

PROS Holdings, Inc.  
Form 10-Q  
August 07, 2008  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington D.C. 20549

**FORM 10-Q**

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

**For the quarterly period ended June 30, 2008**

**OR**

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

**For the Transition Period from**                      **to**

**Commission File Number: 333-141884**

**PROS HOLDINGS, INC.**

(Exact name of registrant as specified in its charter)

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

**76-0168604**  
(I.R.S. Employer Identification No.)

**3100 Main Street, Suite 900, Houston, TX 77002**  
**(713) 335-5151**

(Address and telephone number of principal executive offices)

Indicate by check mark whether 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) had been subject to such filing requirements for the past 90 days. Yes  No

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

Large Accelerated Filer  Accelerated Filer  Non-Accelerated Filer  Smaller Reporting Company

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

The number of shares outstanding of the Registrant's Common Stock, \$0.01 par value, was 26,223,593 as of August 1, 2008.

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PROS Holdings, Inc.

Form 10-Q for the Quarter Ended June 30, 2008

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## Cautionary Statement

*Except for the historical financial information contained herein, the matters discussed in this report on Form 10-Q (as well as documents incorporated herein by reference) may be considered forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Such forward-looking statements include declarations regarding the intent, belief or current expectations of PROS Holdings, Inc. and its management and may be signified by the words expects, anticipates, target, project, goals, estimates, potential, predicts, may, might, could, intends, believes or similar language. You are cautioned that any such forward-looking statements are not guarantees of future performance and involve a number of risks and uncertainties. Actual results could differ materially from those indicated by such forward-looking statements. Factors that could cause or contribute to such differences include those discussed under Risk Factors and elsewhere in this report. PROS Holdings, Inc. disclaims any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.*

Table of Contents**PART I. Financial Information****Item 1. Unaudited Condensed Consolidated Financial Statements****PROS Holdings, Inc.****Condensed Consolidated Balance Sheets****(Dollars in thousands, except share and per share data)****(Unaudited)**

	<b>June 30, 2008</b>	<b>December 31, 2007</b>
<b>Assets:</b>		
Current assets:		
Cash and cash equivalents	\$ 48,816	\$ 44,378
Accounts and unbilled receivables, net of allowance of \$1,575 and \$1,550 respectively	16,856	14,896
Prepaid expenses	443	859
Other current assets	2,497	3,191
Total current assets	68,612	63,324
Property and equipment, net	3,197	3,063
Other long term assets, net	1,897	2,593
Total assets	\$ 73,706	\$ 68,980
<b>Liabilities and stockholders equity:</b>		
Current liabilities:		
Accounts payable	\$ 1,573	\$ 1,466
Accrued liabilities	2,023	2,904
Accrued payroll and other employee benefits	3,479	4,778
Deferred revenue	19,389	20,259
Other current liabilities	4,866	
Total current liabilities	31,330	29,407
Long-term deferred revenue	1,741	5,885
Commitments and contingencies (See Note 4)		
Stockholders equity:		
Common stock, \$0.001 par value, 75,000,000 shares authorized, 30,069,466 and 29,926,529 shares issued, respectively, 26,222,426 and 26,079,489 shares outstanding respectively	30	30
Additional paid-in capital	55,494	53,361
Treasury stock, 3,847,040 common shares at cost	(8,938)	(8,938)
Accumulated deficit	(5,951)	(10,765)
Total stockholders equity	40,635	33,688
Total liabilities and stockholders equity	\$ 73,706	\$ 68,980

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

Table of Contents**PROS Holdings, Inc.****Condensed Consolidated Statements of Operations****(Dollars in thousands, except share and per share data)****(Unaudited)**

