

LogMeIn, Inc.  
Form 10-Q  
October 25, 2012  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

(Mark One)

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

For the quarterly period ended September 30, 2012

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number: 001-34391

**LOGMEIN, INC.**

(Exact name of registrant as specified in its charter)

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**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**500 Unicorn Park Drive**

**Woburn, Massachusetts**  
(Address of principal executive offices)

**20-1515952**  
(I.R.S. Employer  
Identification No.)

**01801**  
(Zip Code)

**781-638-9050**

(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer  Accelerated filer

Non-accelerated filer  (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

As of October 19, 2012, there were 24,803,526 shares of the registrant's Common Stock, par value \$0.01 per share, outstanding.

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**Table of Contents****Part I. Financial Information****Item 1. Financial Statements****LogMeIn, Inc.****Condensed Consolidated Balance Sheets**

|  | December 31,<br>2011  | September 30,<br>2012 |
|--|-----------------------|-----------------------|
| <b>ASSETS</b>  |                       |                       |
| Current assets:  |                       |                       |
| Cash and cash equivalents  | \$ 103,603,684        | \$ 105,003,430        |
| Marketable securities  | 95,040,045            | 100,199,764           |
| Accounts receivable (net of allowance for doubtful accounts of \$109,000 and \$160,000 as of December 31, 2011 and September 30, 2012, respectively)   | 8,747,104             | 10,587,711            |
| Prepaid expenses and other current assets  | 2,411,640             | 3,440,855             |
| Deferred income tax assets   | 1,980,342             | 1,869,239             |
| <b>Total current assets</b>  | <b>211,782,815</b>    | <b>221,100,999</b>    |
| Property and equipment, net  | 5,202,721             | 6,763,666             |
| Restricted cash  | 369,792               | 3,795,979             |
| Intangibles, net   | 3,260,612             | 6,641,574             |
| Goodwill   | 7,258,743             | 18,768,580            |
| Other assets   | 242,122               | 243,210               |
| Deferred income tax assets   | 3,940,312             | 5,829,875             |
| <b>Total assets</b>  | <b>\$ 232,057,117</b> | <b>\$ 263,143,883</b> |
| <b>LIABILITIES AND EQUITY</b>  |                       |                       |
| Current liabilities:   |                       |                       |
| Accounts payable   | \$ 6,275,163          | \$ 6,297,787          |
| Accrued liabilities  | 10,472,805            | 15,189,524            |
| Deferred revenue, current portion  | 55,961,859            | 61,935,097            |
| <b>Total current liabilities</b>   | <b>72,709,827</b>     | <b>83,422,408</b>     |
| Deferred revenue, net of current portion   | 2,302,465             | 3,359,426             |
| Other long-term liabilities  | 1,239,136             | 641,049               |
| <b>Total liabilities</b>   | <b>76,251,428</b>     | <b>87,422,883</b>     |
| Commitments and contingencies (Note 9)   |                       |                       |
| Preferred stock, \$0.01 par value 5,000,000 shares authorized, 0 shares outstanding as of December 31, 2011 and September 30, 2012   |                       |                       |
| Equity:  |                       |                       |
| Common stock, \$0.01 par value 75,000,000 shares authorized as of December 31, 2011 and September 30, 2012; 24,551,641 and 24,803,526 shares issued and outstanding as of December 31, 2011 and September 30, 2012, respectively |                       |                       |
|  | 245,516               | 248,035               |
| Additional paid-in capital   | 154,440,369           | 172,083,754           |
| Retained earnings  | 2,677,128             | 4,046,735             |
| Accumulated other comprehensive loss   | (1,557,324)           | (657,524)             |
| <b>Total equity</b>  | <b>155,805,689</b>    | <b>175,721,000</b>    |

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Total liabilities and equity

\$ 232,057,117

\$ 263,143,883

See notes to condensed consolidated financial statements.

**Table of Contents****LogMeIn, Inc.****Condensed Consolidated Statements of Income**

|                                      | Three Months Ended<br>September 30, |               | Nine Months Ended<br>September 30, |                |
|--------------------------------------|-------------------------------------|---------------|------------------------------------|----------------|
|                                      | 2011                                | 2012          | 2011                               | 2012           |
| Revenue                              | \$ 31,001,833                       | \$ 35,367,700 | \$ 87,138,568                      | \$ 101,852,212 |
| Cost of revenue                      | 2,597,780                           | 3,687,199     | 7,579,681                          | 10,529,245     |
| Gross profit                         | 28,404,053                          | 31,680,501    | 79,558,887                         | 91,322,967     |
| Operating expenses                   |                                     |               |                                    |                |
| Research and development             | 6,105,253                           | 6,788,250     | 15,085,011                         | 19,704,653     |
| Sales and marketing                  | 14,612,072                          | 18,214,952    | 41,654,309                         | 51,534,907     |
| General and administrative           | 5,681,539                           | 4,982,741     | 15,577,184                         | 14,687,992     |
| Legal settlements                    |                                     |               | 1,250,000                          |                |
| Amortization of acquired intangibles | 32,912                              | 145,896       | 216,994                            | 418,841        |
| Total operating expenses             | 26,431,776                          | 30,131,839    | 73,783,498                         | 86,346,393     |
| Income from operations               | 1,972,277                           | 1,548,662     | 5,775,389                          | 4,976,574      |
| Interest income, net                 | 210,209                             | 244,973       | 660,879                            | 678,440        |
| Other expense                        | (146,039)                           | (4,782)       | (406,722)                          | (510,372)      |
| Income before income taxes           | 2,036,447                           | 1,788,853     | 6,029,546                          | 5,144,642      |
| Provision for income taxes           | (908,750)                           | (1,071,163)   | (2,284,772)                        | (3,775,035)    |
| Net income                           | \$ 1,127,697                        | \$ 717,690    | \$ 3,744,774                       | \$ 1,369,607   |
| Net income per share:                |                                     |               |                                    |                |
| Basic                                | \$ 0.05                             | \$ 0.03       | \$ 0.16                            | \$ 0.06        |
| Diluted                              | \$ 0.04                             | \$ 0.03       | \$ 0.15                            | \$ 0.05        |
| Weighted average shares outstanding: |                                     |               |                                    |                |
| Basic                                | 24,233,996                          | 24,784,939    | 24,094,117                         | 24,679,268     |
| Diluted                              | 25,108,470                          | 25,303,230    | 25,108,398                         | 25,341,473     |

See notes to condensed consolidated financial statements.

**Table of Contents****LogMeIn, Inc.****Condensed Consolidated Statements of Comprehensive Income (Loss)**

|   | <b>Three Months Ended<br/>September 30,</b> |              | <b>Nine Months Ended<br/>September 30,</b> |              |
|---|---|--------------|--|--------------|
|   | <b>2011</b>                                 | <b>2012</b>  | <b>2011</b>                                | <b>2012</b>  |
| Net income  | \$ 1,127,697                                | \$ 717,690   | \$ 3,744,774                               | \$ 1,369,607 |
| Other comprehensive (loss) income:                        |   |              |  |              |
| Net unrealized gains on marketable securities, net of tax | 16,477                                      | 52,508       | 13,054                                     | 58,946       |
| Net translation (losses) gains                            | (1,332,067)                                 | 710,653      | (541,570)                                  | 840,854      |
| Total other comprehensive (loss) income                   | (1,315,590)                                 | 763,161      | (528,516)                                  | 899,800      |
| Comprehensive (loss) income                               | \$ (187,893)                                | \$ 1,480,851 | \$ 3,216,258                               | \$ 2,269,407 |

See notes to condensed consolidated financial statements.

**Table of Contents****LogMeIn, Inc.****Condensed Consolidated Statements of Cash Flows**

|  | <b>Nine Months Ended September 30,</b> |                |
|--|--|----------------|
|  | <b>2011</b>                            | <b>2012</b>    |
| <b>Cash flows from operating activities</b>                                      |  |                |
| Net income   | \$ 3,744,774                           | \$ 1,369,607   |
| Adjustments to reconcile net income to net cash provided by operating activities |  |                |
| Depreciation and amortization  | 3,276,737                              | 4,448,388      |
| Amortization of premium on investments   | 119,014                                | 31,612         |
| Provision for bad debts  | 45,000                                 | 77,500         |
| Provision for (benefit from) deferred income taxes                               | 2,087,268                              | (1,782,601)    |
| Income tax benefit from the exercise of stock options                            | (3,666,000)                            |                |
| Stock-based compensation   | 6,535,693                              | 10,406,559     |
| Gain on disposal of equipment  | (396)                                  | (665)          |
| Changes in assets and liabilities:   |  |                |
| Accounts receivable  | (1,639,463)                            | (1,805,431)    |
| Prepaid expenses and other current assets  | 292,236                                | (891,288)      |
| Other assets   | (228,252)                              | (1,089)        |
| Accounts payable   | 1,556,042                              | 9,365          |
| Accrued liabilities  | 463,111                                | 4,228,273      |
| Deferred revenue   | 11,202,306                             | 6,605,495      |
| Other long-term liabilities  | 253,517                                | (598,087)      |
| Net cash provided by operating activities  | 24,041,587                             | 22,097,638     |
| <b>Cash flows from investing activities</b>                                      |  |                |
| Purchases of marketable securities   | (135,066,500)                          | (120,098,150)  |
| Proceeds from sale or disposal of marketable securities                          | 135,000,000                            | 115,000,000    |
| Purchases of property and equipment  | (2,252,724)                            | (4,186,867)    |
| Intangible asset additions   | (245,399)                              | (789,037)      |
| Cash paid for acquisition, net of cash acquired                                  | (10,000,000)                           | (14,831,525)   |
| Increase in restricted cash and deposits   | (25,569)                               | (3,557,760)    |
| Net cash used in investing activities  | (12,590,192)                           | (28,463,339)   |
| <b>Cash flows from financing activities</b>                                      |  |                |
| Proceeds from issuance of common stock upon option exercises                     | 3,231,933                              | 2,595,302      |
| Income tax benefit from the exercise of stock options                            | 3,666,000                              | 4,644,044      |
| Net cash provided by financing activities  | 6,897,933                              | 7,239,346      |
| Effect of exchange rate changes on cash and cash equivalents and restricted cash | (234,338)                              | 526,101        |
| Net increase in cash and cash equivalents  | 18,114,990                             | 1,399,746      |
| Cash and cash equivalents, beginning of period                                   | 77,279,987                             | 103,603,684    |
| Cash and cash equivalents, end of period   | \$ 95,394,977                          | \$ 105,003,430 |
| <b>Supplemental disclosure of cash flow information</b>                          |  |                |
| Cash paid for interest   | \$ 1,090                               | \$ 283         |
| Cash paid for income taxes   | \$ 312,929                             | \$ 780,331     |
| <b>Noncash investing and financing activities</b>                                |  |                |



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|   |    |         |    |         |
|---|----|---------|----|---------|
| Purchases of property and equipment included in accounts payable and accrued liabilities  | \$ | 140,330 | \$ | 915,083 |
| Fair value of contingent consideration in connection with acquisition included in accrued liabilities and other long term liabilities | \$ | 210,398 | \$ | 153,890 |

See notes to condensed consolidated financial statements.

**Table of Contents****LogMeIn, Inc.****Notes to Condensed Consolidated Financial Statements****1. Nature of the Business**

LogMeIn, Inc. (the Company) provides essential cloud-based services for remote access, device management, collaboration, data management and customer care. The Company's product line includes BoldChat®, Cosm™, Cubby™, join.me®, LogMeIn Free®, LogMeIn Pro®, LogMeIn® Central™, LogMeIn Rescue®, LogMeIn® Rescue+Mobile™, LogMeIn Backup®, LogMeIn Ignition™, LogMeIn for iOS, LogMeIn Hamachi®, and RemotelyAnywhere®. The Company is based in Woburn, Massachusetts with wholly-owned subsidiaries in Hungary, The Netherlands, Australia, the United Kingdom, Brazil, Japan, India and Ireland.

**2. Summary of Significant Accounting Policies**

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

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

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

*Marketable Securities* The Company's marketable securities are classified as available-for-sale and are carried at fair value with the unrealized gains and losses, net of tax, reported as a component of accumulated other comprehensive income in equity. Realized gains and losses and declines in value judged to be other than temporary are included as a component of earnings based on the specific identification method. Fair value is determined based on quoted market prices. At December 31, 2011 and September 30, 2012, marketable securities consisted of U.S. government agency securities that have remaining maturities within two years and have an aggregate amortized cost of \$95,051,808 and \$100,118,346 and an aggregate fair value of \$95,040,045 and \$100,199,764, including \$102,552 and \$91,561 of unrealized gains and \$114,315 and \$10,142 of unrealized losses, respectively.

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

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

Revenue from the sales of the Company's Ignition for iPhone, iPad and Android software products, which are sold as a perpetual license, is recognized when there is persuasive evidence of an arrangement, the product has been provided to the customer, the collection of the fee is

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

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

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

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

As of December 31, 2011, no customers accounted for more than 10% of accounts receivable. As of September 30, 2012, one customer accounted for 11% of accounts receivable. No customers accounted for more than 10% of revenue for the three and nine months ended September 30, 2011 or 2012.

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

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

*Foreign Currency Translation* The functional currency of operations outside the United States of America is deemed to be the currency of the local country. Accordingly, the assets and liabilities of the Company's foreign subsidiaries are translated into United States dollars using the period-end exchange rate, and income and expense items are translated using the average exchange rate during the period. Cumulative translation adjustments are reflected as a separate component of equity. Foreign currency transaction gains and losses are charged to operations. The Company had foreign currency losses of approximately \$146,000 and \$407,000 for the three and nine months ended September 30, 2011, respectively, and foreign currency losses of approximately \$5,000 and \$510,000 for the three and nine months ended September 30, 2012, respectively.

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

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

The Company evaluates its uncertain tax positions based on a determination of whether and how much of a tax benefit taken by the Company in its tax filings or positions is more likely than not to be realized. Potential interest and penalties associated with any uncertain tax positions are recorded as a component of income tax expense. Through December 31, 2011 and September 30, 2012, the Company has provided a liability for approximately \$198,000 and \$215,000 for uncertain tax positions, respectively. These uncertain tax positions would impact the Company's effective tax rate if recognized.

