish research or reports about our business or if they publish negative evaluations of our stock, the price of our stock could decline.

We believe that the trading price for our common stock will be affected by research or reports that industry or financial analysts publish about us or our business. If one or more of the analysts who may elect to cover us downgrade their evaluations of our stock, the price of our stock could decline. If one or more of these analysts cease coverage of our company, we could lose visibility in the market for our stock, which in turn could cause our stock price to decline.

We do not intend to pay dividends on our common stock.

We have neither declared nor paid any cash dividends on our common stock. We do not expect to pay dividends on our common stock for the foreseeable future and currently anticipate that all of our earnings will be used for the operation and growth of our business.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

We lease our offices and do not own any real estate. Our corporate headquarters is located in Austin, Texas and currently consists of 109,645 square feet of leased space. We plan to move our corporate headquarters in the second quarter of 2014 to a new location in Austin, Texas. Our future corporate headquarters will consist of approximately 172,000 square feet in the first year and will increase to approximately 230,000 square feet in the second year. We also lease office space domestically and internationally in various locations for our operations, including facilities located in Utah, Colorado, Canada, the Czech Republic, Ireland and India. See Note 15, Commitments and Contingencies, in the Notes to the Consolidated Financial Statements for more information about our lease commitments.

We believe our current facilities, combined with our planned expansions to our facilities, will be adequate for the foreseeable future. If we require additional or substitute space, we believe that we will be able to obtain such space on acceptable, commercially reasonable terms.

ITEM 3. LEGAL PROCEEDINGS

From time to time, we have been and may be involved in various legal proceedings and claims, including the pending litigation discussed below, as well as other legal proceedings and claims that have not been fully resolved and that have arisen in our ordinary course of business. In the opinion of management, there is not at least a reasonable possibility that we may incur a material loss, or a material loss in excess of a recorded accrual, with respect to any legal proceedings. However, the outcome of legal proceedings and claims brought against us are subject to significant uncertainty. Therefore, although management considers the likelihood of such an outcome to be remote, if one or more of these legal matters were resolved against us in the same reporting period for amounts in excess of management's expectations, our consolidated financial statements for a particular period could be materially adversely affected. See the risk factor "Litigation exposure related to our pending and any future litigation could adversely affect our results of operations, profitability and cash flows" in Part I, Item 1A under the heading "Risk Factors."

Uniloc Cases

Uniloc USA, Inc. and parent and/or affiliates have brought two lawsuits against the Company and have brought a series of lawsuits against numerous software companies around the world.

'216 Case

On September 13, 2010, Uniloc USA, Inc. and Uniloc (Singapore) Private Limited (“Uniloc”) brought a lawsuit against the Company and several other defendants in the United States District Court for the Eastern District of Texas (“Eastern District of Texas”). The complaint filed by Uniloc alleges that the Company and each of the other fifteen named defendants' software infringe U.S. patent 5,490,216 (“216 Patent”) allegedly owned by Uniloc. Uniloc alleges that the Company's software, specifically its license key system, infringes upon its patent that utilizes a system for activating software products through a registration process. In September 2011, another company, Sureloc, Inc. (“Sureloc”) claimed that it owned the '216 Patent. As a result, on November 3, 2011, Uniloc and its affiliates filed a lawsuit in the Superior Court of the State of California against Sureloc, Patrick Rooney, and Does 1-100 (the “Sureloc case”), seeking, among other things, a declaratory judgment that Uniloc and not Sureloc, is the exclusive owner of the '216 Patent. Once the Eastern District of Texas was informed of the Sureloc case, all Uniloc cases alleging infringement of the '216 Patent that were pending before the Eastern District of Texas were stayed on December 1, 2011. Subsequently, Uniloc and Sureloc settled their dispute regarding ownership of the '216 Patent, and the California state case against Sureloc case was dismissed with prejudice on September 25, 2012.

On January 25, 2013, the Eastern District of Texas lifted the stay of all Uniloc '216 Patent cases and set the cases for a status conference on February 25, 2013. Following the status conference, on March 21, 2013 Uniloc filed a motion to dismiss all remaining defendants in the '216 Patent cases, without prejudice, and simultaneously filed a new complaint against the Company (as well as any other defendants from the original case that had not reached a settlement agreement with Uniloc). Because this lawsuit is in the initial stages, it is not possible to reliably assess the outcome of the litigation. Therefore, we cannot currently estimate the potential loss, if any, associated with the litigation. We intend to contest the claims associated with this lawsuit vigorously.