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2008	2007	2008	2007
<b>Revenue:</b>				
License and implementation	\$ 13,375	\$ 9,893	\$ 26,181	\$ 18,915
Maintenance and support	5,237	4,522	10,351	8,951
Total revenue	18,612	14,415	36,532	27,866
<b>Cost of revenue:</b>				
License and implementation	3,596	3,218	7,009	6,407
Maintenance and support	1,059	1,105	2,239	2,094
Total cost of revenue	4,655	4,323	9,248	8,501
Gross profit	13,957	10,092	27,284	19,365
<b>Operating expenses:</b>				
Selling, general and administrative	5,593	3,777	10,718	6,925
Research and development	5,159	4,324	9,831	8,065
Income from operations	3,205	1,991	6,735	4,375
Other income (expense):				
Interest income	302	62	724	595
Interest expense		(441)		(457)
Income before income tax provision	3,507	1,612	7,459	4,513
Income tax provision	1,266	344	2,646	950
Net income	2,241	1,268	4,813	3,563
Accretion of preferred stock				(82)
Net earnings attributable to common stockholders	\$ 2,241	\$ 1,268	\$ 4,813	\$ 3,481
Net earnings attributable to common stockholders per share:				
Basic	\$ 0.09	\$ 0.06	\$ 0.18	\$ 0.17
Diluted	\$ 0.08	\$ 0.06	\$ 0.18	\$ 0.16
Weighted average number of shares:				
Basic	26,215,014	20,669,134	26,188,225	20,216,903
Diluted	26,511,933	21,818,421	26,588,661	21,366,190

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



Table of Contents**PROS Holdings, Inc.****Condensed Consolidated Statements of Cash Flows****(Dollars in thousands)****(Unaudited)**

	<b>For the Six Months Ended June 30,</b>	
	<b>2008</b>	<b>2007</b>
<b>Operating activities:</b>		
Net income	\$ 4,813	\$ 3,563
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	642	595
Stock based compensation	1,893	509
Other, net		21
Changes in operating assets and liabilities:		
Accounts receivable, net	(854)	(867)
Unbilled receivables	(1,268)	(1,355)
Prepaid expenses and other	738	(304)
Accounts payable, accrued liabilities, accrued contract labor and accrued payroll	(2,044)	(2,062)
Deferred revenue	1,082	1,037
Net cash provided by operating activities	5,002	1,137
<b>Investing activities:</b>		
Purchases of property and equipment	(805)	(696)
Net cash used in investing activities	(805)	(696)
<b>Financing activities:</b>		
Proceeds from long-term debt		20,000
Dividend on common stock		(41,328)
Payments on long-term debt		(50)
Redemption of redeemable preferred stock		(17,365)
Exercise of stock options	241	661
Initial public offering costs		(313)
Deferred loan costs		(418)
Net cash provided by (used in) financing activities	241	(38,813)
Net increase (decrease) in cash and cash equivalents	4,438	(38,372)
<b>Cash and cash equivalents:</b>		
Beginning of period	44,378	42,540
End of period	\$ 48,816	\$ 4,168

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



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**PROS Holdings, Inc.**

**Notes to Unaudited Condensed Consolidated Financial Statements**

**(unaudited)**

**1. Summary of business and basis of presentation**

**Nature of operations**

PROS Holdings, Inc., a Delaware corporation and subsidiaries (the Company), is a provider of pricing and revenue optimization software products, an emerging category of enterprise applications designed to allow companies to improve financial performance by enabling better pricing. Customers use the Company's software products to gain insight into their pricing strategies, identify detrimental pricing activities, optimize their pricing decision-making and improve their business processes and financial performance. The Company's software products incorporate advanced pricing science, which includes operations research, forecasting and statistics. These innovative science-based software products analyze, execute and optimize pricing strategies using data from traditional enterprise applications, often augmenting it with real-time and historical data. The Company also provides a range of services that include analyzing a company's current pricing processes and implementing the Company's software products to improve pricing performance. The Company provides its software products to enterprises across a range of industries, including manufacturing, distribution, services, hotel and cruise, and airline.

**Basis of presentation**

The Unaudited Condensed Consolidated Financial Statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). In management's opinion, the accompanying interim Unaudited Condensed Consolidated Financial Statements include all adjustments consisting of normal recurring accruals necessary for a fair presentation. Although we believe the disclosures in these financial statements are adequate to make the information presented not misleading, certain information and footnote disclosures normally included in annual financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to the rules and regulations of the U.S. Securities and Exchange Commission (SEC). The year-end Condensed Consolidated Balance Sheet data was derived from audited financial statements but does not include all disclosures required by GAAP.