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



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

|                           | Three Months Ended<br>September 30, |                      | Nine Months Ended<br>September 30, |                       |
|---------------------------|-------------------------------------|----------------------|------------------------------------|-----------------------|
|                           | 2011                                | 2012                 | 2011                               | 2012                  |
| <b>Revenues:</b>          |                                     |                      |                                    |                       |
| United States             | \$ 19,867,371                       | \$ 22,982,648        | \$ 55,866,804                      | \$ 66,066,405         |
| United Kingdom            | 2,938,313                           | 3,250,174            | 8,305,706                          | 9,345,362             |
| International - all other | 8,196,149                           | 9,134,878            | 22,966,058                         | 26,440,445            |
| <b>Total revenue</b>      | <b>\$ 31,001,833</b>                | <b>\$ 35,367,700</b> | <b>\$ 87,138,568</b>               | <b>\$ 101,852,212</b> |

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

The Company has entered into agreements with certain customers that contractually obligate the Company to indemnify the customer from certain claims alleging that the Company's products infringe third-party patents, copyrights, or trademarks. The term of these indemnification obligations is generally perpetual. The maximum potential amount of future payments the Company could be required to make under these indemnification obligations is unlimited.

Through January 1, 2012, the Company had not experienced any losses related to these indemnification obligations. On March 15, 2012, the Company received a request for indemnification from a customer in connection with a third-party claim that the customer's use of a LogMeIn service infringed the third party's patent. The Company was able to utilize funds from a designated escrow arrangement associated with a recent acquisition to settle this matter in September 2012 without any impact on the Company's financial statements.

As of October 24, 2012, the Company has received notice from four of its customers that they have received letters from a third-party claiming that their use of certain LogMeIn services infringe upon the third-party's patents. The Company is currently evaluating these claims and its potential indemnification obligations and therefore is unable to reasonably estimate a potential range of loss or expense associated with these claims at this time.

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

The Company excluded the following options to purchase common shares and restricted stock units because they had an anti-dilutive impact:

|   | Three Months Ended<br>September 30, |                  | Nine Months Ended<br>September 30, |                  |
|---|-------------------------------------|------------------|------------------------------------|------------------|
|   | 2011                                | 2012             | 2011                               | 2012             |
| Options to purchase common shares               | 1,012,875                           | 1,822,704        | 935,225                            | 1,545,701        |
| Restricted stock units                          |                                     | 690,824          |                                    | 139,516          |
| <b>Total options and restricted stock units</b> | <b>1,012,875</b>                    | <b>2,513,528</b> | <b>935,225</b>                     | <b>1,685,217</b> |



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

|   | Three Months Ended<br>September 30,<br>2011 | Nine Months Ended<br>September 30,<br>2011 |
|---|---|--|
| <b>Basic:</b>                                       |   |  |
| Net income  | \$ 1,127,697                                | \$ 3,744,774                               |
| Weighted average common shares outstanding, basic   | 24,233,996                                  | 24,094,117                                 |
| Net income, basic                                   | \$ 0.05                                     | \$ 0.16                                    |
| <b>Diluted:</b>                                     |   |  |
| Net income  | \$ 1,127,697                                | \$ 3,744,774                               |
| Weighted average common shares outstanding          | 24,233,996                                  | 24,094,117                                 |
| Add: Options to purchase common shares              | 874,474                                     | 1,014,281                                  |
| Weighted average common shares outstanding, diluted | 25,108,470                                  | 25,108,398                                 |
| Net income, diluted                                 | \$ 0.04                                     | \$ 0.15                                    |
|   | Three Months Ended<br>September 30,<br>2012 | Nine Months Ended<br>September 30,<br>2012 |
| <b>Basic:</b>                                       |   |  |
| Net income  | \$ 717,690                                  | \$ 1,369,607                               |
| Weighted average common shares outstanding, basic   | 24,784,939                                  | 24,679,268                                 |
| Net income, basic                                   | \$ 0.03                                     | \$ 0.06                                    |
| <b>Diluted:</b>                                     |   |  |
| Net income  | \$ 717,690                                  | \$ 1,369,607                               |
| Weighted average common shares outstanding          | 24,787,939                                  | 24,679,268                                 |
| Add: Common stock equivalents                       | 518,291                                     | 662,205                                    |
| Weighted average common shares outstanding, diluted | 25,303,230                                  | 25,341,473                                 |
| Net income, diluted                                 | \$ 0.03                                     | \$ 0.05                                    |



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

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

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

**3. Fair Value of Financial Instruments**

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

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

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

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

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

|  |               | Basis of Fair Value Measurements   |   |  |
|--|---------------|--|---|--|
|  | Balance       | Quoted Prices<br>in Active<br>Markets for<br>Identical<br>Items<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
| <b>Balance at December 31, 2011</b>                                |               |  |   |  |
| Cash equivalents money market funds                                | \$ 53,839,536 | \$ 53,839,536  | \$  | \$   |
| Cash equivalents bank deposits                                     | 5,032,135     |  | 5,032,135   |  |
| Short-term marketable securities U.S. government agency securities | 95,040,045    | 85,040,105   | 9,999,940   |  |
| Contingent consideration liability                                 | 212,536       |  |   | 212,536  |
| <b>Balance at September 30, 2012</b>                               |               |  |   |  |
| Cash equivalents money market funds                                | 49,365,014    | 49,365,014   |   |  |
| Cash equivalents bank deposits                                     | 5,035,903     |  | 5,035,903   |  |
| Short-term marketable securities U.S. government agency securities | 100,199,764   | 75,164,544   | 25,035,220  |  |

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|                                    |         |         |
|------------------------------------|---------|---------|
| Contingent consideration liability | 153,890 | 153,890 |
|------------------------------------|---------|---------|

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

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

|   | <b>Nine Months<br/>Ended<br/>September 30,<br/>2012</b> |
|---|---|
| Balance beginning of period   | \$ 212,536  |
| Transfers into Level 3  |   |
| Payments  | (89,012)  |
| Change in fair value (included within research and development expense) | 30,366  |
| <b>Balance end of period</b>  | <b>\$ 153,890</b>                                       |

**4. Acquisitions**

On July 19, 2011, the Company acquired substantially all of the assets of Connected Environments (BVI) Limited, a British Virgin Island limited company and Connected Environments, Limited, a U.K. limited company (collectively Connected Environments ), primarily including their Cosm service, for an initial cash payment of \$10 million plus contingent payments totaling up to \$5.2 million. The Cosm service is a cloud-based connectivity and data management platform for the Internet of Things. The Company acquired Cosm to expand its capabilities with embedded devices and enter into the Internet of Things market. The operating results of the acquired Cosm service, of which there was no revenue for the three and nine months ended September 30, 2011 and 2012, and \$1.1 million of expense in both the three and nine months ended September 30, 2011 and \$1.3 million and \$4.6 million of expenses during the three and nine months ended September 30, 2012, respectively, are included in the consolidated financial statements beginning on the acquisition date.

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

The purchase price was allocated as follows:

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

The asset purchase agreement included a contingent payment provision requiring the Company to make additional payments to the shareholders of Connected Environments, as well as certain employees, on the first and second anniversaries of the acquisition, contingent upon the continued employment of certain employees and the achievement of certain product performance metrics. The range of the contingent payments that the Company could pay is between \$0 to \$4,898,000. The Company has concluded that the arrangement is a compensation arrangement and is accruing the maximum payout ratably over the performance period, as it believes it is probable that the criteria will be met. The Company paid approximately \$1.7 million of contingent payments in July 2012 and expects to pay the remaining \$3.2 million in July 2013.

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

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

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

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On January 6, 2012, the Company acquired substantially all of the assets of Bold Software, LLC ( Bold ), a Wichita, Kansas-based limited liability corporation, for a cash purchase price of approximately \$15.3 million plus contingent, retention-based bonuses totaling \$1.5 million, which are expected to be paid over a two year period from the date of acquisition. Bold is a leading provider of web chat and customer communications software. Bold's operating results, of which there was approximately \$1.2 million and \$3.1 million of revenue for the three and nine months ended September 30, 2012, respectively, and \$1.4 million and \$3.9 million of expenses during the three and nine months ended September 30, 2012, respectively, are included in the condensed consolidated financial statements beginning on the acquisition date.

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

The purchase price was allocated as follows:

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

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

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

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

**5. Goodwill and Intangible Assets**

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

Changes in goodwill for the nine months ended September 30, 2012, are as follows:

|   |              |
|---|--------------|
| Balance, December 31, 2011                  | \$ 7,258,743 |
| Goodwill related to the acquisition of Bold | 11,178,000   |

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|  |               |
|--|---------------|
| Foreign currency translation adjustments | 331,837       |
| Balance, September 30, 2012              | \$ 18,768,580 |

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Intangible assets consist of the following:

|                                 | Estimated Useful Life | December 31, 2011     |                          |                     | September 30, 2012    |                          |                     |
|---------------------------------|-----------------------|-----------------------|--------------------------|---------------------|-----------------------|--------------------------|---------------------|
|                                 |                       | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount |
| Identifiable intangible assets: |                       |                       |                          |                     |                       |                          |                     |
| Trade name and trademark        | 1 -5 years            | \$ 635,506            | \$ 635,506               | \$                  | \$ 665,564            | \$ 659,508               | \$ 6,056            |
| Customer base                   | 5 -7 years            | 1,003,068             | 1,003,068                |                     | 3,767,557             | 1,332,160                | 2,435,397           |
| Domain names                    | 5 years               | 222,826               | 51,499                   | 171,327             | 513,570               | 110,936                  | 402,634             |
| Software                        | 4 years               | 298,977               | 298,977                  |                     | 298,977               | 298,977                  |                     |
| Technology                      | 3 -6 years            | 4,475,281             | 1,831,276                | 2,644,005           | 5,710,887             | 2,829,471                | 2,881,416           |
| Non-compete agreements          | 5 years               | 0                     | 0                        |                     | 160,291               | 6,459                    | 153,832             |
| Internally developed software   | 3 years               | 539,612               | 94,332                   | 445,280             | 1,041,997             | 279,758                  | 762,239             |
|                                 |                       | \$ 7,175,270          | \$ 3,914,658             | \$ 3,260,612        | \$ 12,158,843         | \$ 5,517,269             | \$ 6,641,574        |

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

The Company capitalized \$108,138 and \$207,501 during the three months ended September 30, 2011 and 2012, respectively and \$245,464 and \$502,385 during the nine months ended September 30, 2011 and 2012, respectively of costs related to internally developed computer software to be sold as a service incurred during the application development stage and is amortizing these costs over the expected lives of the related services. The Company paid \$15,094 and \$290,745 to acquire domain names in both the three and nine months ended September 30, 2012.

The Company is amortizing its intangible assets based upon the pattern in which their economic benefit will be realized, or if this pattern cannot be reliably determined, using the straight-line method over their estimated useful lives. Amortization expense for intangible assets was \$294,462 and \$533,164 for the three months ended September 30, 2011 and 2012, respectively, and \$514,486 and \$1,588,583 for the nine months ended September 30, 2011 and 2012, respectively. Amortization relating to software, technology and internally developed software is recorded within cost of revenues and the amortization of trade name and trademark, customer base, domain names, and non-compete agreements is recorded within operating expenses. Future estimated amortization expense for intangible assets is as follows at September 30, 2012:

| Amortization Expense (Years Ending December 31) | Amount              |
|---|---------------------|
| 2012 (Three months ending December 31)          | \$ 556,041          |
| 2013  | 2,236,873           |
| 2014  | 1,693,784           |
| 2015  | 859,255             |
| 2016  | 592,891             |
| Thereafter                                      | 702,730             |
| <b>Total</b>                                    | <b>\$ 6,641,574</b> |

**Table of Contents****6. Accrued Expenses**

Accrued expenses consisted of the following:

|                               | December 31,<br>2011 | September 30,<br>2012 |
|-------------------------------|----------------------|-----------------------|
| Marketing programs            | \$ 1,770,611         | \$ 3,122,468          |
| Payroll and payroll related   | 5,333,430            | 7,420,895             |
| Professional fees             | 795,720              | 1,143,133             |
| Other accrued expenses        | 2,573,044            | 3,503,028             |
| <b>Total accrued expenses</b> | <b>\$ 10,472,805</b> | <b>\$ 15,189,524</b>  |

**7. Income Taxes**

The Company recorded a provision for federal, state and foreign income taxes of approximately \$0.9 million and \$1.1 million for the three months ended September 30, 2011 and 2012, respectively, and \$2.3 million and \$3.8 million for the nine months ended September 30, 2011 and 2012, respectively. The Company's effective tax rate has increased for the three and nine months ended September 30, 2012, as compared to the three and nine month ending September 30, 2011 as a result of losses generated by its Cosm subsidiary, for which no corresponding benefit has been recognized.

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

The Company files income tax returns in the U.S. federal jurisdiction and various state and foreign jurisdictions. The Company's income tax returns since inception are open to examination by federal, state, and foreign tax authorities. The Company has recorded a liability related to uncertain tax provisions of approximately \$198,000 and \$215,000 as of December 31, 2011 and September 30, 2012, respectively. The Company's policy is to record estimated interest and penalty related to the underpayment of income taxes or unrecognized tax benefits as a component of its income tax provision. During the three and nine months ended September 30, 2011, the Company did not recognize any interest or penalties in its statements of income. During the three and nine months ended September 30, 2012, the Company recognized approximately \$2,000 in interest related to uncertain tax provisions in its statements of income. There are no accruals for interest or penalties at December 31, 2011 or September 30, 2012.

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

**8. Stock Based Awards**

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



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the 2009 Plan will be reduced by one and sixty-two hundredths (1.62) shares for each share delivered in settlement of any award of Restricted Stock, Restricted Stock Units or other stock based awards and one share for each share delivered in settlement of an Option or a Stock Appreciation Right, and removed the provision that allows our board of directors to re-price underwater awards without stockholder approval. There were 1,354,813 shares available for grant under the 2009 Plan as of September 30, 2012.

The Company uses the Black-Scholes option-pricing model to estimate the grant date fair value of stock awards. The Company estimates the expected volatility of its common stock at the date of grant based on the historical volatility of comparable public companies over the option's expected term as well as its own stock price volatility since the Company's IPO. The Company estimates expected term based on historical exercise activity and giving consideration to the contractual term of the options, vesting schedules, employee turnover, and

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expectation of employee exercise behavior. The assumed dividend yield is based upon the Company's expectation of not paying dividends in the foreseeable future. The risk-free rate for periods within the estimated life of the stock award is based on the U.S. Treasury yield curve in effect at the time of grant. Historical employee turnover data is used to estimate pre-vesting stock awards forfeiture rates. The compensation expense is amortized on a straight-line basis over the requisite service period of the stock award, which is generally four years for options and three years for restricted stock units.