'696 Case

On March 30, 2012, Uniloc Luxembourg, S.A. and Uniloc USA, Inc. brought a lawsuit against the Company and several other defendants in the Eastern District of Texas. The complaint filed by Uniloc alleges that the Company and each of the other fifteen named defendants' software infringe U.S. patent 7,024,696 (“696 Patent”) allegedly owned by Uniloc. Uniloc alleges that the Company's software, specifically its license key system, infringes upon its patent that utilizes a system for activating software products through a registration process. On November 18, 2013, the Eastern District of Texas, at the request of Uniloc dismissed this case with prejudice. Therefore, the case is no longer pending and cannot be refiled by Uniloc.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

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PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Market Information

Our common stock is listed on the New York Stock Exchange ("NYSE") under the symbol "SWI." The following table sets forth for the periods indicated the high and low sales prices per share of our common stock as reported on the NYSE:

	Sales Price Per Share in 2013	
Quarter	Low	High
Fourth Quarter	$31.94	$39.15
Third Quarter	$34.54	$46.25
Second Quarter	$37.96	$59.57
First Quarter	$52.06	$61.52

	Sales Price Per Share in 2012	
Quarter	Low	High
Fourth Quarter	$44.83	$58.57
Third Quarter	$39.10	$60.95
Second Quarter	$35.34	$48.64
First Quarter	$27.25	$42.22

On February 12, 2014, the last reported sales price of our common stock on the NYSE was $43.10 per share and, as of December 31, 2013, there were 22 holders of record of our common stock. Because many of our shares of common stock are held by brokers and other institutions on behalf of stockholders, this number is not representative of the total number of stockholders represented by these stockholders of record.

Dividend Policy

We have neither declared nor paid any cash dividends on our common stock and we do not expect to pay dividends on our common stock for the foreseeable future. We anticipate that all of our earnings will be used for the operation and growth of our business. Any future determination to pay dividends on our common stock would be subject to the discretion of our board of directors and would depend upon various factors, including our results of operations, financial condition and liquidity requirements, restrictions that may be imposed by applicable law and our contracts, and other factors deemed relevant by our board of directors.

Performance Graph

The graph set forth below compares the cumulative total stockholder return on our common stock between May 20, 2009 (the date of our initial public offering, or IPO) and December 31, 2013, with the cumulative total return of (i) the Russell Midcap Index and (ii) the Nasdaq Computer Index, or the Industry Index. This graph assumes the investment of $100 on May 20, 2009 in our common stock at our IPO offering price of $12.50 per share, the Russell Midcap Index and the Industry Index, and assumes the reinvestment of dividends, if any. The Industry Index consists of NASDAQ-listed computer hardware and software companies that provide products or services. Note that historic stock price performance is not necessarily indicative of future stock price performance.

The information contained in the Stock Performance Graph shall not be deemed to be soliciting material or to be filed with the SEC nor shall such information be incorporated by reference into any future filing under the Securities Act of 1933 or the Exchange Act, except to the extent we specifically incorporate it by reference into such filing.

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Issuer Purchases of Equity Securities

Period	Number of Shares Purchased	Average Price Paid Per Share (1)	Total Number of Shares Purchased as Part of a Publicly Announced Plan or Program (2)	Approximate Dollar Value of Shares That May Yet Be Purchased Under the Plan or Program (in thousands) (1), (2)
October 1-31, 2013	212,275	$35.64	212,275	$28,798
November 1-30, 2013	177,766	33.64	177,766	22,818
December 1-31, 2013	146,354	34.66	146,354	17,746
Total	536,395	34.71	536,395	17,746

(1) Amounts exclude fees and commissions associated with the share repurchases.

(2) On July 29, 2013, we announced that our Board of Directors approved a share repurchase program, authorizing us to purchase up to $50.0 million of our outstanding common stock. We are authorized to make purchases in the open market, including pursuant to a Rule 10b5-1 plan, or in privately negotiated transactions. We expect that purchases will be funded using our cash on hand, cash generated from operations or borrowings under our Credit Agreement. Shares were retired upon repurchase. We expect the repurchases will occur on or before August 1, 2014 although the exact timing of repurchases and number of shares of common stock to be purchased will depend upon market conditions and other factors. The program may be extended, suspended or discontinued at any time without prior notice.