**Basis of consolidation**

The Unaudited Condensed Consolidated Financial Statements include the accounts of PROS Holdings, Inc., and its wholly-owned subsidiaries. All significant intercompany transactions and balances have been eliminated in consolidation.

**Use of estimates**

The Company's management makes estimates and assumptions in the preparation of its Unaudited Condensed Consolidated Financial Statements in conformity with GAAP. These estimates and assumptions may affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the Unaudited Condensed Consolidated Financial Statements and the reported amounts of revenue and expenses during the reporting periods. Actual results could differ from those estimates. The complexity of the estimation process and issues related to the assumptions, risks and uncertainties inherent in the application of the percentage-of-completion method of revenue recognition affect the amounts of revenue, expenses, unbilled receivables and deferred revenue. Numerous internal and external factors can affect estimates. Estimates are also used for, but not limited to, receivables, allowance for doubtful accounts, useful lives of assets, depreciation, income taxes and deferred tax asset valuation, valuation of stock options and accrued liabilities.

**Dollar amounts**

The dollar amounts presented in the tabular data within these footnote disclosures are stated in thousands of dollars, except per unit amounts, or as noted within the context of each footnote disclosure.

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**Fair Value Measurements**

On January 1, 2008, the Company adopted Statement of Financial Accounting Standards ( SFAS ) No. 157, *Fair Value Measurements*, for the fair value measurement of financial assets and financial liabilities measured on a recurring basis. There was no impact to the Unaudited Condensed Consolidated Financial Statements as a result of the adoption of SFAS No. 157 as it relates to financial assets and financial liabilities. In February 2008, the Financial Accounting Standards Board ( FASB ) issued FASB Staff Position No. FAS 157-2, *Effective Date of FASB Statement No. 157*, which defers the effective date for us to January 1, 2009 for all nonfinancial assets and liabilities, except those that are recognized or disclosed at fair value on a recurring basis (that is, at least annually). The Company elected to delay the application of SFAS No. 157 to nonfinancial assets and nonfinancial liabilities, as allowed by FASB Staff Position No. FAS 157-2. The Company believes there will be no impact from the adoption of SFAS No. 157 as it relates to nonfinancial assets and nonfinancial liabilities. For additional information on our adoption of SFAS No. 157, please see Note 5 of the Notes to the Unaudited Condensed Consolidated Financial Statements.

**Foreign currency**

A small percentage of our contracts are denominated in foreign currencies and therefore a portion of our revenue is subject to foreign currency risks. Gains and losses from foreign currency transactions, such as those resulting from the settlement of receivables, are included in the Unaudited Condensed Consolidated Statements of Operations.

**Revenue recognition**

The Company's revenue is recognized in accordance with the provisions of the American Institute of Certified Public Accountants Statement of Position ( SOP ) 97-2, *Software Revenue Recognition* and related interpretations. The Company generates revenue from the licensing of the right to use its software products directly to end-users, implementation, training services, sales of post-contract support and maintenance and support.

Revenue from perpetual software licenses and implementation services is recognized as the services are performed using the percentage-of-completion method in accordance with the provisions contained within SOP 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts*. Our software license arrangements typically include implementation services that are considered essential to the customers' usability of the licensed software products and therefore new software license revenue is generally recognized together with the implementation services based on the percentage-of-completion method. The percentage-of-completion computation is measured by the percentage of man-days incurred during the reporting period as compared to the estimated total man-days necessary for each contract for implementation of the software products. If, at the commencement of a contract, the contract fee is not fixed or determinable, revenue is deferred until the contract fee becomes fixed or determinable. If there is significant uncertainty about contract completion or receipt of payment, revenue is deferred until the uncertainty is sufficiently resolved. Under fixed-fee contracts, should a loss be anticipated on a contract, the full amount thereof is recorded when the loss is determined.

The Company also licenses software products for fixed terms. Fixed-term licenses include maintenance during the license period. Because products are not delivered at the inception of the term, revenue and costs for fixed-term licenses are deferred until the delivery of the product and then recognized ratably over the term of the license. Revenue from fixed-term licenses, which is included in license and implementation revenue in the Unaudited Condensed Consolidated Statements of Operations, represented approximately 3.8% and 5.4%, of total revenue for the

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three months ended June 30, 2008 and 2007, respectively, and approximately 3.7% and 5.5%, of total revenue for the six months ended June 30, 2008 and 2007, respectively.