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

|                          | Three Months Ended<br>September 30, |       | Nine Months Ended<br>September 30, |               |
|--------------------------|-------------------------------------|-------|------------------------------------|---------------|
|                          | 2011                                | 2012  | 2011                               | 2012          |
| Expected dividend yield  | 0.00%                               | 0.00% | 0.00%                              | 0.00%         |
| Risk-free interest rate  | 1.13%                               | 0.73% | 1.13% - 2.28%                      | 0.73% - 0.87% |
| Expected term (in years) | 6.25                                | 6.25  | 5.56 - 6.25                        | 5.56 - 6.25   |
| Volatility               | 60%                                 | 55%   | 60%                                | 55% - 60%     |

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

|                                   | Number of<br>Shares | Weighted<br>Average<br>Exercise<br>Price | Weighted<br>Average<br>Remaining<br>Contractual<br>Term<br>(Years) | Aggregate<br>Intrinsic<br>Value |
|-----------------------------------|---------------------|--|--|---------------------------------|
| Outstanding, January 1, 2012      | 2,626,260           | \$ 22.34                                 | 7.4  | \$ 44,093,090                   |
| Granted                           | 720,516             | 35.23                                    |  |                                 |
| Exercised                         | (251,885)           | 10.30                                    |  | \$ 5,300,925                    |
| Forfeited                         | (184,067)           | 32.16                                    |  |                                 |
| Outstanding, September 30, 2012   | 2,910,824           | \$ 25.95                                 | 7.4  | \$ 14,339,873                   |
| Exercisable at December 31, 2011  | 1,100,792           | \$ 9.54                                  | 5.5  | \$ 32,040,375                   |
| Exercisable at September 30, 2012 | 1,315,061           | \$ 16.34                                 | 5.7  | \$ 13,221,779                   |

The aggregate intrinsic value was calculated based on the positive differences between the fair value of the Company's common stock on December 31, 2011 of \$38.55 and \$22.43 per share on September 30, 2012, or at time of exercise, and the exercise price of the options.

The weighted average grant date fair value of stock options issued or modified was \$22.42 per share for the year ended December 31, 2011, and \$19.12 for the nine months ended September 30, 2012.

During the three and nine months ended September 30, 2012, the Company granted 247,166 and 715,032 restricted stock units, respectively, containing time-based vesting conditions which generally lapse over a three year period. Upon vesting, the restricted stock units entitle the holder to receive one share of common stock for each restricted stock unit. As of September 30, 2012, the Company estimates that 565,121 shares of restricted stock units with an intrinsic value of approximately \$18,179,932 and a weighted average remaining contractual term of 2.6 years will ultimately vest.

The following table summarizes restricted stock unit activity:

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|                                   | Number of Shares<br>Underlying Restricted<br>Stock Units | Weighted Average<br>Grant Date<br>Fair Value |
|-----------------------------------|--|--|
| Unvested as of January 1, 2012    |  | \$   |
| Restricted stock units granted    | 715,032  | 32.23  |
| Restricted stock units vested     |  |  |
| Restricted stock units forfeited  | (12,042)   | 35.66  |
| Unvested as of September 30, 2012 | 702,990  | \$ 32.17                                     |

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

|                            | Three Months Ended<br>September 30, |              | Nine Months Ended<br>September 30, |               |
|----------------------------|-------------------------------------|--------------|------------------------------------|---------------|
|                            | 2011                                | 2012         | 2011                               | 2012          |
| Cost of revenue            | \$ 65,167                           | \$ 134,103   | \$ 236,742                         | \$ 349,073    |
| Research and development   | 421,482                             | 843,930      | 1,095,110                          | 2,000,097     |
| Sales and marketing        | 801,678                             | 1,519,973    | 1,983,721                          | 3,370,642     |
| General and administrative | 1,250,749                           | 1,835,546    | 3,220,120                          | 4,686,747     |
|                            | \$ 2,539,076                        | \$ 4,333,552 | \$ 6,535,693                       | \$ 10,406,559 |

As of September 30, 2012, there was approximately \$41,909,000 of total unrecognized share-based compensation cost, net of estimated forfeitures, related to unvested stock awards which are expected to be recognized over a weighted average period of 2.6 years. The total unrecognized share-based compensation cost will be adjusted for future changes in estimated forfeitures.

**9. Commitments and Contingencies**

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

In April 2012, the Company entered into a lease for a new corporate headquarters located in Boston, Massachusetts. The landlord is obligated to rehabilitate the existing building and the Company expects that the lease term will begin in February 2013 and extend through May 2023. The aggregate amount of minimum lease payments to be made over the term of the lease is approximately \$41.3 million. Pursuant to the terms of the lease, the landlord is responsible for making certain improvements to the leased space up to an agreed upon cost to the landlord. Any excess costs for these improvements will be billed by the landlord to the Company as additional rent. The Company estimates these excess costs to be approximately \$4.2 million. The lease required a security deposit of approximately \$3.3 million in the form of an irrevocable standby letter of credit which is collateralized by a bank deposit in the amount of approximately \$3.5 million or 105 percent of the security deposit. The security deposit is classified as restricted cash. The lease includes an option to extend the original term of the lease for two successive five year periods.

In October 2012, the Company entered into a lease for new office space in Dublin, Ireland. The term of the new office space began in October 2012 and extends through October 2022. The approximate annual lease payments for the new office space are \$174,000 (EUR 135,000). The lease agreement required a security deposit of approximately \$226,000 (EUR 176,000) and contains a termination option which allows the Company to terminate the lease pursuant to certain lease provisions.

Rent expense under all leases was approximately \$725,000 and \$793,000 for the three months ended September 30, 2011 and 2012, respectively, and \$2,185,000 and \$2,359,000 for the nine months ended September 30, 2011 and 2012, respectively. The Company records rent expense on a straight-line basis for leases with scheduled escalation clauses or free rent periods.

The Company also enters into hosting services agreements with third-party data centers and internet service providers that are subject to annual renewal. Hosting fees incurred under these arrangements aggregated approximately \$457,000 and \$821,000 for the three months ended September 30, 2011 and 2012, respectively, and \$1,381,000 and \$2,207,000 for the nine months ended September 30, 2011 and 2012, respectively.

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

| Years Ending December 31               |              |
|--|--------------|
| 2012 (Three months ending December 31) | \$ 1,560,000 |
| 2013                                   | 4,771,000    |

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|                              |               |
|------------------------------|---------------|
| 2014                         | 5,593,000     |
| 2015                         | 5,375,000     |
| 2016                         | 5,498,000     |
| Thereafter                   | 29,388,000    |
| Total minimum lease payments | \$ 52,185,000 |

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*Litigation* On September 8, 2010, 01 Communique Laboratory, Inc., or 01, filed a complaint that named the Company as a defendant in a lawsuit in the U.S. District Court for the Eastern District of Virginia (Civil Action No. 1:10cv1007) alleging that the Company infringed U.S. Patent No. 6,928,479, which allegedly is owned by 01 and has claims directed to a particular application or system for providing a private communication portal from one computer to a second computer. The complaint sought damages in an unspecified amount and injunctive relief. On April 1, 2011, the U.S. District Court for the Eastern District of Virginia granted the Company's motion for summary judgment of non-infringement and issued a written order regarding this decision on May 4, 2011. On May 13, 2011, 01 filed a notice of appeal appealing the court's ruling granting summary judgment. On July 31, 2012, the U.S. Court of Appeals for the Federal Circuit vacated the lower court's summary judgment of non-infringement ruling and remanded the case back to the U.S. District Court for the Eastern District of Virginia with a revised claim construction. A trial calendar has not been established at this time. Despite the U.S. Court of Appeal's decision to vacate the lower court's summary judgment ruling and revise the 479 patent's claim construction, the Company continues to believe that it has strong defenses to the claims made by 01 and intends to vigorously defend against them. At this time the Company remains unable to reasonably estimate a possible loss or range of loss associated with this litigation.

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On November 3, 2010, Gemini IP LLC, or Gemini, filed a complaint that named the Company as a defendant in a lawsuit in the U.S. District Court for the Eastern District of Texas (Civil Action No. 4:07-cv-521) alleging that the Company infringed U.S. Patent No. 6,117,932, which allegedly is owned by Gemini and has claims related to a system for operating an IT helpdesk. The complaint sought damages in an unspecified amount and injunctive relief. On April 25, 2011, the Company and Gemini entered into a License Agreement which granted the Company a fully-paid license that covers the patent at issue in the action and mutually released each party from all claims. The Company paid Gemini a one-time licensing fee of \$1,250,000 in connection with the License Agreement. As a result, the action was dismissed by the court on May 23, 2011.

The Company is from time to time subject to various other legal proceedings and claims, either asserted or unasserted, which arise in the ordinary course of business. The Company routinely assesses its current litigation and/or threatened litigation as to the probability of ultimately incurring a liability, and records its best estimate of the ultimate loss in situations where the Company assesses the likelihood of loss as probable. While the outcome of these other claims cannot be predicted with certainty, management does not believe that the outcome of any of these other legal matters will have a material adverse effect on the Company's consolidated financial statements.

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

*The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the unaudited condensed consolidated financial statements and the related notes thereto included elsewhere in this Quarterly Report on Form 10-Q and the audited consolidated financial statements and notes thereto and management's discussion and analysis of financial condition and results of operations for the year ended December 31, 2011 included in our Annual Report on Form 10-K, filed with the Securities and Exchange Commission, or SEC, on February 24, 2012. This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act. These statements are often identified by the use of words such as may, will, expect, believe, anticipate, intend, could, estimate, or continue, and similar expressions or variations. Such forward-looking statements are subject to risks, uncertainties and other factors that could cause actual results and the timing of certain events to differ materially from future results expressed or implied by such forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those discussed in the section titled Risk Factors, set forth in Part II, Item 1A of this Quarterly Report on Form 10-Q and elsewhere in this Report. The forward-looking statements in this Quarterly Report on Form 10-Q represent our views as of the date of this Quarterly Report on Form 10-Q. We anticipate that subsequent events and developments will cause our views to change. However, while we may elect to update these forward-looking statements at some point in the future, we have no current intention of doing so except to the extent required by applicable law. You should, therefore, not rely on these forward-looking statements as representing our views as of any date subsequent to the date of this Quarterly Report on Form 10-Q.*

**Overview**

LogMeIn provides essential cloud-based services for remote access, device management, data management, customer care, and collaboration. Serving small and medium-sized businesses, or SMBs, IT service providers, mobile carriers, customer service centers, original equipment manufacturers, or OEMs, and consumers, we believe our cloud-based services are used to connect more Internet-enabled devices worldwide than any other connectivity platform on the market. Businesses and IT service providers use our services to deliver remote, end-user support and to access and manage computers and other Internet-enabled devices more effectively and efficiently from a remote location. Consumers and mobile workers use our remote connectivity services to access computer resources remotely and to collaborate with other users. A growing number of business-to-consumer and business-to-business OEMs use our services to connect their devices and device-created data to the Internet. Our services, which are deployed and accessed from anywhere with an Internet connection, are secure, scalable and easy for our customers to try, purchase and use.

We offer six free services and nine premium services. Sales of our premium services are generated through word-of-mouth referrals, web-based advertising, expiring free trials that we convert to paid subscriptions and direct marketing to new and existing customers.

We derive our revenue principally from subscription fees from SMBs, IT service providers, mobile carriers, customer service centers, OEMs, and consumers. The majority of our customers subscribe to our services on an annual basis. Our revenue is driven primarily by the number and type of our premium services for which our paying customers subscribe. For the nine months ended September 30, 2012, we generated revenues of \$101.9 million, compared to \$87.1 million for the nine months ended September 30, 2011, an increase of approximately \$14.7 million. In fiscal 2011, we generated revenues of \$119.5 million.

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### **Certain Trends and Uncertainties**

The following represents a summary of certain trends and uncertainties, which could have a significant impact on our financial condition and results of operations. This summary is not intended to be a complete list of potential trends and uncertainties that could impact our business in the long or short term. The summary, however, should be considered along with the factors identified in the section titled "Risk Factors" set forth in Part II, Item 1A of this Quarterly Report on Form 10-Q and elsewhere in this report.

We continue to closely monitor current adverse economic conditions, particularly as they impact SMBs, IT service providers and consumers. We are unable to predict the likely duration and severity of the current adverse economic conditions in the United States and other countries, but the longer the duration the greater risks we face in operating our business.

We believe that competition will continue to increase. Increased competition could result from existing competitors or new competitors that enter the market because of the potential opportunity. We will continue to closely monitor competitive activity and respond accordingly. Increased competition could have an adverse effect on our financial condition and results of operations.

We believe that as we continue to grow revenue at expected rates, our cost of revenue and operating expenses, including sales and marketing, research and development and general and administrative expenses will increase in absolute dollar amounts. For a description of the general trends we anticipate in various expense categories, see "Cost of Revenue and Operating Expenses" below.

There is frequent litigation in the software and technology industries based on allegations of infringement or other violations of intellectual property rights. We have been, and may in the future be, subject to third party patent infringement or other intellectual property-related lawsuits as we face increasing competition and become increasingly visible. Any adverse determination related to intellectual property claims or litigation could adversely affect our business, financial condition and operating results.

### **Sources of Revenue**

We derive our revenue principally from subscription fees from SMBs, IT service providers, mobile carriers, customer service centers, OEMs and consumers. Our revenue is driven primarily by the number and type of our premium services for which our paying customers subscribe and is not concentrated within one customer or group of customers. The majority of our customers subscribe to our services on an annual basis and pay in advance, typically with a credit card, for their subscription. A smaller percentage of our customers subscribe to our services on a monthly basis through either month-to-month commitments or annual commitments that are then paid monthly with a credit card. We initially record a subscription fee as deferred revenue and then recognize it ratably, on a daily basis, over the life of the subscription period. Typically, a subscription automatically renews at the end of a subscription period unless the customer specifically terminates it prior to the end of the period.