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ITEM 6. SELECTED CONSOLIDATED FINANCIAL DATA

We have derived the following consolidated statement of income data for 2013, 2012 and 2011 and consolidated balance sheet data as of December 31, 2013 and 2012 from our audited consolidated financial statements contained in this Annual Report on Form 10-K. We have derived the following consolidated statement of income data for 2010 and 2009 and consolidated balance sheet data as of December 31, 2011, 2010 and 2009 from our audited consolidated financial statements included in our other SEC filings and not included in this Annual Report. You should read the consolidated financial data set forth below in conjunction with our consolidated financial statements and related notes and the information under "Management's Discussion and Analysis of Financial Condition and Results of Operations." Our historical results are not necessarily indicative of our results to be expected in any future period.

Consolidated Statements of Income Data:	Year Ended December 31,				
(in thousands, except per share data)	2013	2012	2011	2010	2009
Revenue:					
License	$135,839	$123,984	$92,254	$75,603	$62,378
Maintenance and other	191,491	144,980	106,104	76,790	54,068
Subscription (1)	8,055	—	—	—	—
Total revenue	335,385	268,964	198,358	152,393	116,446
Cost of revenue	27,916	18,400	11,989	7,930	4,860
Gross profit	307,469	250,564	186,369	144,463	111,586
Operating expenses:					
Sales and marketing	99,289	73,046	53,850	43,252	30,548
Research and development	37,514	28,769	21,332	15,731	11,199
General and administrative	49,044	35,649	28,076	23,476	26,038
Accrued earnout gain	(125)	(570)	(664)	—	—
Total operating expenses	185,722	136,894	102,594	82,459	67,785
Operating income	121,747	113,670	83,775	62,004	43,801
Other income (expense):					
Interest income	396	430	308	177	267
Interest expense	(215)	—	—	(1,146)	(4,253)
Other income (expense), net	(425)	419	720	115	90
Total other income (expense)	(244)	849	1,028	(854)	(3,896)
Income before income taxes	121,503	114,519	84,803	61,150	39,905
Income tax expense	31,725	33,176	22,360	16,404	10,396
Net income	$89,778	$81,343	$62,443	$44,746	$29,509
Basic earnings per share available to common stockholders	$1.19	$1.10	$0.86	$0.65	$0.58
Diluted earnings per share available to common stockholders	$1.17	$1.07	$0.84	$0.61	$0.52
Shares used in computation of basic earnings per share	75,182	74,166	72,812	68,664	51,042
Shares used in computation of diluted earnings per share	76,475	76,035	74,413	72,862	56,824

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Consolidated Balance Sheet Data:	December 31,				
(in thousands)	2013	2012	2011	2010	2009
Cash and cash equivalents	$165,973	$179,702	$122,707	$142,003	$129,788
Short-term and long-term investments	30,339	62,099	29,688	—	—
Working capital	48,991	146,554	93,187	108,203	89,699
Deferred revenue	135,191	102,756	77,147	55,758	38,647
Total assets	706,342	517,395	362,408	247,477	181,470
Current debt obligations (2)	40,000	—	—	—	—
Long-term obligations	21,791	9,391	4,367	3,992	29,377
Total stockholders’ equity	483,894	382,814	264,947	175,609	89,066

(1) Subscription revenue is from the sale of products introduced as a result of our acquisition of N-able in the second quarter of 2013. See Note 2, Acquisitions, in the Notes to the Consolidated Financial Statements in Item 8 of Part II of this Annual Report on Form 10-K, for additional information regarding our acquisition of N-able.

(2) Current debt obligations as of December 31, 2013 consist of outstanding principal amounts under a revolving loan that was used to finance a portion of the consideration paid upon the acquisition of Confio. See Note 9, Credit Agreement, in the Notes to the Consolidated Financial Statements in Item 8 of Part II of this Annual Report on Form 10-K, for additional information regarding our Credit Agreement and Note 2, Acquisitions, in the Notes to the Consolidated Financial Statements in Item 8 of Part II of this Annual Report on Form 10-K, for additional information regarding our acquisition of Confio.

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ITEM 7. 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 "Selected Consolidated Financial Data" and our consolidated financial statements and related notes included elsewhere in this report. In addition to historical consolidated financial information, the following discussion contains forward-looking statements that reflect our plans, estimates and beliefs. Our actual results could differ materially and adversely from those anticipated in the forward-looking statements. See the sections entitled "Safe Harbor Cautionary Statement" and "Risk Factors" above for a discussion of the uncertainties, risks and assumptions associated with these statements.

Overview

We design, develop, market, sell and support powerful yet easy-to-use enterprise-class IT infrastructure management software to IT professionals in organizations of all sizes. Our product offerings range from individual software tools to more comprehensive software products that solve problems encountered every day by IT professionals and help to enable efficient and effective management of their network, systems and application infrastructure. Our products are ready-to-use, featuring intuitive and easily customized user interfaces and built-in workflows. Our products can be downloaded directly from our websites and installed and configured by our end-users in a matter of hours. Our customers include small- and mid-size businesses, large enterprises, managed service providers, and local, state and federal government entities that have purchased our products.