The Company also licenses software products through subscriptions. Similar to fixed-term license arrangements, revenue and costs for subscription licenses are deferred until the delivery of the product and then recognized ratably over the subscription term. Maintenance, which is stated separately in the agreement, is recognized in accordance with the terms of the agreements and is included in maintenance revenue and represented approximately 1.1% and 1.9%, of total revenue for the three months ended June 30, 2008 and 2007, respectively, and approximately 1.0% and 1.5%, of total revenue for the six months ended June 30, 2008 and 2007, respectively. Revenue from subscriptions, which is included in license and implementation revenue in the Unaudited Condensed Consolidated Statements of Operations, represented approximately 4.3%, and 6.4%, of total revenue for the three months ended June 30, 2008 and 2007, respectively, and approximately 6.1%, and 6.6%, of total revenue for the six months ended June 30, 2008 and 2007, respectively.

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Maintenance and support revenue includes post-contract customer support and the right to unspecified software updates and enhancements on a when and if available basis. For arrangements containing both license and implementation and post-contract customer support, maintenance and support revenue is generally attributed to those contracts based on specific renewal pricing contained therein, which provides vendor-specific fair value of the maintenance and support services, and is recognized ratably over the period in which the services are provided.

Software license and implementation services that have been performed, but for which the Company has not invoiced the customer, are recorded as unbilled receivables, and invoices that have been issued before the software license and implementation services have been performed are recorded as deferred revenue in the accompanying Unaudited Condensed Consolidated Balance Sheets. The Company generally invoices for maintenance and support services on a monthly or quarterly basis through the maintenance and support period.

At March 31, 2008, the Company had \$1.1 million of capitalized implementation costs included in other assets, \$0.2 million in accounts receivable and \$6.1 million of long-term deferred revenue related to a subscription contract from a customer that delivered a notice of contract termination in April 2008. These amounts have been netted and are classified as other current liabilities as future recognition of revenue has been discontinued due to the uncertainty of its realization. This amount will continue to be presented in the Unaudited Condensed Consolidated Balance Sheet as other current liabilities until the matter is resolved.

**Income taxes**

The Company uses the asset and liability method to account for income taxes, including recognition of deferred tax assets and liabilities for the anticipated future tax consequences attributable to differences between financial statement amounts and their respective tax basis. The Company reviews its deferred tax assets for recovery. A valuation allowance is established when the Company believes that it is more likely than not that some portion of its deferred tax assets will not be realized. Changes in the valuation allowance from period to period are included in the Company's tax provision in the period of change.

In June 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109*, (FIN 48). FIN 48 clarifies the accounting for uncertainties in income taxes recognized in an enterprise's financial statements. FIN 48 requires the Company to determine whether it is more likely than not that a tax position will be sustained upon examination by the appropriate taxing authority. If a tax position meets the more likely than not recognition criteria, FIN 48 requires the tax position be measured at the largest amount of benefit greater than 50% likely of being realized upon ultimate settlement. We adopted the provisions of FIN 48 on January 1, 2007. The adoption of FIN 48 did not have a material effect on our consolidated financial position, results of operations or cash flows.

Our Federal effective tax rate historically has been lower than the statutory rate of 35% largely due to the application of general business tax credits. In December 2007, Congress recessed without reinstating the Research and Experimentation (R&E) tax credit. Therefore, the Company has not recorded any tax benefits for the three or six months ended June 30, 2008 from the R&E tax credit. Since its enactment in 1981, Congress has reinstated on a retroactive basis the R&E tax credit several times. However, unless the credit is reinstated, PROS will continue to record Federal income taxes in 2008 at the enacted Federal rate of 35%, net of other tax credits that may benefit the Company, if any.

**Recent accounting pronouncement**

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In May 2008, the FASB issued SFAS No. 162, *The Hierarchy of Generally Accepted Accounting Principles* ( SFAS No. 162 ). SFAS No. 162 identifies, within the accounting literature established by the FASB, the sources and hierarchy of the accounting principles to be used in the preparation of financial statements of nongovernmental entities that are presented in conformity with GAAP. SFAS No. 162 is effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board ( PCAOB ) amendments to AU Section 411, *The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles*. The adoption is not expected to have an impact on the Company's Unaudited Condensed Consolidated Financial Statements.