In addition to our subscription fees, to a lesser extent, we also generate revenue from license and annual maintenance fees from the licensing of our RemotelyAnywhere product. We license RemotelyAnywhere to our customers on a perpetual basis. Because we do not have vendor specific objective evidence of fair value, or VSOE, for our maintenance arrangements, we record the initial license and maintenance fee as deferred revenue and recognize the fees as revenue ratably, on a daily basis, over the initial maintenance period. We also initially record maintenance fees for subsequent maintenance periods as deferred revenue and recognize revenue ratably, on a daily basis, over the maintenance period. We also generate revenue from the license of our Ignition for iPhone, iPad and Android product, which is sold as a perpetual license and is recognized as delivered. In the fourth quarter of 2011, we introduced LogMeIn for iOS, a free app for iPhones and iPads, to the Apple App Store and changed our Ignition for iPhone and iPad business model from a perpetually-based licensing model to a subscription-based business model. Long term, we believe that change will have a positive impact on our business and our lifetime customer value, but short-term the business model change will impact the revenue recognized from our Ignition product.

### **Employees**

We have increased our number of full-time employees to 535 at September 30, 2012 as compared to 482 at December 31, 2011 and 448 at September 30, 2011.

### **Cost of Revenue and Operating Expenses**



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We allocate certain overhead expenses, such as rent and utilities, to expense categories based on the headcount in or office space occupied by personnel in that expense category as a percentage of our total headcount or office space. As a result, an overhead allocation associated with these costs is reflected in the cost of revenue and each operating expense category.

*Cost of Revenue.* Cost of revenue consists primarily of costs associated with our data center operations and customer support centers, including wages and benefits for personnel, telecommunication and hosting fees for our services, equipment maintenance, software license and maintenance fees and depreciation. Additionally, amortization expense associated with the acquired software and technology as well as internally developed software is included in cost of revenue. The expenses related to hosting our services and supporting our free and premium customers is related to the number of customers who subscribe to our services and the complexity and redundancy of our services and hosting infrastructure. We expect cost of revenue expenses to increase in absolute dollars but remain relatively constant as a percentage of revenue as we continue to increase our number of customers over time.

*Research and Development.* Research and development expenses consist primarily of wages and benefits for development personnel, professional fees associated with outsourced development projects and depreciation associated with assets used in development. We have focused our research and development efforts on both improving ease of use and functionality of our existing services, as well as developing new offerings. The majority of our research and development employees are located in our development centers in Europe. Therefore, a majority of research and development expense is subject to fluctuations in foreign exchange rates. We capitalized approximately \$0.4 million and \$0.2 million for the nine months ended September 30, 2012 and September 30, 2011, respectively, of costs related to internally developed computer

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software to be sold as a service, which was incurred during the application development stage. The majority of research and development costs have been expensed as incurred. We expect that research and development expenses will increase in absolute dollars as we continue to enhance and expand our services and as a result of contingent payment costs associated with the acquisition of Bold and remain relatively constant as a percentage of revenue.

*Sales and Marketing.* Sales and marketing expenses consist primarily of online search and advertising costs, wages, commissions and benefits for sales and marketing personnel, offline marketing costs such as media advertising and trade shows, professional fees and credit card processing fees. Online search and advertising costs consist primarily of pay-per-click payments to search engines and other online advertising media such as banner ads. Offline marketing costs include radio and print advertisements as well as the costs to create and produce these advertisements, and tradeshow, including the costs of space at tradeshow and costs to design and construct tradeshow booths. Advertising costs are expensed as incurred. In order to continue to grow our business and awareness of our services, we expect that we will continue to commit resources to our sales and marketing efforts. We expect that sales and marketing expenses will increase in absolute dollars but remain relatively constant as a percentage of revenue.

*General and Administrative.* General and administrative expenses consist primarily of wages and benefits for management, human resources, internal IT support, finance and accounting personnel, professional fees, insurance and other corporate expenses. We expect general and administrative expenses to increase primarily due to the significant legal costs associated with our continued defense against the patent infringement claims made by 01 Communique. Additionally, general and administrative expenses will increase as we continue to add personnel, enhance our internal information systems, incur additional expenses related to audit, accounting and insurance costs. We expect that our general and administrative expenses will significantly increase in both absolute dollars and as a percentage of revenue primarily related to defending the patent infringement claims made by 01 (see Note 9 to the Condensed Consolidated Financial Statements).

## **Critical Accounting Policies**

Our financial statements are prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of our financial statements and related disclosures requires us to make estimates, assumptions and judgments that affect the reported amount of assets, liabilities, revenue, costs and expenses, and related disclosures. We base our estimates and assumptions on historical experience and other factors that we believe to be reasonable under the circumstances. We evaluate our estimates and assumptions on an ongoing basis. Our actual results may differ from these estimates under different assumptions and conditions. Our most critical accounting policies are listed below:

Revenue recognition;

Income taxes;

Goodwill and acquired intangible assets;

Stock-based compensation; and

Loss contingencies.

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The following table sets forth selected consolidated statements of operations data for each of the periods indicated as a percentage of total revenue.

|                                      | Three Months Ended September 30, |           | Nine Months Ended September 30, |           |
|--------------------------------------|----------------------------------|-----------|---------------------------------|-----------|
|                                      | 2011                             | 2012      | 2011                            | 2012      |
| Revenue                              | 100%                             | 100%      | 100%                            | 100%      |
| Cost of revenue                      | 8                                | 10        | 9                               | 10        |
| <b>Gross profit</b>                  | <b>92</b>                        | <b>90</b> | <b>91</b>                       | <b>90</b> |
| Operating expenses:                  |                                  |           |                                 |           |
| Research and development             | 20                               | 19        | 17                              | 19        |
| Sales and marketing                  | 47                               | 52        | 48                              | 51        |
| General and administrative           | 18                               | 15        | 18                              | 15        |
| Legal settlements                    |                                  |           | 1                               |           |
| Amortization of acquired intangibles |                                  |           |                                 |           |
| Total operating expenses             | 85                               | 86        | 84                              | 85        |
| Income from operations               | 7                                | 4         | 7                               | 5         |
| Interest and other expense, net      |                                  | 1         |                                 |           |
| Income before for income taxes       | 7                                | 5         | 7                               | 5         |
| (provision) for income taxes         | (3)                              | (3)       | (3)                             | (4)       |
| Net income                           | 4%                               | 2%        | 4%                              | 1%        |

**Three Months Ended September 30, 2012 and 2011**

*Revenue.* Revenue for the three months ended September 30, 2012 was \$35.4 million, an increase of \$4.4 million, or 14%, over revenue of \$31.0 million for the three months ended September 30, 2011. The majority of the increase was due to an increase in revenue from new customers, as our total number of subscribers increased to approximately 435,000 at September 30, 2012 from approximately 343,000 subscribers at September 30, 2011, and incremental add-on revenues from our existing customer base. The increase in revenue from new customers and incremental add-on revenue from our existing customer base was partially offset by a decrease in perpetual license revenue, primarily caused by the change in our business model related to our Ignition for iPhone and iPad product, from a perpetually based licensing model to a subscription based business model.

*Cost of Revenue.* Cost of revenue for the three months ended September 30, 2012 was \$3.7 million, an increase of \$1.1 million, or 42%, over cost of revenue of \$2.6 million for the three months ended September 30, 2011. As a percentage of revenue, cost of revenue was 10% and 8% for the three months ended September 30, 2012 and 2011, respectively. The increase in absolute dollars was primarily a result of an increase in both the number of customers using our premium services and the total number of devices that connected to our services, including devices owned by free users, which resulted in increased hosting and customer support costs. The costs associated with managing our data centers and the hosting of our services increased by \$0.6 million in the three months ended September 30, 2012 compared to the three months ended September 30, 2011. The increase was also due to a \$0.3 million increase in personnel-related costs, including stock-based compensation, as we increased the number of customer support employees to support our overall growth, as well as a \$0.1 million increase in amortization of intangible assets primarily due to the Cosm acquisition in July 2011 and the Bold acquisition in January 2012.

*Research and Development Expenses.* Research and development expenses for the three months ended September 30, 2012 were \$6.8 million, an increase of \$0.7 million, or 11%, over research and development expenses of \$6.1 million for the three months ended September 30, 2011. As a percentage of revenue, research and development expenses were 19% and 20% for the three months ended September 30, 2012 and 2011, respectively. The increase in absolute dollars was primarily due to a \$0.7 million increase in personnel-related costs, including a \$0.4 million increase in stock-based compensation, as we hired additional employees to improve the ease of use and functionality of our existing services and

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develop new service offerings, and retained employees from the acquisitions of Cosm and Bold in July 2011 and January 2012, respectively. These were offset by a \$0.1 million increase in costs related to internally developed computer software to be sold as a service which was incurred during the application development stage and therefore capitalized rather than expensed.

*Sales and Marketing Expenses.* Sales and marketing expenses for the three months ended September 30, 2012 were \$18.2 million, an increase of 3.6 million, or 25%, over sales and marketing expenses of \$14.6 million for the three months ended September 30, 2011. As a percentage of revenue, sales and marketing expenses were 52% and 47% for the three months ended September 30, 2012 and 2011, respectively. The increase in absolute dollars was primarily due to a \$1.9 million increase in personnel-related and recruiting costs, including

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\$0.7 million in stock-based compensation, as we hired additional employees to support our growth in sales and expand our marketing efforts and a \$1.1 million increase in marketing program costs. The increase was also due to a \$0.2 million increase in credit card processing fees and a \$0.1 million increase in professional fees.

*General and Administrative Expenses.* General and administrative expenses for the three months ended September 30, 2012 were \$5.0 million, a decrease of \$0.7 million, or 12%, over general and administrative expenses of \$5.7 million for the three months ended September 30, 2011. As a percentage of revenue, general and administrative expenses were 15% and 18% for the three months ended September 30, 2012 and 2011, respectively. The decrease in absolute dollars was primarily due to a \$1.3 million accrual for uncollected sales taxes during the third quarter of 2011, which was offset by a \$0.7 million increase in personnel related and recruiting costs, including a \$0.6 million increase in stock-based compensation, as we increased the number of general and administrative employees to support our overall growth.

*Amortization of Intangibles.* Amortization of intangibles for the three months ended September 30, 2012 and 2011 was \$0.1 million and \$0, respectively. The amortization of intangibles for the three months ended September 30, 2012 related primarily to the value of intangible assets acquired in our January 2012 acquisition of Bold.

*Interest and Other Income, Net.* Interest and other income, net was income of approximately \$0.2 million and \$0.1 million for the three months ended September 30, 2012 and September 30, 2011, respectively. The increase was primarily related to a decrease in foreign currency losses.

*Income Taxes.* During the three months ended September 30, 2012 and September 30, 2011, we recorded a provision for federal, state and foreign income taxes of approximately \$1.1 million and \$0.9 million, respectively. Our effective tax rate increased year-over-year as a result of losses incurred in our Cosm subsidiary for which no corresponding benefit was recognized during the three months ended September 30, 2012. At each balance sheet date, we assess the likelihood that deferred tax assets will be realized, and recognize a valuation allowance if it is more likely than not that some portion of the deferred tax assets will not be realized. This assessment requires judgment as to the likelihood and amounts of future taxable income by tax jurisdiction. As of December 31, 2011 and September 30, 2012, we maintained a full valuation allowance related to the deferred tax assets of our Hungarian and Cosm subsidiaries. These entities have historical losses and we concluded it was not more likely than not that these deferred tax assets are realizable.

*Net Income.* We recognized net income of \$0.7 million for the three months ended September 30, 2012 compared to a net income of \$1.1 million for the three months ended September 30, 2011. For the three months ended September 30, 2012, revenue increased \$4.4 million while cost of revenue increased \$1.1 million, operating expenses increased \$3.6 million, other income increased \$0.1 million, and our tax provision increased \$0.2 million, resulting in approximately a \$0.4 million decrease in net income.

The \$4.4 million increase in revenue is primarily due to an increase in revenue from new customers and add-on revenues from our existing customer base, partially offset by a decrease in Ignition product revenue, mainly caused by the change in our business model related to our Ignition for iPhone and iPad app from a perpetually based licensing model to a subscription based business model.

The \$1.1 million increase in cost of revenue is primarily due to a \$0.6 million increase in costs to manage our data centers, a \$0.3 million increase in personnel-related costs, and a \$0.1 million increase in acquisition related amortization.

The \$3.6 million increase in operating expenses is primarily due to a \$3.2 million increase in personnel-related costs, including a \$1.7 million increase in stock-based compensation, a \$0.2 million increase in audit fees, and a \$0.2 million increase in amortization and depreciation.

The \$0.2 million increase in our tax provision is primarily due to a provision for federal, state, and foreign income taxes of \$1.1 million for the three months ended September 30, 2012, compared to a \$0.9 million provision for the three months ended September 30, 2011.

**Nine Months Ended September 30, 2012 and 2011**

*Revenue.* Revenue for the nine months ended September 30, 2012 was \$101.9 million, an increase of \$14.7 million, or 17%, over revenue of \$87.1 million for the nine months ended September 30, 2011. The majority of the increase was due to an increase in revenue from new customers, as our total number of subscribers increased to approximately 435,000 at September, 2012 from approximately 343,000 subscribers at September 30, 2011, and incremental add-on revenues from our existing customer base. The increase in revenue from new customers and incremental add-on revenue from our existing customer base was partially offset by a decrease in perpetual license revenue, primarily caused by the change in our business model related to our Ignition for iPhone and iPad product from a perpetually based licensing model to a subscription based business model.

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*Cost of Revenue.* Cost of revenue for the nine months ended September 30, 2012 was \$10.5 million, an increase of \$2.9 million, or 39%, over cost of revenue of \$7.6 million for the nine months ended September 30, 2011. As a percentage of revenue, cost of revenue was 10% and 9% for the nine months ended September 30, 2012 and 2011, respectively. The increase in absolute dollars was primarily a result of an increase in both the number of customers using our premium services and the total number of devices that connected to our services, including devices owned by free users, which resulted in increased hosting and customer support costs. The costs associated with managing our data centers and the hosting of our services increased by \$1.4 million in the nine months ended September 30, 2012 compared to the nine months ended September 30, 2011. The increase was also due to a \$0.7 million increase in personnel-related costs, including stock-based compensation, as we increased the number of customer support employees to support our overall growth, and a \$0.8 million increase in amortization of intangible assets primarily due to the Cosm acquisition in July 2011 and the Bold acquisition in January 2012.