Acquisitions

We have made multiple acquisitions of businesses as part of our growth strategy, including the following acquisitions during 2013:

- In May 2013, we acquired N-able Technologies International, Inc., or N-able, for $127.7 million. The acquisition of N-able increased our product offerings and we believe will allow us to leverage the large opportunity associated with the adoption of cloud and SaaS-based services among small and medium-sized businesses, or SMBs, by enhancing our remote monitoring and management, or RMM, offerings and adding managed service provider, or MSP, service automation to the broad range of management challenges that we address for the IT industry.
- In October 2013, we acquired Confio Corporation, or Confio, a database performance management company, for approximately $103.0 million. By acquiring Confio, we added database performance management solutions to our product portfolio.

We account for our acquisitions using the acquisition method of accounting. Accordingly, the financial results for our acquisitions are included in our consolidated financial results since the applicable acquisition dates. For further information regarding these acquisitions, see Note 2, Acquisitions in the Notes to Consolidated Financial Statements in Item 8 of Part II of this Annual Report on Form 10-K.

Key Financial Highlights

Key financial highlights for 2013 include the following:

- Total revenue was $335.4 million for 2013 compared to $269.0 million for 2012, or an increase of 24.7%;
- Combined maintenance and subscription revenue for 2013 was $199.5 million compared to $145.0 million for 2012, representing 37.6% year-over-year growth in recurring revenue;
- Net income was $89.8 million for 2013 compared to $81.3 million for 2012, or an increase of 10.4%;
- Net income was $1.17 per share on a fully diluted basis for 2013 compared to $1.07 per share on a fully diluted basis for 2012, or an increase of 9.3%, and
- Cash flow from operating activities was $163.3 million for 2013 compared to $143.4 million for 2012, or an increase of 13.9%.

In 2013, we invested across our business and, in particular, in areas that we believe are an important foundation for our long term growth such as:

- We released key new versions of our products, which continued to improve the usability and add features our customers rely on daily. We also released additional free tools, which reflects our continued commitment to the IT community and our customers;

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- We focused on finding new ways to communicate and sell to our customer base. Our customer base continues to grow and evolve with our business and we have to find new ways to deliver value to these customers;
- We continued to expand our international research and development locations allowing us to respond to user demand and support new product releases and enhancements for our acquired and internally developed technologies. In addition, we are focused on the integration of the core products in our portfolio in order to deliver a suite of products with a seamless user experience; and
- We invested in brand awareness in emerging markets, such as security and systems management, and critical geographies like Germany, UK, Australia and Brazil. This investment was designed to place us front and center as companies search for information and solutions for their IT management challenges.

We are committed to our business model and have continued to focus on ways to leverage and refine our model. We are pursuing a number of strategies that we believe will enable us to continue to grow. We have made progress towards our goals in recent periods but there are still many areas where we believe that we can continue to grow and improve. We expect to grow our business by investing in the following initiatives:

- Expanding our web presence, brand awareness and improving our communication with prospects and our current customer base both domestically and internationally;
- Accelerating the rate at which we are selling additional products into our install base;
- Improving the competitive positioning of our products by investing in new product features and infrastructure;
- Increasing our presence in several key geographic markets including Asia-Pacific, Latin America, Europe, Middle East and Africa by expanding our product portfolio, localizing marketing material, and establishing new relationships with distributors and resellers;
- Acquiring and internally developing products that will expand our presence in our current markets or new markets; and
- Expanding our international operations company-wide at lower cost locations to drive our competitive advantage.

We expect to continue to generate solid growth while delivering strong operating income and to increase our cash flows from operating activities with our disciplined approach to investing in our business combined with our large market opportunity.

Key Business Metrics

We review a number of key business metrics to help us monitor the performance of our business model and to identify trends affecting our business. The measures that we believe are the primary indicators of our quarterly and annual performance are as follows:

Revenue Growth

Revenue growth includes the total revenue growth in our license, maintenance and subscription revenue, which are critical to our long-term success. We have employed a differentiated business model for marketing and selling high volumes of enterprise-class software, which is focused on revenue growth at high operating margins. We regularly review our total revenue growth to measure the success of our investments and strategic business decisions. We have built a financial and operational model that focuses on the long-term value of our customer relationships. After the initial new license or subscription purchase, our goal is to create opportunities for sales of additional products, license or subscription upgrades and renewal purchases from the customer. This is an important component of our financial model and future revenue growth. This model is based on the premise that we will be able to deliver ongoing value to our customers and maintain a long-term financial relationship with the users of our IT management products. Our recurring revenue, which includes maintenance and subscription revenue, is reflective of the relationship we have built with our customers. Our annual revenue growth percentages were 24.7%, 35.6% and 30.2% for the years ended December 31, 2013, 2012 and 2011, respectively. We expect our revenue growth to be approximately 22-25% for the fiscal year 2014.