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The following tables set forth the computation of basic and diluted earnings per share:

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2008	2007	2008	2007
<b>Numerator:</b>				
Net earnings attributable to common stockholders	\$ 2,241	\$ 1,268	\$ 4,813	\$ 3,481
<b>Denominator:</b>				
Weighted average shares (basic)	26,215	20,669	26,188	20,217
Dilutive effect of stock options and warrants	297	1,149	401	1,149
Weighted average shares (diluted)	26,512	21,818	26,589	21,366
Basic earnings per share	\$ 0.09	\$ 0.06	\$ 0.18	\$ 0.17
Diluted earnings per share	\$ 0.08	\$ 0.06	\$ 0.18	\$ 0.16

The Company has excluded 1,552,875 and 1,382,500 potential common shares from the computation of the three and six months ended June 30, 2008 and 2007 dilutive earning per share, respectively, because the effect would have been antidilutive.

**3. Stock-based compensation stock options**

The Company maintains incentive stock option plans to provide long-term incentives to its key employees, officers, directors and consultants. In February 2008, the Company increased the number of shares available by 900,000 under an evergreen provision in the Company's 2007 equity incentive plan. As of June 30, 2008, 2,770,000 shares of common stock have been reserved for issuance and 132,647 shares remained available for grant. Options generally have a ten-year term and typically vest over four years. At June 30, 2008, there were an estimated \$13.1 million of total unrecognized compensation costs related to share-based compensation arrangements for options granted. These costs will be recognized over a weighted average period of 3.3 years.

The following is a summary of the Company's option activity for the six months ended June 30, 2008.

	Number of shares under option	Weighted average exercise price	Aggregate intrinsic value (1)
Outstanding, December 31, 2007	2,062	\$ 8.00	
Granted	955	14.42	
Forfeited	(81)	8.76	
Exercised	(143)	1.69	
Outstanding, June 30, 2008	2,793	\$ 10.50	\$ 7,346
Exercisable June 30, 2008	499	\$ 6.19	\$ 2,586

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(1) The aggregate intrinsic value was calculated based on the positive difference between the estimated fair value of the Company's common stock on June 30, 2008 of \$11.23 and the exercise price of the underlying options.



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The following table summarizes information about stock options outstanding at June 30, 2008.

Range of exercise prices	Outstanding as of June 30, 2008	Options outstanding		Exercisable as of June 30, 2008	Options exercisable	
		Weighted average remaining contractual life (in years)	Weighted average exercise price		Weighted average remaining contractual life (in years)	Weighted average exercise price
\$0.00-\$0.25	17,750	6.0	\$ 0.25	15,875	6.0	\$ 0.25
\$0.26-\$1.00	131,242	7.4	\$ 0.62	42,157	7.4	\$ 0.65
\$1.01-\$3.00	29,750	1.8	\$ 2.60	29,750	1.8	\$ 2.60
\$3.01-\$6.00	1,042,791	8.7	\$ 6.00	323,901	8.7	\$ 6.00
\$6.01-\$11.00	210,375	9.0	\$ 11.00	65,410	9.0	\$ 11.00
\$11.01-\$16.73	1,361,000	9.6	\$ 15.13	22,218	9.6	\$ 14.38
	2,792,908	9.0	\$ 10.50	499,311	9.0	\$ 6.19

**4. Commitments and Contingencies****Litigation**

In the ordinary course of our business, we regularly become involved in contract and other negotiations and, in more limited circumstances, become involved in legal proceedings, claims and litigation. We periodically assess our liabilities and contingencies in connection with these matters, based upon the latest information available. Should it be probable that we have incurred a loss and the loss, or range of loss, can be reasonably estimated, we will record reserves in the consolidated financial statements. In other instances, because of the uncertainties related to the probable outcome and/or amount or range of loss, we are unable to make a reasonable estimate of a liability, no reserve will be recorded. As additional information becomes available, we adjust our assessment and estimates of such liabilities accordingly. It is possible that the ultimate resolution of our liabilities and contingencies could be at amounts that are different from any recorded reserves and that such differences could be material.