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*Research and Development Expenses.* Research and development expenses for the nine months ended September 30, 2012 were \$19.7 million, an increase of \$4.6 million, or 31%, over research and development expenses of \$15.1 million for the nine months ended September 30, 2011. As a percentage of revenue, research and development expenses were 19% and 17% for the nine months ended September 30, 2012 and 2011, respectively. The increase in absolute dollars was primarily due to a \$4.2 million increase in personnel-related costs, including a \$0.9 million increase in stock-based compensation, as we hired additional employees to improve the ease of use and functionality of our existing services and develop new service offerings, retained employees from the acquisitions of Cosm and Bold in July 2011 and January 2012, respectively, and an increase of \$1.5 million and \$0.3 million for contingent payment costs also associated with the Cosm and Bold acquisitions, respectively (see note 4 to the condensed consolidated financial statements). These were offset by a \$0.2 million increase in costs related to internally developed computer software to be sold as a service which was incurred during the application development stage and therefore capitalized rather than expensed.

*Sales and Marketing Expenses.* Sales and marketing expenses for the nine months ended September 30, 2012 were \$51.5 million, an increase of \$9.8 million, or 24%, over sales and marketing expenses of \$41.7 million for the nine months ended September 30, 2011. As a percentage of revenue, sales and marketing expenses were 51% and 48% for the nine months ended September 30, 2012 and 2011, respectively. The increase in absolute dollars was primarily due to a \$5.9 million increase in personnel-related and recruiting costs, including \$1.4 million in stock-based compensation, as we hired additional employees to support our growth in sales and expand our marketing efforts and \$2.5 million increase in marketing program costs. The increase was also due to a \$0.3 million increase in travel-related costs, a \$0.3 million increase in credit card processing fees, a \$0.3 million increase in professional fees, and a \$0.2 million increase in hardware and software maintenance costs.

*General and Administrative Expenses.* General and administrative expenses for the nine months ended September 30, 2012 were \$14.7 million, a decrease of \$0.9 million, or 6%, over general and administrative expenses of \$15.6 million for the nine months ended September 30, 2011. As a percentage of revenue, general and administrative expenses were 15% and 18% for the nine months ended September 30, 2012 and 2011, respectively. The decrease in absolute dollars was primarily due to a \$3.0 million decrease in legal costs associated with our defense against the patent infringement claims made by 01 Communique, and a \$1.3 million decrease due to an accrual for uncollected sales tax during the third quarter 2011. This was offset by a \$2.4 million increase in personnel-related costs, primarily consisting of a \$1.5 million increase in stock-based compensation, a \$0.6 million increase in audit fees, a \$0.2 million increase in travel related costs, a \$0.1 million increase in miscellaneous tax costs, and a \$0.1 million in director fees.

*Legal Settlement Expenses.* Legal settlement expenses for the nine months ended September 30, 2012 were \$0 compared to \$1.3 million for the nine months ended September 30, 2011. Legal settlement expenses for the nine months ended September 30, 2011 were related to the License Agreement we entered into with Gemini IP LLC on April 25, 2011 (see Note 9 to the Notes to the Condensed Consolidated Financial Statements).

*Amortization of Intangibles.* Amortization of intangibles for the nine months ended September 30, 2012 and 2011 were \$0.4 million and \$0.2 million, respectively. The amortization of intangibles for the nine months ended September 30, 2012 related primarily to the value of intangible assets acquired in our January 2012 acquisition of Bold. The amortization of intangibles for the nine months ended September 30, 2011 related primarily to the value of intangible assets acquired in our July 2006 acquisition of Applied Networking, Inc., which is fully amortized as of September 30, 2012.

*Interest and Other Income, Net.* Interest and other income, net was income of approximately \$0.2 million for the nine months ended September 30, 2012 and income of approximately \$0.3 million for the nine months ended September 30, 2011. The decrease was primarily related to an increase in foreign currency losses.

*Income Taxes.* During the nine months ended September 30, 2012 and September 30, 2011, we recorded a provision for federal, state and foreign income taxes of approximately \$3.8 million and \$2.3 million, respectively. Our effective tax rate increased year-over-year as a result of losses incurred in our Cosm subsidiary for which no corresponding benefit was recognized during the nine months ended September 30, 2012. At each balance sheet date, we assess the likelihood that deferred tax assets will be realized, and recognize a valuation allowance if it is more likely than not that some portion of the deferred tax assets will not be realized. This assessment requires judgment as to the likelihood and amounts of future taxable income by tax jurisdiction. As of December 31, 2011 and September 30, 2012, we maintained a full valuation allowance related to the deferred tax assets of our Hungarian and Cosm subsidiaries. These entities have historical losses and we concluded it was not more likely than not that these deferred tax assets are realizable.

*Net Income.* We recognized net income of \$1.4 million for the nine months ended September 30, 2012 compared to net income of \$3.7 million for the nine months ended September 30, 2011. For the nine months ended September 30, 2012, revenue increased \$14.7 million while cost of revenue increased \$2.9 million, operating expenses increased \$12.6 million, our tax provision increased \$1.5 million and other expenses increased \$0.1 million, resulting in approximately a \$2.4 million decrease in net income.

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The \$14.7 million increase in revenue is primarily due to an increase in revenue from new customers and add-on revenues from our existing customer base, partially offset by a decrease in Ignition product revenue, mainly caused by the change in our business model related to our Ignition for iPhone and iPad app from a perpetually based licensing model to a subscription based business model.

The \$2.9 million increase in cost of revenue is primarily due to a \$1.4 million increase in costs to manage our data centers and the hosting of our services, \$0.7 million related to an increase in personnel-related costs, and a \$0.8 million increase in acquisition related amortization.



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The \$12.6 million increase in operating expenses is primarily due to a \$12.3 million increase in personnel-related costs, including a \$3.8 million increase in stock-based compensation and a \$0.3 million increase in professional fees.

The \$1.5 million increase in our tax provision is primarily due to a provision for federal, state, and foreign income taxes of \$3.8 million for the nine months ended September 30, 2012, compared to a \$2.3 million for the nine months ended September 30, 2011.

**Liquidity and Capital Resources**

The following table sets forth the major sources and uses of cash for each of the periods set forth below:

|   | <b>Nine Months Ended September 30,</b> |                 |
|---|--|-----------------|
|   | <b>2011</b>                            | <b>2012</b>     |
|   | <b>(in thousands)</b>                  |                 |
| Net cash provided by operations           | \$ 24,041                              | \$ 22,098       |
| Net cash used in investing activities     | (12,590)                               | (28,463)        |
| Net cash provided by financing activities | 6,898                                  | 7,239           |
| Effect of exchange rate changes           | (234)                                  | 526             |
| <b>Net increase (decrease) in cash</b>    | <b>\$ 18,115</b>                       | <b>\$ 1,400</b> |

At September 30, 2012, our principal source of liquidity was cash and cash equivalents and short-term marketable securities totaling \$205.2 million.

**Cash Flows From Operating Activities**

Net cash inflows from operating activities during the nine months ended September 30, 2012 were mainly attributable to non-cash operating expenses, including \$10.4 million for stock compensation, and \$4.4 million for depreciation and amortization. Net cash inflows from operating activities were also attributable to a \$6.6 million increase in deferred revenue associated with the increase in subscription sales orders and customer growth, and a \$4.3 million increase in accounts payable and accrued expenses, offset by a \$1.8 million increase in accounts receivable, a \$0.6 million decrease in other long-term liabilities, and a \$0.9 million increase in prepaid expenses and other current assets. We expect that our future cash flows from operating activities will be impacted by costs associated with the relocation of our corporate headquarters to Boston, Massachusetts and by the contingent payments associated with the Cosm and Bold acquisitions. Additionally, we expect to incur significant legal costs associated with our continued defense against the patent infringement claims made by 01 Communique which will impact our future cash flows from operating activities.

Net cash inflows from operating activities during the nine months ended September 30, 2011 were mainly attributable to a \$11.2 million increase in deferred revenue associated with the increase in subscription sales orders and customer growth. Net cash inflows from operating activities were also attributable to non-cash operating expenses, including \$3.3 million for depreciation and amortization, \$6.5 million for stock compensation and a \$2.1 million provision from deferred income taxes, offset by non-cash benefits, including a \$3.7 million income tax benefit from the exercise of stock options. The increase in net cash inflows from operating activities were also attributable to a \$2.0 million increase in accounts payable and accrued expenses offset by a \$1.6 million increase in accounts receivable.

**Cash Flows From Investing Activities**

Net cash used in investing for the nine months ended September 30, 2012 was primarily related to the acquisition of Bold for \$14.8 million, net of cash acquired, and the purchase of \$120.1 million of marketable securities offset by proceeds of \$115.0 million from redemption and maturity of marketable securities. Net cash used in investing activities also related to the addition of \$4.2 million in property and equipment mainly related to the expansion and upgrade of our data center capacity, the expansion and upgrade of our internal IT infrastructure and expansion of our offices. Restricted cash and deposits also increased \$3.6 million as a result of the letter of credit associated with the lease of our new corporate headquarters in Boston. We also had \$0.8 million in intangible asset additions related to the purchase of domain names, trademarks and internally developed software.

Net cash used in investing for the nine months ended September 30, 2011 was primarily related to the acquisition of Cosm for \$10.0 million and the addition of \$2.3 million in property and equipment mainly related to the expansion and upgrade of our data center capacity as well as the

expansion and upgrade of our internal IT infrastructure.

Our future capital requirements may vary materially from historical levels and will depend on many factors including, but not limited to, the relocation of our corporate headquarters to Boston, Massachusetts and the expansion of our other existing offices, the establishment of additional offices in the United States and worldwide, the expansion of our data center infrastructure, the development of new services and the expansion of our sales, support, development and marketing organizations necessary to support our growth. Since our inception, we have experienced increases in our expenditures consistent with the growth in our operations and personnel, and we anticipate that our expenditures will continue to increase in the future. We also intend to make investments in computer equipment and systems and infrastructure related to existing and new offices as we move and expand our facilities, add additional personnel and continue to grow our business. We are not currently party to any purchase contracts related to future capital expenditures.

**Table of Contents****Cash Flows From Financing Activities**

Net cash provided by financing activities for the nine months ended September 30, 2012 was primarily related to a \$4.6 million income tax benefit from the exercise of stock options as well as \$2.6 million in proceeds received from the issuance of common stock upon exercise of stock options.

Net cash provided by financing activities for the nine months ended September 30, 2011 was primarily related to \$3.2 million in proceeds received from the issuance of common stock upon exercise of stock options as well as a \$3.7 million income tax benefit from the exercise of stock options.

During the last three years, inflation and changing prices have not had a material effect on our business and we do not expect that inflation or changing prices will materially affect our business in the foreseeable future.

**Off-Balance Sheet Arrangements**

We do not engage in any off-balance sheet financing activities, nor do we have any interest in entities referred to as variable interest entities.

**Contractual Obligations**

The following table summarizes our contractual obligations at September 30, 2012 and the effect such obligations are expected to have on our liquidity and cash flow in future periods.

|                             | Total                | Payments Due by Period |                      |                      |                      |
|-----------------------------|----------------------|------------------------|----------------------|----------------------|----------------------|
|                             |                      | Less Than<br>1 Year    | 1-3 Years            | 3-5 Years            | More Than<br>5 Years |
| Operating lease obligations | \$ 50,000,000        | 2,738,000              | 11,035,000           | 10,213,000           | 26,014,000           |
| Hosting service agreements  | 2,185,000            | 2,116,000              | 69,000               |                      |                      |
| <b>Total</b>                | <b>\$ 52,185,000</b> | <b>\$ 4,854,000</b>    | <b>\$ 11,104,000</b> | <b>\$ 10,213,000</b> | <b>\$ 26,014,000</b> |

The commitments under our operating leases shown above consist primarily of lease payments for our future corporate headquarters located in Boston, Massachusetts (see Note 9 to the Condensed Consolidated Financial Statements), our current corporate headquarters located in Woburn, Massachusetts, our international sales and marketing offices located in The Netherlands, Australia, the United Kingdom, Ireland, India and Japan and our research and development offices in Hungary and contractual obligations related to our data centers.

In April 2012, we entered into a lease for a new corporate headquarters located in Boston, Massachusetts. The landlord is obligated to rehabilitate the existing building and we expect that the lease term will begin in February 2013 and extend through May 2023. The aggregate amount of minimum lease payments to be made over the term of the lease is approximately \$41.3 million. Pursuant to the terms of the lease, the landlord is responsible for making certain improvements to the leased space up to an agreed upon cost to the landlord. Any excess costs for these improvements will be billed by the landlord to us as additional rent. We estimate these excess costs to be approximately \$4.2 million. The lease required a security deposit of approximately \$3.3 million in the form of an irrevocable standby letter of credit which is collateralized by a bank deposit in the amount of approximately \$3.5 million or 105 percent of the security deposit. The security deposit is classified as restricted cash. The lease includes an option to extend the original term of the lease for two successive five year periods.

In October 2012, we entered into a lease for new office space in Dublin, Ireland. The term of the new office space began in October 2012 and extends through October 2022. The approximate annual lease payments for the new office space are \$174,000 (EUR 135,000). The lease agreement required a security deposit of approximately \$226,000 (EUR 176,000) and contains a termination option which allows us to terminate the lease pursuant to certain lease provisions.

**Recent Accounting Pronouncements**

In September 2011, the Financial Accounting Standards Board ( FASB ) issued an Accounting Standards Update ( ASU ) which simplifies how companies test goodwill for impairment. The amendment permits an entity to first assess qualitative factors to determine whether it is more

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likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test described in goodwill accounting standard. We adopted this ASU and it did not have a material effect on our financial position, results of operations or cash flows.

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

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

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

**Foreign Currency Exchange Risk.** Our results of operations and cash flows are subject to fluctuations due to changes in foreign currency exchange rates as a result of the majority of our research and development expenditures being made from our Hungarian research and development facilities, and in our international sales and marketing offices in The Netherlands, the United Kingdom, Australia, Japan, Ireland, Brazil and India. In the nine months ended September 30, 2012, approximately 14%, 2%, 9%, 2%, 1% and 1% of our operating expenses occurred in our operations in Hungary, The Netherlands, the United Kingdom, Australia, Japan and Ireland, respectively, and less than 1% each in Brazil and India. In the nine months ended September 30, 2011, approximately 14%, 4%, 5%, 2% and less than 1% of our operating expenses occurred in our operations in Hungary, The Netherlands, the United Kingdom, Australia, Japan, and Brazil, respectively.