Non-GAAP Operating Income and Non-GAAP Operating Margin

Our management uses non-GAAP operating income and non-GAAP operating margin as key measures of our performance. Because our non-GAAP operating income excludes certain items such as amortization of intangible assets, stock-based compensation and related employer-paid payroll taxes, certain acquisition related adjustments and restructuring charges that may not be indicative of our core business, we believe that this measure provides us with additional useful information to measure and understand our performance, particularly with respect to changes in performance from period to period. We use non-GAAP operating income and non-GAAP operating margin in the preparation of our budgets and to measure and monitor our performance. Non-GAAP operating income and non-GAAP operating margin is not determined in accordance with GAAP and is not a substitute for, or superior to, financial measures determined in accordance with GAAP. We increased our investments in the business in the last half of 2013 and we expect our non-GAAP operating margin to be approximately 40-41% for fiscal year 2014.

For further discussion regarding non-GAAP financial measures including non-GAAP operating income, see "Non-GAAP Financial Measures" below.

Opportunities, Trends and Uncertainties

Businesses, governments and other organizations are increasingly relying on networks, systems, and applications to execute their operations, facilitate their internal and external communications and transact business with their customers and partners. The size of these networks, the number of applications and servers, and the complexity of physical and virtual server environments are increasing as organizations place more reliance on them. In addition, business initiatives to capture, store, and analyze an increasing amount of organizational data are creating new IT management challenges. Furthermore, the adoption of cloud computing technologies, which is shifting a growing number of critical workloads off premises, is also creating new IT management complexities and placing increasing importance on the performance of IT assets as compute resources become more distributed. The development and evolution of cloud computing technologies is also allowing a growing number of small and medium-sized organizations to rely upon third parties, known as managed service providers, for their IT management needs. These managed service providers need powerful, yet easy-to-use and affordable solutions in order to address a wide range of IT management issues for the thousands of small and medium-sized organizations they serve.

In order to address these challenges, we offer a cohesive portfolio of powerful, yet easy-to-use and affordably priced IT management products spanning networks, systems, and application management. This includes software that we have either developed or acquired that allows IT professionals to manage the performance, health, and configurations of network devices, firewalls, applications, physical and virtual servers, storage devices, as well as software for log and security information management. It also includes software that provides IT professionals with mobile and remote access to their IT infrastructure and software to help them track and resolve IT issues along with their IT assets. Lastly, our portfolio includes a set of cloud-based remote monitoring and management products that allow managed service providers to remotely access and address a broad range of IT issues faced by their customers in order to ensure the performance and security of their networks, desktops, servers, and other proprietary systems. We believe that IT-related trends and the limitations of existing offerings present a significant market opportunity for our products and we have begun to increase our investment as a percentage of revenue to take advantage of this market opportunity. We expect our revenue to continue to grow as we capitalize on these and other market opportunities through acquisitions and development. However, our ability to meet our target will depend on a number of factors and assumptions, many of which are outside of our control. Further, any revenue growth and operating synergies of our acquired products and businesses depends on our ability to successfully integrate those products and businesses and may be lower than expected if we are unable to do so in the future.

In 2013, we recognized 26.5% of our revenue from sales by our international subsidiaries, which includes all subsidiaries outside of North America. We believe there is a substantial opportunity for additional sales of our software in Europe, Middle East and Africa, or EMEA, region, the Asian-Pacific region, and the Latin American region. We intend to increase our sales, marketing and support operations in these regions. However, we believe there is significant uncertainty regarding the economic conditions in certain of these geographic regions, particularly in parts of Europe. While we believe that any difficult economic conditions may adversely affect the sales of our products, this could also offer us an opportunity to market and sell our products to mid-size businesses and enterprise customers at compelling prices compared to the prices of some competing products.