During April 2008, a customer delivered a notice of termination of its contract and filed a breach of contract complaint alleging failure to deliver software the customer purchased. In May 2008, the Company filed a counterclaim. The Company believes the customer's termination is wrongful and intends to vigorously defend this matter and to seek payment of remaining amounts owed under the contract. Given the inherent uncertainties in any litigation, the Company is unable to make any predictions as to the ultimate outcome and no provision for loss or other costs has been recorded. For additional information, see Note 1 to our Notes to the Unaudited Condensed Consolidated Financial Statements.

Based on our review of the latest information available, we do not believe any liability, in connection with current contracts and other negotiations or pending or threatened legal proceedings, claims and litigation would have a material adverse effect on our financial statements.

**5. Fair value measurements**

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The Company adopted SFAS No. 157 effective January 1, 2008 for financial assets and financial liabilities measured on a recurring basis. SFAS No. 157 applies to all financial assets and financial liabilities that are being measured and reported on a fair value basis. There was no impact as a result of the adoption of SFAS No. 157 to the Unaudited Condensed Consolidated Financial Statements as it relates to financial assets and financial liabilities. SFAS No. 157 requires disclosure that establishes a framework for measuring fair value and expands disclosure about fair value measurements. The statement requires fair value measurements to be classified and disclosed in one of the following three categories:

Level 1: Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities;

Level 2: Quoted prices in markets that are not active or inputs which are observable, either directly or indirectly, for substantially the full term of the asset or liability;

Level 3: Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e., supported by little or no market activity).

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The Company invests in short-term interest bearing obligations with original maturities less than 90 days, primarily money market funds. We do not enter into investments for trading or speculative purposes. From time to time, the Company can and will invest in marketable securities. Securities for which the Company has the ability and intent to hold to maturity are classified as held to maturity. Securities classified as trading securities or available for sale are recorded at fair value. As of June 30, 2008, there were no investments in marketable securities.

As of June 30, 2008, the Company had \$21.1 million invested in diversified money market fund investments, \$16.0 million invested in government money market funds, \$8.0 million invested in treasury money market funds and \$2.0 million invested in commercial paper investments. These investments are required to be measured at fair value on a recurring basis. The Company has determined that the money market fund investments and the commercial paper investments are defined as Level 1 in the fair value hierarchy. As of June 30, 2008, the fair value of the money market investments was an asset of \$45.1 million and the fair value of the commercial paper investments was an asset of \$2.0 million.

In February 2008, the FASB issued FASB Staff Position No. FAS 157-2, *Effective Date of FASB Statement No. 157*, which defers the effective date for us to January 1, 2009 for all nonfinancial assets and liabilities, except those that are recognized or disclosed at fair value on a recurring basis (that is, at least annually). The Company elected to delay the application of SFAS No. 157 to nonfinancial assets and nonfinancial liabilities, as allowed by FASB Staff Position No. FAS 157-2. We believe the adoption of FASB Staff Position No. FAS 157-2 will not have a material impact on the Company's Unaudited Condensed Consolidated Financial Statements.

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**Item 2. Management's discussion and analysis of financial condition and results of operations**

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

**Cautionary statement**

The following discussion should be read along with the Unaudited Condensed Consolidated Financial Statements and Unaudited Notes to Condensed Consolidated Financial Statements included in Item 1 of this Quarterly Report on Form 10-Q, as well as the Audited Consolidated Financial Statements and Notes to Consolidated Financial Statements and Management's Discussion and Analysis of Financial Condition and Results of Operations for the year ended December 31, 2007 set forth in our annual report on Form 10-K and filed with the Securities and Exchange Commission (SEC). This Management's Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These forward-looking statements regarding future events and our future results are based on current expectations, estimates, forecasts and projections, and the beliefs and assumptions of our management including, without limitation, our expectations regarding the following: the sales of our software products and services; the impact of our revenue recognition; our belief that our current assets, including cash, cash equivalents, and expected cash flows from operating activities, will be sufficient to fund our operations; our anticipated additions to property, plant and equipment; our belief that our facilities are suitable and adequate to meet our current operating needs; our belief that that we do not have any material exposure to changes in the fair value of our investment portfolio as a result of changes in interest rates. Words such as we expect, anticipate, target, project, believe, goals, estimate, potential, predict, may, might, could, intend, variations of these types of words and similar expressions are intended to identify these forward-looking statements. Readers are cautioned that these forward-looking statements are predictions and are subject to risks, uncertainties, and assumptions that are difficult to predict. Therefore, actual results may differ materially and adversely from those expressed in any forward-looking statements.