Additionally, an increasing percentage of our sales outside the United States are denominated in local currencies and, thus, also subject to fluctuations due to changes in foreign currency exchange rates. To date, changes in foreign currency exchange rates have not had a material impact on our operations, and a future change of 20% or less in foreign currency exchange rates would not materially affect our operations. At this time we do not, but may in the future, enter into any foreign currency hedging programs or instruments that would hedge or help offset such foreign currency exchange rate risk.

**Interest Rate Sensitivity.** Interest income is sensitive to changes in the general level of U.S. interest rates. However, based on the nature and current level of our cash and cash equivalents and short-term marketable securities, which are primarily consisted of cash, money market instruments, government securities and agency bonds, we believe there is no material risk of exposure to changes in the fair value of our cash and cash equivalents and marketable securities as a result of changes in interest rates.

**ITEM 4. CONTROLS AND PROCEDURES**

**Evaluation of Disclosure Controls and Procedures.** Our management, with the participation of our chief executive officer and chief financial officer, evaluated the effectiveness of our disclosure controls and procedures as of September 30, 2012. The term disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company's management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on the evaluation of our disclosure controls and procedures as of September 30, 2012, our chief executive officer and chief financial officer concluded that, as of such date, our disclosure controls and procedures were effective at the reasonable assurance level.

**Changes in Internal Controls.** No changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) occurred during the quarter ended September 30, 2012 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**PART II. OTHER INFORMATION****Item 1. Legal Proceedings**

On September 8, 2010, 01 Communique Laboratory, Inc., or 01, filed a complaint that named us as a defendant in a lawsuit in the U.S. District Court for the Eastern District of Virginia (Civil Action No. 1:10cv1007) alleging that we infringed U.S. Patent No. 6,928,479, which allegedly is owned by 01 and has claims directed to a particular application or system for providing a private communication portal from one computer to a second computer. The complaint sought damages in an unspecified amount and injunctive relief. On April 1, 2011, the U.S. District Court for the Eastern District of Virginia granted our motion for summary judgment of non-infringement. The court issued a written order regarding this

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decision on May 4, 2011. On May 13, 2011, 01 filed a notice of appeal appealing the court's ruling granting summary judgment. On July 31, 2012, the U.S. Court of Appeals for the Federal Circuit vacated the lower court's summary judgment of non-infringement ruling and

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remanded the case back to the U.S. District Court for the Eastern District of Virginia with revised claim construction. A trial calendar has not been established at this time. Despite the U.S. Court of Appeals decision to vacate the lower court's summary judgment ruling and revise the patent's claim construction, we continue to believe that we have strong defenses to the claims made by 01 and intend to vigorously defend against them. 479

We are from time to time subject to various legal proceedings and claims, either asserted or unasserted, which arise in the ordinary course of business. While the outcome of these other claims cannot be predicted with certainty, management does not believe that the outcome of any of these other legal matters will have a material adverse effect on our consolidated financial statements.

### **Item 1A. Risk Factors**

*Our business is subject to numerous risks. We caution you that the following important factors, among others, could cause our actual results to differ materially from those expressed in forward-looking statements made by us or on our behalf in filings with the SEC, press releases, communications with investors and oral statements. Any or all of our forward-looking statements in this Quarterly Report on Form 10-Q and in any other public statements we make may turn out to be wrong. They can be affected by inaccurate assumptions we might make or by known or unknown risks and uncertainties. Many factors mentioned in the discussion below will be important in determining future results. Consequently, no forward-looking statement can be guaranteed. Actual future results may differ materially from those anticipated in forward-looking statements. We undertake no obligation to update any forward-looking statements, whether as a result of new information, future events or otherwise. You are advised, however, to consult any further disclosure we make in our reports filed with the SEC.*

### **RISKS RELATED TO OUR BUSINESS**

#### ***We may be unable to maintain profitability.***

We experienced net losses of \$9.1 million for 2007, and \$5.4 million for 2008. In the quarter ended September 30, 2008, we achieved profitability and reported net income for the first time. We reported net income of \$8.8 million for 2009, \$21.1 million for 2010, \$5.8 million for 2011 and reported net income of \$1.4 million for the nine months ended September 30, 2012. We cannot predict if we will sustain this profitability or, if we fail to sustain this profitability, attain profitability again in the near future or at all. We expect to continue making significant future expenditures to develop and expand our business. Our growth in revenue and customer base may not be sustainable, and we may not achieve sufficient revenue to achieve or maintain profitability. We may incur significant losses in the future for a number of reasons, including due to the other risks described in this report and we may encounter unforeseen expenses, difficulties, complications and delays and other unknown events. Accordingly, we may not be able to maintain profitability, and we may incur significant losses for the foreseeable future.

#### ***Growth of our business may be adversely affected if businesses, IT support providers or consumers do not adopt remote access, support and collaboration solutions more widely.***

Our services employ new and emerging technologies for remote access, support and collaboration. Our target customers may hesitate to accept the risks inherent in applying and relying on new technologies or methodologies to supplant traditional methods of remote connectivity. Our business will not be successful if our target customers do not accept the use of our remote access and remote support technologies.

#### ***Assertions by a third party that our services and solutions infringe its intellectual property, whether or not correct, could subject us to costly and time-consuming litigation or expensive licenses.***

There is frequent litigation in the software and technology industries based on allegations of infringement or other violations of intellectual property rights. We have been, and may in the future be, subject to third party patent infringement or other intellectual property-related lawsuits as we face increasing competition and become increasingly visible. Regardless of the merit of these claims, they can be time-consuming, result in costly litigation and diversion of technical and management personnel or require us to develop a non-infringing technology or enter into license agreements. There can be no assurance that such licenses will be available on acceptable terms and conditions, if at all, and although we have previously licensed proprietary technology, we cannot be certain that the owners' rights in such technology will not be challenged, invalidated or circumvented. For these reasons and because of the potential for court awards that are difficult to predict, it is not unusual to find even arguably unmeritorious claims settled for significant amounts. In addition, many of our service agreements require us to indemnify our customers from certain third-party intellectual property infringement claims, which could increase our costs as a result of defending such claims and may require that we pay damages if there were an adverse ruling related to any such claims. These types of claims could harm our relationships with our customers, deter future customers from subscribing to our services or expose us to further litigation. Any adverse determination related to intellectual property claims or litigation could prevent us from offering all or a portion of our services to customers due to an injunction or require us to pay damages or license fees, which could adversely affect our business, financial condition and operating

results.



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For information concerning pending patent infringement cases, please refer to Part II, Item 1 entitled "Legal Proceedings" and Note 9 of the Notes to Condensed Consolidated Financial Statements.

***We depend on search engines to attract a significant percentage of our customers, and if those search engines change their listings or increase their pricing, it would limit our ability to attract new customers.***

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Many of our customers locate our website through search engines, such as Google. Search engines typically provide two types of search results, algorithmic and purchased listings, and we rely on both types.

Algorithmic listings cannot be purchased and are determined and displayed solely by a set of formulas designed by the search engine. Search engines revise their algorithms from time to time in an attempt to optimize search result listings. If the search engines on which we rely for algorithmic listings modify their algorithms in a manner that reduces the prominence of our listing, fewer potential customers may click through to our website, requiring us to resort to other costly resources to replace this traffic. Any failure to replace this traffic could reduce our revenue and increase our costs. In addition, costs for purchased listings have increased in the past and may increase in the future, and further increases could have negative effects on our financial condition.

***If we are unable to attract new customers to our services on a cost-effective basis, our revenue and results of operations will be adversely affected.***

We must continue to attract a large number of customers on a cost-effective basis, many of whom have not previously used on-demand, remote-connectivity solutions. We rely on a variety of marketing methods to attract new customers to our services, such as paying providers of online services and search engines for advertising space and priority placement of our website in response to Internet searches. Our ability to attract new customers also depends on the competitiveness of the pricing of our services. If our current marketing initiatives are not successful or become unavailable, if the cost of such initiatives were to significantly increase, or if our competitors offer similar services at lower prices, we may not be able to attract new customers on a cost-effective basis and, as a result, our revenue and results of operations would be adversely affected.

***If we are unable to retain our existing customers, our revenue and results of operations would be adversely affected.***

We sell our services pursuant to agreements that are generally one year in duration. Our customers have no obligation to renew their subscriptions after their subscription period expires, and these subscriptions may not be renewed on the same or on more profitable terms. As a result, our ability to grow depends in part on subscription renewals. We may not be able to accurately predict future trends in customer renewals, and our customers' renewal rates may decline or fluctuate because of several factors, including their satisfaction or dissatisfaction with our services, the prices of our services, the prices of services offered by our competitors or reductions in our customers' spending levels. If our customers do not renew their subscriptions for our services, renew on less favorable terms, or do not purchase additional functionality or subscriptions, our revenue may grow more slowly than expected or decline, and our profitability and gross margins may be harmed.

***If we fail to convert our free users to paying customers, our revenue and financial results will be harmed.***

A significant portion of our user base utilizes our services free of charge through our free services or free trials of our premium services. We seek to convert these free and trial users to paying customers of our premium services. If our rate of conversion suffers for any reason, our revenue may decline and our business may suffer.

***Our business strategy includes acquiring or investing in other companies, which may divert our management's attention, result in additional dilution to our stockholders and consume resources that are necessary to sustain our business.***

Our business strategy includes acquiring complementary services, technologies or businesses. For example, in July 2011 we acquired substantially all of the assets and liabilities of Connected Environments (BVI) Ltd. and Connected Environments Ltd. and their Cosm service and in January 2012 we acquired substantially all of the assets and liabilities of Bold Software, LLC and its BoldChat service. We also may enter into relationships with other businesses to expand our portfolio of services or our ability to provide our services in foreign jurisdictions, which could involve preferred or exclusive licenses, additional channels of distribution, discount pricing or investments in other companies. Negotiating these transactions can be time-consuming, difficult and expensive, and our ability to close these transactions may often be subject to conditions or approvals that are beyond our control. Consequently, these transactions, even if undertaken and announced, may not close.

An acquisition, investment or new business relationship may result in unforeseen operating difficulties and expenditures. In particular, we may encounter difficulties assimilating or integrating the businesses, technologies, products, personnel or operations of the acquired companies, particularly if the key personnel of the acquired company choose not to work for us, the company's software is not easily adapted to work with ours or we have difficulty retaining the customers of any acquired business due to changes in management or otherwise. Acquisitions may also disrupt our business, divert our resources and require significant management attention that would otherwise be available for development of our business. Moreover, the anticipated benefits of any acquisition, investment or business relationship may not be realized or we may be exposed to unknown liabilities. For one or more of those transactions, we may:

issue additional equity securities that would dilute our stockholders;

use cash that we may need in the future to operate our business;

incur debt on terms unfavorable to us or that we are unable to repay;

incur large charges or substantial liabilities;

encounter difficulties retaining key employees of the acquired company or integrating diverse software codes or business cultures;  
and

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become subject to adverse tax consequences, substantial depreciation or deferred compensation charges. Any of these risks could harm our business and operating results.

***We expect that integrating an acquired company's operations may present challenges.***

The integration of an acquired company such as our recent acquisition of substantially all of the assets and liabilities of Connected Environments (BVI) Ltd. and Connected Environments Ltd. and their Cosm service and our recent acquisition of substantially all of the assets and liabilities of Bold Software, LLC and its BoldChat service requires, among other things, coordination of administrative, sales and marketing, accounting and finance functions and expansion of information and management systems. Integration may prove to be difficult initially due to the necessity of coordinating geographically separate organizations and integrating personnel with disparate business backgrounds and corporate cultures. We may not be able to retain key employees of Connected Environments, Bold Software or any other acquired company. Additionally, the process of integrating a new product or service may require a disproportionate amount of time and attention of our management and financial and other resources. Any difficulties or problems encountered in the integration of a new product or service could have a material adverse effect on our business.

The integration of an acquired company may cost more than we anticipate, and it is possible that we will incur significant additional unforeseen costs in connection with the integration that may negatively impact our earnings.

In addition, we may only be able to conduct limited due diligence on an acquired company's operations. Following an acquisition, we may be subject to unforeseen liabilities arising from an acquired company's past or present operations. These liabilities may be greater than the warranty and indemnity limitations we negotiate. Any unforeseen liability that is greater than these warranty and indemnity limitations could have a negative impact on our financial condition.

Even if successfully integrated, there can be no assurance that our operating performance after an acquisition will be successful or will fulfill management's objectives.

***We use a limited number of data centers to deliver our services. Any disruption of service at these facilities could harm our business.***

We host our services and serve all of our customers from five third-party data center facilities, of which four are located in the United States and one is located in Europe. We do not control the operation of these facilities. The owners of our data center facilities have no obligation to renew their agreements with us on commercially reasonable terms, or at all. If we are unable to renew these agreements on commercially reasonable terms, we may be required to transfer to new data center facilities, and we may incur significant costs and possible service interruption in connection with doing so.

Any changes in third-party service levels at our data centers or any errors, defects, disruptions or other performance problems with our services could harm our reputation and may damage our customers' businesses. Interruptions in our services might reduce our revenue, cause us to issue credits to customers, subject us to potential liability, cause customers to terminate their subscriptions or harm our renewal rates.

Our data centers are vulnerable to damage or interruption from human error, intentional bad acts, pandemics, earthquakes, hurricanes, floods, fires, war, terrorist attacks, power losses, hardware failures, systems failures, telecommunications failures and similar events. At least one of our data facilities is located in an area known for seismic activity, increasing our susceptibility to the risk that an earthquake could significantly harm the operations of these facilities. The occurrence of a natural disaster or an act of terrorism, or vandalism or other misconduct, a decision to close the facilities without adequate notice or other unanticipated problems could result in lengthy interruptions in our services.