We expect the U.S. federal government to continue to be a significant market opportunity, as we believe the ease of deployment, power and scalability of our products gives us a competitive advantage to sell to various agencies and departments of the U.S. federal government. The U.S. federal government new license sales, including both direct sales and sales through distributors and resellers, were 9.4% of our total new license sales in 2013 as compared to 10.7% and 12.8% of our total new license sales in 2012 and 2011, respectively. We have experienced and continue to expect inconsistency in the buying pattern of the U.S. federal government for larger transactions with our products. We believe that many of our larger transactions, both new licenses and maintenance renewals, with the U.S. federal government are dependent on specific projects that may not be continued at the same scale in the future due to budgetary cuts or other reasons, and the reduction or cancellation of specific projects such as these could result in our sales to the U.S. federal government growing less rapidly than expected or even decreasing. In addition, our sales, both new licenses and maintenance renewals, to the U.S. federal government are largely dependent on systems integrators, distributors and resellers whose purchases from us have been difficult to predict.

Key Components of Our Results of Operations

Sources of Revenue

Our revenue is primarily comprised of license, maintenance and subscription revenue.

License, Maintenance and Other Revenue. We primarily license our software under perpetual licenses, which ordinarily include one year of maintenance as part of the initial purchase price of the product. License revenue reflects the revenue recognized from sales of new perpetual licenses and upgrades of license size to our software. We have experienced annual growth in license revenue. Customers can renew, and generally have renewed, their maintenance agreements at our standard list maintenance renewal pricing for their software products. Current customers with maintenance agreements are entitled to receive unspecified upgrades or enhancements when and if they become available. Maintenance revenue is an important source of our future revenue. We have experienced strong and consistent annual and quarterly growth in maintenance and other revenue. Because our maintenance base continues to grow each year due to new license sales, high customer retention and acquisitions, we expect maintenance revenue to continue to increase in absolute dollars in future periods.

Subscription Revenue. We primarily derive subscription revenue from fees received from customers for time-based license arrangements and software-as-a-service, or SaaS, offerings which were introduced during the second quarter of 2013 as a result of our acquisition of N-able. We currently sell our subscription products separately from our perpetual offerings.

Cost of Revenue

Cost of revenue primarily consists of personnel costs related to providing technical support services, amortization of acquired developed product technologies and royalty and hosting fees. Personnel costs include salaries, bonuses and stock-based compensation and related employer-paid payroll taxes for technical support personnel, as well as an allocation of our facilities, information technology, employee benefit and other overhead costs. We allocate stock-based compensation expense and related employer-paid payroll taxes to personnel costs based on the expense category in which the option or restricted stock unit holder works. We allocate overhead, such as rent, computer and other technology costs, and employee benefit costs to personnel costs in each expense category based on worldwide headcount in that category.

The amortization of developed product technologies can vary significantly each period based on the size and timing of our acquisitions. We expect our cost of revenue to increase in absolute dollars and to fluctuate as a percentage of revenue as we acquire additional companies or technologies and as we increase our headcount to support new customers and product offerings.

Operating Expenses

We classify our operating expenses into four categories: sales and marketing, research and development, general and administrative and accrued earnout gain.

Our operating expenses primarily consist of personnel costs, contract research and development costs, marketing program costs and legal, accounting, consulting and other professional service fees. Personnel costs for each category of operating expenses primarily include employee compensation costs and facility overhead costs. We include restructuring charges related to severance and relocation in the employee's respective department.

Our operating expenses increased in absolute dollars and as a percentage of revenue in 2013 compared to 2012 and 2011, as we have continued to build infrastructure and add employees through acquisitions and organic growth across all departments in order to accelerate and support our growth. The number of full-time employees as of December 31, 2013 was 1,312, as compared to 865 as of December 31, 2012 and 628 as of December 31, 2011. We added 188 full-time employees with the N-able acquisition in May 2013 and 70 full-time employees with the acquisition of Confio in October 2013, which increased our operating expenses in the second half of 2013. We expect these acquisitions will continue to increase our operating expenses in future periods as we invest in these businesses.

We expect our operating expenses to continue to increase in absolute dollars as we make long-term investments in our business both domestically and internationally. As we acquire additional companies or technologies and integrate the businesses, our operating expenses in future periods may increase in absolute dollars and fluctuate as a percentage of revenue as a result of such acquisitions. In addition, we intend to continue to grant equity awards to our current executives and employees and those who join us in the future through acquisitions or otherwise, which will result in additional stock-based compensation expense.

Sales and Marketing. Sales and marketing expenses primarily consist of personnel costs for our sales, marketing and business development employees and executives, commissions earned by our sales personnel, the cost of marketing programs such as paid search, trade shows, search engine optimization and management, website maintenance and design and the cost of business development programs. We will continue to hire sales personnel in the United States and in our international sales offices to drive new license sales growth. We also expect to continue to invest in our websites, online user community site, brand awareness initiatives and marketing programs to drive customer downloads and support our new product launches.

Research and Development. Research and development expenses primarily consist of personnel costs for our product development employees and executives and, to a lesser extent, contractor fees. We have devoted our development efforts primarily to expanding our product line and increasing the functionality and enhancing the ease-of-use of our software products. We have significantly increased our research and development employee headcount with the acquisition of N-able and the continued expansion of our research and development centers in the Czech Republic and India. We expect to continue to invest in our research and development activities by hiring engineers in our international locations, which will allow us to continue our research and development growth strategy internationally.

General and Administrative. General and administrative expenses primarily consist of personnel costs for our executive, finance, legal, human resources and administrative personnel and amortization of acquired intangible assets. Legal, accounting and other professional service fees, restructuring charges related to the closing of certain offices along with general corporate expenses are also recorded in general and administrative expenses. We expect to incur higher administrative costs in future periods as our business continues to grow both organically and through acquisitions.

Accrued Earnout Gain. Accrued earnout gain represents the change in the fair value of the contingent consideration liability recorded in connection with our acquisitions due to subsequent adjustments in the probability assumptions. We review the probability of achieving the earnout objectives each quarter to determine if the probability assumptions need to be adjusted and the contingent consideration revalued.

Other Income (Expense)

Other income (expense) primarily consists of interest income, interest expense, transactional foreign exchange gains (losses), foreign exchange contracts gains (losses) and grant income. We periodically receive government grant income related to grants in our Czech Republic and Ireland entities for the creation of job positions and related training costs. The amount and timing of the grant payments is determined by the Czech and Irish governments. Interest income represents interest received on our cash, cash equivalents and short-term and long-term investments, including any amortization or accretion of the premium and discount. Interest expense is associated with outstanding borrowings under our Credit Agreement dated October 2013. Foreign exchange gains (losses) primarily relate to expenses and billing transactions denominated in currencies other than the functional currency of the associated subsidiary. Foreign exchange contracts gains (losses) relate to the settlement of foreign currency forward contracts utilized to hedge foreign currency exposures that are not formally designated as hedges.

Income Tax Expense

Income tax expense primarily consists of corporate income taxes related to profits resulting from the sale of our software offerings by our four entities that sell our software, two in the United States, one in Canada and one in Ireland. The rate of taxation on income earned by our U.S. entities is higher than the rate of taxation on income earned by our Canadian and Irish entities. If our international income, as a percentage of total income, increases as we expect, then our effective income tax rate should correspondingly decline. However, our effective tax rate may be affected by many other factors, such as changes in tax laws, regulations or rates, new interpretations of existing laws or regulations, the impact of accounting for stock-based compensation, the impact of accounting for business combinations, the impact of accounting for uncertain tax positions, changes in our international structure, shifts in the amount of taxable income earned in the United States, as compared with other regions in the world, and changes in overall levels of income before tax.

Our results of operations reflect an income tax benefit from the tax credit incentives under the U.S. research and experimentation tax credit, or R&E tax credit, for the years ended December 31, 2011 and 2013. Our results of operations for the year ended December 31, 2012 do not reflect an income tax benefit related to the R&E tax credits as the R&E tax credit expired on December 31, 2011. However, the R&E tax credit was extended by the signing of the American Taxpayer Relief Act of 2012, or the Act, on January 2, 2013. The Act retroactively reinstated and extended the R&E tax credit from January 1, 2012 through December 31, 2013. Since the Act was enacted during 2013, the income tax benefit related to the 2012 R&E tax credit was reflected in our results of operations for the year ended December 31, 2013. Additionally, the 2013 R&E tax credit is also reflected in our results of operations for the year ended December 31, 2013.

The tax credit expired on December 31, 2013, and may not be renewed, or if renewed, it may be renewed on terms significantly less favorable than current tax incentives or on terms resulting in our disqualification from the benefits of the R&E tax credit. The elimination or significant reduction in the R&E tax credit would increase our effective tax rate and could adversely affect our results of operations in the future.

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Critical Accounting Policies and Estimates

Our consolidated financial statements are prepared in conformity with United States of America generally accepted accounting principles, or GAAP, and require our management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, costs and expenses and related disclosures. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances. In many instances, we could reasonably use different accounting estimates, and in some instances, changes in the accounting estimates are reasonably likely to occur from period to period. Accordingly, actual results could differ significantly from the estimates made by our management. To the extent that there are differences between our estimates and actual results, our future financial statement presentation, financial condition, results of operations and cash flows will be affected, perhaps materially.