***If the security of our customers' confidential information stored in our systems is breached or otherwise subjected to unauthorized access, our reputation may be harmed, and we may be exposed to liability and a loss of customers.***

Our system stores our customers' confidential information, including credit card information and other critical data. Any accidental or willful security breaches or other unauthorized access could expose us to liability for the loss of such information, time-consuming and expensive litigation and other possible liabilities as well as negative publicity. Techniques used to obtain unauthorized access or to sabotage systems change frequently and generally are difficult to recognize and react to. We and our third-party data center facilities may be unable to anticipate these techniques or to implement adequate preventative or reactionary measures.

In addition, many states have enacted laws requiring companies to notify individuals of data security breaches involving their personal data. These mandatory disclosures regarding a security breach often lead to widespread negative publicity, which may cause our customers to lose confidence in the effectiveness of our data security measures. Any security breach, whether successful or not, would harm our reputation, and it

could cause the loss of customers.

*Failure to comply with data protection standards may cause us to lose the ability to offer our customers a credit card payment option which would increase our costs of processing customer orders and make our services less attractive to our customers, the majority of which purchase our services with a credit card.*

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Major credit card issuers have adopted data protection standards and have incorporated these standards into their contracts with us. If we fail to maintain our compliance with the data protection and documentation standards adopted by the major credit card issuers and applicable to us, these issuers could terminate their agreements with us, and we could lose our ability to offer our customers a credit card payment option. Most of our individual and SMB customers purchase our services online with a credit card, and our business depends substantially upon our ability to offer the credit card payment option. Any loss of our ability to offer our customers a credit card payment option would make our services less attractive to them and hurt our business. Our administrative costs related to customer payment processing would also increase significantly if we were not able to accept credit card payments for our services.

***Failure to effectively and efficiently service SMBs would adversely affect our ability to increase our revenue.***

We market and sell a significant amount of our services to SMBs. SMBs are challenging to reach, acquire and retain in a cost-effective manner. To grow our revenue quickly, we must add new customers, sell additional services to existing customers and encourage existing customers to renew their subscriptions. Selling to and retaining SMBs is more difficult than selling to and retaining large enterprise customers because SMB customers generally:

have high failure rates;

are price sensitive;

are difficult to reach with targeted sales campaigns;

have high churn rates in part because of the scale of their businesses and the ease of switching services; and

generate less revenues per customer and per transaction.

In addition, SMBs frequently have limited budgets and may choose to spend funds on items other than our services. Moreover, SMBs are more likely to be significantly affected by economic downturns than larger, more established companies, and if these organizations experience economic hardship, they may be unwilling or unable to expend resources on IT.

If we are unable to market and sell our services to SMBs with competitive pricing and in a cost-effective manner, our ability to grow our revenue quickly and become profitable will be harmed.

***We may not be able to respond to rapid technological changes with new services, which could have a material adverse effect on our sales and profitability.***

The on-demand, cloud-based, remote-connectivity solutions market is characterized by rapid technological change, frequent new service introductions and evolving industry standards. Our ability to attract new customers and increase revenue from existing customers will depend in large part on our ability to enhance and improve our existing services, introduce new services and sell into new markets. To achieve market acceptance for our services, we must effectively anticipate and offer services that meet changing customer demands in a timely manner. Customers may require features and capabilities that our current services do not have. If we fail to develop services that satisfy customer preferences in a timely and cost-effective manner, our ability to renew our services with existing customers and our ability to create or increase demand for our services will be harmed.

We may experience difficulties with software development, industry standards, design or marketing that could delay or prevent our development, introduction or implementation of new services and enhancements. The introduction of new services by competitors, the emergence of new industry standards or the development of entirely new technologies to replace existing service offerings could render our existing or future services obsolete. If our services become obsolete due to wide-spread adoption of alternative connectivity technologies such as other Web-based computing solutions, our ability to generate revenue may be impaired. In addition, any new markets into which we attempt to sell our services, including new countries or regions, may not be receptive.

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If we are unable to successfully develop or acquire new services, enhance our existing services to anticipate and meet customer preferences or sell our services into new markets, our revenue and results of operations would be adversely affected.

***The market in which we participate is competitive, with low barriers to entry, and if we do not compete effectively, our operating results may be harmed.***

The markets for remote-connectivity solutions are competitive and rapidly changing, with relatively low barriers to entry. With the introduction of new technologies and market entrants, we expect competition to intensify in the future. In addition, pricing pressures and increased competition generally could result in reduced sales, reduced margins or the failure of our services to achieve or maintain widespread market acceptance. Often we compete against existing services that our potential customers have already made significant expenditures to acquire and implement.

Certain of our competitors offer, or may in the future offer, lower priced, or free, products or services that compete with our solutions. This competition may result in reduced prices and a substantial loss of customers for our solutions or a reduction in our revenue.

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We compete with Citrix Systems, WebEx (a division of Cisco Systems) and others. Certain of our solutions, including our free remote access service, also compete with current or potential services offered by Microsoft and Apple. Many of our actual and potential competitors enjoy competitive advantages over us, such as greater name recognition, longer operating histories, more varied services and larger marketing budgets, as well as 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. If we are not able to compete effectively, our operating results will be harmed.

### ***Industry consolidation may result in increased competition.***

Some of our competitors have made or may make acquisitions or may enter into partnerships or other strategic relationships to offer a more comprehensive service than they individually had offered. In addition, new entrants not currently considered to be competitors may enter the market through acquisitions, partnerships or strategic relationships. We expect these trends to continue as companies attempt to strengthen or maintain their market positions. Many of the companies driving this trend have significantly greater financial, technical and other resources than we do and may be better positioned to acquire and offer complementary services and technologies. The companies resulting from such combinations may create more compelling service offerings and may offer greater pricing flexibility than we can or may engage in business practices that make it more difficult for us to compete effectively, including on the basis of price, sales and marketing programs, technology or service functionality. These pressures could result in a substantial loss of customers or a reduction in our revenues.

### ***Original equipment manufacturers may adopt solutions provided by our competitors.***

Original equipment manufacturers may in the future seek to build the capability for on-demand, remote-connectivity solutions into their products. We may compete with our competitors to sell our services to, or partner with, these manufacturers. Our ability to attract and partner with these manufacturers will, in large part, depend on the competitiveness of our services. If we fail to attract or partner with, or our competitors are successful in attracting or partnering with, these manufacturers, our revenue and results of operations would be affected adversely.

### ***Our quarterly operating results may fluctuate in the future. As a result, we may fail to meet or exceed the expectations of research analysts or investors, which could cause our stock price to decline.***

Our quarterly operating results may fluctuate as a result of a variety of factors, many of which are outside of our control. If our quarterly operating results or guidance fall below the expectations of research analysts or investors, the price of our common stock could decline substantially. Fluctuations in our quarterly operating results or guidance may be due to a number of factors, including, but not limited to, those listed below:

our ability to renew existing customers, increase sales to existing customers and attract new customers;

the amount and timing of operating costs and capital expenditures related to the operation, maintenance and expansion of our business;

service outages or security breaches;

whether we meet the service level commitments in our agreements with our customers;

changes in our pricing policies or those of our competitors;

the timing and success of new application and service introductions and upgrades by us or our competitors;



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changes in sales compensation plans or organizational structure;

the timing of costs related to the development or acquisition of technologies, services or businesses;

seasonal variations or other cyclicalities in the demand for our services;

general economic, industry and market conditions and those conditions specific to Internet usage and online businesses;

the purchasing and budgeting cycles of our customers;

the financial condition of our customers; and

geopolitical events such as war, threat of war or terrorist acts.

We believe that our quarterly revenue and operating results may vary significantly in the future and that period-to-period comparisons of our operating results may not be meaningful. You should not rely on past results as an indication of future performance.

***If our services are used to commit fraud or other similar intentional or illegal acts, we may incur significant liabilities, our services may be perceived as not secure and customers may curtail or stop using our services.***

Our services enable direct remote access to third-party computer systems. We do not control the use or content of information accessed by our customers through our services. If our services are used to commit fraud or other bad or illegal acts, such as posting, distributing or transmitting any software or other computer files that contain a virus or other harmful component, interfering or disrupting third-party networks, infringing any third party's copyright, patent, trademark, trade secret or other proprietary rights or rights of publicity or privacy, transmitting any unlawful, harassing, libelous, abusive, threatening, vulgar or otherwise objectionable material, or accessing

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unauthorized third-party data, we may become subject to claims for defamation, negligence, intellectual property infringement or other matters. As a result, defending such claims could be expensive and time-consuming, and we could incur significant liability to our customers and to individuals or businesses who were the targets of such acts. As a result, our business may suffer and our reputation will be damaged.

***We provide minimum service level commitments to some of our customers, the failure of which to meet could cause us to issue credits for future services or pay penalties, which could significantly harm our revenue.***

Some of our customer agreements now, and may in the future, provide minimum service level commitments regarding items such as uptime, functionality or performance. If we are unable to meet the stated service level commitments for these customers or suffer extended periods of unavailability for our service, we are or may be contractually obligated to provide these customers with credits for future services or pay other penalties. Our revenue could be significantly impacted if we are unable to meet our service level commitments and are required to provide a significant amount of our services at no cost or pay other penalties. We do not currently have any reserves on our balance sheet for these commitments.

***If we fail to manage our growth effectively, we may be unable to execute our business plan, maintain high levels of service or address competitive challenges adequately.***

We increased our revenue from \$51.7 million in 2008 to \$74.4 million in 2009 to \$101.1 million in 2010 to \$119.5 million in 2011 and to \$101.9 million for the nine months ended September 30, 2012. Our growth has placed, and may continue to place, a significant strain on our managerial, administrative, operational, financial and other resources. We intend to further expand our overall business, customer base, headcount and operations both domestically and internationally. Creating a global organization and managing a geographically dispersed workforce will require substantial management effort and significant additional investment in our infrastructure. We will be required to continue to improve our operational, financial and management controls and our reporting procedures and we may not be able to do so effectively. As such, we may be unable to manage our expenses effectively in the future, which may negatively impact our gross profit or operating expenses in any particular quarter.

***If we do not effectively expand and train our work force, our future operating results will suffer.***

We plan to continue to expand our work force both domestically and internationally to increase our customer base and revenue. We believe that there is significant competition for qualified personnel with the skills and technical knowledge that we require. Our ability to achieve significant revenue growth will depend, in large part, on our success in recruiting, training and retaining sufficient numbers of personnel to support our growth. New hires require significant training and, in most cases, take significant time before they achieve full productivity. Our recent hires and planned hires may not become as productive as we expect, and we may be unable to hire or retain sufficient numbers of qualified individuals. If our recruiting, training and retention efforts are not successful or do not generate a corresponding increase in revenue, our business will be harmed.

***Our sales cycles for enterprise customers, which currently account for approximately 10 to 15% of our overall sales, can be long, unpredictable and require considerable time and expense, which may cause our operating results to fluctuate.***

The timing of our revenue from sales to enterprise customers is difficult to predict. These efforts require us to educate our customers about the use and benefit of our services, including the technical capabilities and potential cost savings to an organization. Enterprise customers typically undertake a significant evaluation process that has in the past resulted in a lengthy sales cycle, typically several months. We spend substantial time, effort and money on our enterprise sales efforts without any assurance that our efforts will produce any sales. In addition, service subscriptions are frequently subject to budget constraints and unplanned administrative, processing and other delays. If sales expected from a specific customer for a particular quarter are not realized in that quarter or at all, our results could fall short of public expectations and our business, operating results and financial condition could be adversely affected.

***Our long-term success depends, in part, on our ability to expand the sales of our services to customers located outside of the United States, and thus our business is susceptible to risks associated with international sales and operations.***

We currently maintain offices and have sales personnel or independent consultants outside of the United States and are expanding our international operations. Our international expansion efforts may not be successful. In addition, conducting international operations subjects us to new risks that we have not generally faced in the United States.

These risks include:

localization of our services, including translation into foreign languages and adaptation for local practices and regulatory requirements;

lack of familiarity with and unexpected changes in foreign regulatory requirements;

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

difficulties in managing and staffing international operations;

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fluctuations in currency exchange rates;

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

dependence on certain third parties, including channel partners with whom we do not have extensive experience;

the burdens of complying with a wide variety of foreign laws and legal standards;

increased financial accounting and reporting burdens and complexities;

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

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

Operating in international markets also requires significant management attention and financial resources. The investment and additional resources required to establish operations and manage growth in other countries may not produce desired levels of revenue or profitability.

***Adverse economic conditions or reduced IT spending may adversely impact our revenues and profitability.***

Our business depends on the overall demand for IT and on the economic health of our current and prospective customers. The use of our service is often discretionary and may involve a commitment of capital and other resources. Weak economic conditions in the United States, European Union and other key international economies may affect the rate of IT spending and could adversely impact our customers' ability or willingness to purchase our services, delay prospective customers' purchasing decisions, reduce the value or duration of their subscription contracts, or affect renewal rates, all of which could have an adverse effect on our business, operating results and financial condition.

***Our success depends on our customers' continued high-speed access to the Internet and the continued reliability of the Internet infrastructure.***

Because our services are designed to work over the Internet, our revenue growth depends on our customers' high-speed access to the Internet, as well as the continued maintenance and development of the Internet infrastructure. The future delivery of our services will depend on third-party Internet service providers to expand high-speed Internet access, to maintain a reliable network with the necessary speed, data capacity and security, and to develop complementary products and services, including high-speed modems, for providing reliable and timely Internet access and services. The success of our business depends directly on the continued accessibility, maintenance and improvement of the Internet as a convenient means of customer interaction, as well as an efficient medium for the delivery and distribution of information by businesses to their employees. All of these factors are out of our control.

To the extent that the Internet continues to experience increased numbers of users, frequency of use or bandwidth requirements, the Internet may become congested and be unable to support the demands placed on it, and its performance or reliability may decline. Any future Internet outages or delays could adversely affect our ability to provide services to our customers.

***Our success depends in large part on our ability to protect and enforce our intellectual property rights.***

We rely on a combination of copyright, service mark, trademark and trade secret laws, as well as confidentiality procedures and contractual restrictions, to establish and protect our proprietary rights, all of which provide only limited protection. In addition, we have one issued patent and three patents pending, and we are in the process of filing additional patents. We cannot assure you that any patents will issue from our currently pending patent applications in a manner that gives us the protection that we seek, if at all, or that any future patents issued to us will not be challenged, invalidated or circumvented. Any patents that may issue in the future from pending or future patent applications may not provide sufficiently broad protection or they may not prove to be enforceable in actions against alleged infringers. Also, we cannot assure you

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that any future service mark or trademark registrations will be issued for pending or future applications or that any registered service marks or trademarks will be enforceable or provide adequate protection of our proprietary rights.