In many cases, the accounting treatment of a particular transaction is specifically dictated by GAAP and does not require management's judgment in its application, while in other cases, management's judgment is required in selecting among available alternative accounting standards that allow different accounting treatment for similar transactions. We believe that these accounting policies requiring significant management judgment and estimates are critical to understanding our historical and future performance, as these policies relate to the more significant areas of our financial results. These critical accounting policies are:

- Valuation of goodwill, intangibles, long-lived assets and contingent consideration, including accrued earnouts;
- Revenue recognition;
- Stock-based compensation;
- Income taxes; and
- Loss contingencies.

Acquisitions, Goodwill and Identifiable Intangible Assets. When we acquire businesses, we allocate the purchase price to the fair value of the assets acquired and liabilities assumed, including identifiable intangible assets. Any residual purchase price is recorded as goodwill. We must also estimate the fair value of any contingent consideration. The operating results of acquisitions are included in our consolidated financial statements from the effective date of the acquisition.

The fair value of identifiable intangible assets is based on significant judgments made by management. We typically engage third party valuation appraisal firms to assist us in determining the fair values and useful lives of the assets acquired. Such valuations and useful life determinations require us to make significant estimates and assumptions. These estimates and assumptions are based on historical experience and information obtained from management, and also include, but are not limited to, future expected cash flows earned from the intangible asset and discount rates applied in determining the present value of those cash flows. Unanticipated events and circumstances may occur that could affect the accuracy or validity of such assumptions, estimates or actual results.

The acquired developed product technologies recorded for each acquisition were feasible at the date of acquisition as they were being actively marketed and sold by the acquired company at the acquisition date. In addition to the acquired developed product technologies, we also record intangible assets for the acquired company's customer relationships, customer backlog, trademarks, in process research and development and non-competition covenants.

An impairment of goodwill or indefinite-lived intangible assets is recognized when the carrying amount of the assets exceeds their fair value. The process of evaluating the potential impairment is highly subjective and requires the application of significant judgment. For purposes of the annual impairment test, we assess qualitative factors to determine if it is more likely than not that goodwill and indefinite-lived assets might be impaired and whether it is necessary to perform the quantitative impairment test which considers our market capitalization compared with the carrying amount of our net assets on the date of the test, since we have only one reporting unit. If an event occurs that would cause us to revise our estimates and assumptions used in analyzing the value of our goodwill and other intangible assets with indefinite lives, the revision could result in a non-cash impairment charge that could have a material impact on our financial results. As of December 31, 2013 and 2012, we performed our annual review of goodwill and indefinite-lived intangible assets and concluded that no impairment existed for our reporting unit during any of the periods presented. No impairment charges have been required to date.

We evaluate long-lived assets, including identifiable intangible assets and other assets, for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. Events or changes in circumstances that could result in an impairment review include, but are not limited to, significant underperformance relative to historical or projected future operating results, significant changes in the manner of use of the acquired assets or the strategy for our overall business, and significant negative industry or economic trends. If an event occurs that would cause us to revise our estimates and assumptions used in analyzing the value of our property and equipment or our finite-lived intangibles and other assets, that revision could result in a non-cash impairment charge that could have a material impact on our financial results. As of December 31, 2013 and 2012, there were no indicators that our long-lived assets were impaired.

Contingent Consideration. Our acquisitions may include contingent consideration payments based on future sales or product milestones of an acquired entity. We estimate the fair value of contingent consideration liabilities based on certain milestones of the acquired companies and estimated probabilities of achievement and discount the liabilities to present value using our pre-tax cost of debt. We believe our estimates and assumptions are reasonable; however, there is significant judgment involved. Changes in the fair value of contingent consideration liabilities may result from changes in discount periods, changes in the timing and amount of sales and/or other specific milestone estimates and changes in probability assumptions with respect to the likelihood of achieving the various earnout criteria. At each reporting date, the contingent consideration liability is revalued to estimated fair value and changes in fair value subsequent to the acquisitions are reflected in net income in the consolidated statements of income and could cause a material impact to, and volatility in, our operating results.

Revenue Recognition

We derive substantially all of our revenue from the licensing of our software products, the sale of annual maintenance agreements for these products and our subscription products and services. In accordance with current guidance, we recognize revenue for software, maintenance and subscriptions when persuasive evidence of an arrangement exists, delivery has occurred, the sales price is fixed or determinable and collectability is reasonably assured. Our return policy generally does not allow our customers to return software products.

We generally use a purchase order, an authorized credit card, an electronic or manually signed license agreement, or the receipt of a cash payment as evidence of an arrangement. We