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

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

*Our use of open source software could negatively affect our ability to sell our services and subject us to possible litigation.*

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A portion of the technologies licensed by us incorporate so-called open source software, and we may incorporate open source software in the future. Such open source software is generally licensed by its authors or other third parties under open source licenses. If we fail to comply with these licenses, we may be subject to certain conditions, including requirements that we offer our services that incorporate the open source software for no cost, that we make available source code for modifications or derivative works we create based upon, incorporating or using the open source software and/or that we license such modifications or derivative works under the terms of the particular open source license. If an author or other third party that distributes such open source software were to allege that we had not complied with the conditions of one or more of these licenses, we could be required to incur significant legal expenses defending against such allegations and could be subject to significant damages, enjoined from the sale of our services that contained the open source software and required to comply with the foregoing conditions, which could disrupt the distribution and sale of some of our services.

***We rely on third-party software, including server software and licenses from third parties to use patented intellectual property that is required for the development of our services, which may be difficult to obtain or which could cause errors or failures of our services.***

We rely on software licensed from third parties to offer our services, including server software from Microsoft and patented third-party technology. In addition, we may need to obtain future licenses from third parties to use intellectual property associated with the development of our services, which might not be available to us on acceptable terms, or at all. Any loss of the right to use any software required for the development and maintenance of our services could result in delays in the provision of our services until equivalent technology is either developed by us, or, if available, is identified, obtained and integrated, which could harm our business. Any errors or defects in third-party software could result in errors or a failure of our services which could harm our business.

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

Ensuring that we have adequate internal financial and accounting controls and procedures in place so that we can produce accurate financial statements on a timely basis is a costly and time-consuming effort. Our internal controls 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 in the United States of America. In addition, Section 404 of the Sarbanes-Oxley Act of 2002, or the Sarbanes-Oxley Act, requires an annual management assessment of the effectiveness of our internal controls over financial reporting and a report from our independent registered public accounting firm addressing the effectiveness of our internal controls over financial reporting. We have documented, tested and improved, to the extent necessary, our internal controls over financial reporting for the year ended December 31, 2011. 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.

***Material defects or errors in the software we use to deliver our services could harm our reputation, result in significant costs to us and impair our ability to sell our services.***

The software applications underlying our services are inherently complex and may contain material defects or errors, particularly when first introduced or when new versions or enhancements are released. We have from time to time found defects in our services, and new errors in our existing services may be detected in the future. Any defects that cause interruptions to the availability of our services could result in:

a reduction in sales or delay in market acceptance of our services;

sales credits or refunds to our customers;

loss of existing customers and difficulty in attracting new customers;

diversion of development resources;

harm to our reputation; and

increased insurance costs.

After the release of our services, defects or errors may also be identified from time to time by our internal team and by our customers. The costs incurred in correcting any material defects or errors in our services may be substantial and could harm our operating results.

***Government regulation of the Internet and e-commerce and of the international exchange of certain technologies is subject to possible unfavorable changes, and our failure to comply with applicable regulations could harm our business and operating results.***

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As Internet commerce continues to evolve, increasing regulation by federal, state or foreign governments becomes more likely. For example, we believe increased regulation is likely in the area of data privacy, and laws and regulations applying to the solicitation, collection, processing or use of personal or consumer information could affect our customers' ability to use and share data, potentially reducing demand for our products and services. 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 the exchange of information over the Internet could result in reduced growth or a decline in the use of the Internet and could diminish the viability of our Internet-based services, which could harm our business and operating results.

Our software products contain encryption technologies, certain types of which are subject to U.S. and foreign export control regulations and, in some foreign countries, restrictions on importation and/or use. We have submitted our encryption products for technical review under U.S. export regulations and have received the necessary approvals. Any failure on our part to comply with encryption or other applicable export control requirements could result in financial penalties or other sanctions under the U.S. export regulations, which could harm our business and operating results. Foreign regulatory restrictions could impair our access to technologies that we seek for improving our products and services and may also limit or reduce the demand for our products and services outside of the United States.

***Our operating results may be harmed if we are required to collect sales or other related taxes for our subscription services in jurisdictions where we have not historically done so.***

Primarily due to the nature of our services in certain states and countries, we do not believe we are required to collect sales or other related taxes from our customers in certain states or countries. However, one or more other states or countries may seek to impose sales or other tax collection obligations on us, including for past sales by us or our resellers and other partners. A successful assertion that we should be collecting sales or other related taxes on our services could result in substantial tax liabilities for past sales, discourage customers from purchasing our services or otherwise harm our business and operating results. In September 2011, we agreed to make a payment in the amount of \$1.3 million to resolve uncollected sales tax claims with a state tax assessor's office.

***The loss of key personnel or an inability to attract and retain additional personnel may impair our ability to grow our business.***

We are highly dependent upon the continued service and performance of our senior management team and key technical and sales personnel, including our President and Chief Executive Officer, Chief Financial Officer and Chief Technical Officer. These officers are not party to an employment agreement with us, and they may terminate employment with us at any time with no advance notice. The replacement of these officers likely would involve significant time and costs, and the loss of these officers may significantly delay or prevent the achievement of our business objectives.

We face intense competition for qualified individuals from numerous technology, software and manufacturing companies. For example, our competitors may be able to attract and retain a more qualified engineering team by offering more competitive compensation packages. If we are unable to attract new engineers and retain our current engineers, we may not be able to develop and maintain our services at the same levels as our competitors and we may, therefore, lose potential customers and sales penetration in certain markets. Our failure to attract and retain suitably qualified individuals could have an adverse effect on our ability to implement our business plan and, as a result, our ability to compete would decrease, our operating results would suffer and our revenues would decrease.

***Our business is substantially dependent on market demand for, and acceptance of, the on-demand model for the use of software.***

We derive, and expect to continue to derive, substantially all of our revenue from the sale of on-demand solutions. As a result, widespread acceptance and use of the on-demand business model is critical to our future growth and success. Under the perpetual or periodic license model for software procurement, users of the software typically run applications on their hardware. Because companies are generally predisposed to maintaining control of their IT systems and infrastructure, there may be resistance to the concept of accessing the functionality that software provides as a service through a third party. If the market for on-demand, software solutions fails to grow or grows more slowly than we currently anticipate, demand for our services could be negatively affected.



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**RISKS RELATED TO OWNERSHIP OF OUR COMMON STOCK**

*Our failure to raise additional capital or generate the cash flows necessary to expand our operations and invest in our services could reduce our ability to compete successfully.*

We may need to raise additional funds, and we may not be able to obtain additional debt or equity financing on favorable terms, if at all. If we raise additional equity financing, our stockholders may experience significant dilution of their ownership interests, and the per share value of our common stock could decline. If we engage in debt financing, we may be required to accept terms that restrict our ability to incur additional indebtedness and force us to maintain specified liquidity or other ratios. If we need additional capital and cannot raise it on acceptable terms, we may not be able to, among other things:

develop or enhance our services;

continue to expand our development, sales and marketing organizations;

acquire complementary technologies, products or businesses;

expand our operations, in the United States or internationally;

hire, train and retain employees; or

respond to competitive pressures or unanticipated working capital requirements.

*Our stock price may be volatile, and the market price of our common stock may drop in the future.*

Prior to the completion of our initial public offering, or IPO, in July 2009, there was no public market for shares of our common stock. During the period from our IPO until October 25, 2012, our common stock has traded as high as \$49.50 and as low as \$15.15. An active, liquid and orderly market for our common stock may not develop or be sustained, which could depress the trading price of our common stock. Some of the factors that may cause the market price of our common stock to fluctuate include:

fluctuations in our quarterly financial results or the quarterly financial results of companies perceived to be similar to us;

fluctuations in our recorded revenue, even during periods of significant sales order activity;

changes in estimates of our financial results or recommendations by securities analysts;

failure of any of our services to achieve or maintain market acceptance;

changes in market valuations of similar companies;

success of competitive products or services;

changes in our capital structure, such as future issuances of securities or the incurrence of debt;

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announcements by us or our competitors of significant services, contracts, acquisitions or strategic alliances;

regulatory developments in the United States, foreign countries or both;

litigation involving our company, our general industry or both;

additions or departures of key personnel;

general perception of the future of the remote-connectivity market or our services;

investors' general perception of us; and

changes in general economic, industry and market conditions.

In addition, if the market for technology stocks or the stock market in general experiences a loss of investor confidence, the trading price of our common stock could decline for reasons unrelated to our business, financial condition or results of operations. If any of the foregoing occurs, it could cause our stock price to fall and may expose us to class action lawsuits that, even if unsuccessful, could be costly to defend and a distraction to management.

***A significant portion of our total outstanding shares may be sold into the public market at any time, which could cause the market price of our common stock to drop significantly, even if our business is doing well.***

If our existing stockholders sell a large number of shares of our common stock or the public market perceives that such existing stockholders might sell shares of common stock, the trading price of our common stock could decline significantly.

***If securities or industry analysts do not publish or cease publishing research or reports about us, our business or our market, or if they change their recommendations regarding our stock adversely, our stock price and trading volume could decline.***

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The trading market for our common stock is influenced by the research and reports that industry or securities analysts publish about us, our business, our market or our competitors. If any of the analysts who cover us or may cover us in the future change their recommendation regarding our stock adversely, or provide more favorable relative recommendations about our competitors, our stock price would likely decline. If any analyst who covers us or may cover us in the future were to cease coverage of our company or fail to regularly publish reports on us, we could lose visibility in the financial markets, which in turn could cause our stock price or trading volume to decline.

***Our management has broad discretion over the use of our existing cash resources and might not use such funds in ways that increase the value of our common stock.***

Our management will continue to have broad discretion to use our cash resources. Our management might not apply these cash resources in ways that increase the value of our common stock.

***We do not expect to declare any dividends in the foreseeable future.***

We do not anticipate declaring any cash dividends to holders of our common stock in the foreseeable future. Consequently, stockholders must rely on sales of their common stock after price appreciation, which may never occur, as the only way to realize any future gains on the value of their shares of our common stock.

***As a public company, we incur significant additional costs which could harm our operating results.***

As a public company, we incur significant legal, accounting and other expenses, including costs associated with public company reporting requirements. We also have incurred and will continue to incur costs associated with current corporate governance requirements, including requirements under Section 404 and other provisions of the Sarbanes-Oxley Act, as well as rules implemented by the Securities and Exchange Commission, or SEC, and The NASDAQ Global Select Market. The expenses incurred by public companies for reporting and corporate governance purposes have increased dramatically. We expect these rules and regulations to substantially increase our legal and financial compliance costs and to make some activities more time-consuming and costly. We also expect these new rules and regulations may make it more difficult and more expensive for us to maintain director and officer liability insurance, and we may be required to accept reduced policy limits and coverage or incur substantially higher costs to obtain the same or similar coverage previously available. As a result, it may be more difficult for us to attract and retain qualified individuals to serve on our board of directors or as our executive officers.

***Anti-takeover provisions contained in our certificate of incorporation and bylaws, as well as provisions of Delaware law, could impair a takeover attempt.***

Our certificate of incorporation, bylaws and Delaware law contain provisions that could have the effect of rendering more difficult or discouraging an acquisition deemed undesirable by our board of directors. Our corporate governance documents include provisions:

authorizing blank check preferred stock, which could be issued with voting, liquidation, dividend and other rights superior to our common stock;

limiting the liability of, and providing indemnification to, our directors and officers;

limiting the ability of our stockholders to call and bring business before special meetings and to take action by written consent in lieu of a meeting;

requiring advance notice of stockholder proposals for business to be conducted at meetings of our stockholders and for nominations of candidates for election to our board of directors;

controlling the procedures for the conduct and scheduling of board of directors and stockholder meetings;

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providing the board of directors with the express power to postpone previously scheduled annual meetings and to cancel previously scheduled special meetings;

limiting the determination of the number of directors on our board of directors and the filling of vacancies or newly created seats on the board to our board of directors then in office; and

providing that directors may be removed by stockholders only for cause.

These provisions, alone or together, could delay hostile takeovers and changes in control of our company or changes in our management.

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As a Delaware corporation, we are also subject to provisions of Delaware law, including Section 203 of the Delaware General Corporation law, which prevents some stockholders holding more than 15% of our outstanding common stock from engaging in certain business combinations without approval of the holders of substantially all of our outstanding common stock. Any provision of our certificate of incorporation or bylaws or Delaware law that has the effect of delaying or deterring a change in control could limit the opportunity for our stockholders to receive a premium for their shares of our common stock, and could also affect the price that some investors are willing to pay for our common stock.

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

(a) Sales of Unregistered Securities

We did not sell any unregistered securities in the three months ended September 30, 2012.

**Item 6. Exhibits**

The exhibits listed in the Exhibit Index immediately preceding the exhibits are filed (other than exhibits 32.1 and 32.2) as part of this Quarterly Report on Form 10-Q and such Exhibit Index is incorporated herein by reference.

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**SIGNATURES**

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

**LOGMEIN, INC.**

Date: October 25, 2012

By: /s/ Michael K. Simon

Michael K Simon  
President and Chief Executive Officer

(Principal Executive Officer)

Date: October 25, 2012

By: /s/ James F. Kelliher

James F. Kelliher  
Chief Financial Officer

(Principal Financial Officer)

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*EXHIBIT INDEX*

Listed and indexed below are all Exhibits filed as part of this report.

**Exhibit**

| <b>No.</b> | <b>Description</b>   |
|------------|--|
| 31.1       | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 by Chief Executive Officer.   |
| 31.2       | Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 by Chief Financial Officer.   |
| 32.1       | Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, by Chief Executive Officer.  |
| 32.2       | Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, by Chief Financial Officer.  |
| 101        | The following materials from LogMeIn, Inc.'s Quarterly Report on Form 10-Q for the quarter ended September 30, 2012, formatted in XBRL (Extensible Business Reporting Language): (i) the Condensed Consolidated Balance Sheets, (ii) Condensed Consolidated Statements of Operations, (iii) the Condensed Consolidated Statements of Comprehensive Income, (iv) the Condensed Consolidated Statements of Cash Flows, and (v) Notes to Condensed Consolidated Financial Statements. |