**Overview**

We are a leading provider of pricing and revenue optimization software, an emerging category of enterprise applications designed to allow companies to improve financial performance by enabling better pricing. By using our software products, our customers gain insight into their pricing strategies, identify detrimental pricing practices, optimize their pricing decision-making and improve their business processes and financial performance. Our software products incorporate advanced pricing science, which includes operations research, forecasting and statistics. Our innovative science-based software products analyze, execute and optimize pricing strategies using data from traditional enterprise applications, often augmenting it with real-time and historical data. Our software also uses data elements that are determined using advanced pricing science and are stored in our database. We provide professional services to configure our software products to meet the specific pricing needs of each customer.

Many of our customers process large volumes of individually priced business-to-consumer and business-to-business transactions every day. Our high-performance, real-time, dynamic pricing products differ from static retail pricing products by delivering the relevant pricing information at the time the price is quoted, the deal is negotiated and the sale transaction is made. Our software products are also used to provide optimized price lists and goal-driven price guidance. While companies in our target industries differ in the wide range of business-to-business and business-to-customer products and services that they provide, many are similar in their need to optimally and dynamically price each individual transaction.

**Critical accounting policies and estimates**

We prepare our Unaudited Condensed Consolidated Financial Statements in accordance with accounting principles general accepted in the United States of America ( GAAP ). We make estimates and assumptions in the preparation of our Unaudited Condensed Consolidated Financial Statements, and our estimates and assumptions may affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the Unaudited Condensed Consolidated Financial Statements, and the reported amounts of revenue and expenses during the reporting periods. Actual results could differ from those estimates. The complexity and judgment of our estimation process and issues related to the assumptions, risks and uncertainties inherent in the application of the percentage-of-completion method of accounting affect the amounts of revenue,

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expenses, unbilled receivables and deferred revenue. Estimates are also used for, but not limited to, receivables, allowance for doubtful accounts, useful lives of assets, depreciation, income taxes and deferred tax asset valuation, valuation of stock options, other current liabilities and accrued liabilities. Numerous internal and external factors can affect estimates. The critical accounting policies related to the estimates and judgments are discussed in our Annual Report on Form 10-K for the year ended December 31, 2007 under Management's Discussion and Analysis of Financial Condition and Results of Operations. There have been no changes to our critical accounting policies during the three or six months ended June 30, 2008.

Our Federal effective tax rate historically has been lower than the statutory rate of 35% largely due to the application of general business tax credits. In December 2007, Congress recessed without reinstating the Research and Experimentation ( R&E ) tax credit. Therefore, the Company has not recorded any tax benefits for the three or six months ended June 30, 2008 from the R&E tax credit. Since its enactment in 1981, Congress has reinstated on a retroactive basis the R&E tax credit several times. However, unless the credit is reinstated, PROS will continue to record Federal income taxes in 2008 at the enacted Federal rate of 35%, net of other tax credits that may benefit the Company, if any. Should the R&E tax credit be reinstated on a retroactive basis for 2008 the estimated Federal effective tax rate is expected to be 28%.

**Results of operations***Comparison of three months ended June 30, 2008 with three months ended June 30, 2007**Revenue:*

(Dollars in thousands)	For the Three Months Ended June 30,		2007		Variance \$	Variance %
	2008	As a percentage of total revenue	Amount	As a percentage of total revenue		
License and implementation	\$ 13,375	72%	\$ 9,893	69%	\$ 3,482	35%
Maintenance and support	5,237	28%	4,522	31%	715	16%
Total	\$ 18,612	100%	\$ 14,415	100%	\$ 4,197	29%

License and implementation. License and implementation revenue increased \$3.5 million to \$13.4 million for the three months ended June 30, 2008 from \$9.9 million for the three months ended June 30, 2007, representing a 35% increase. Generally, revenue is recognized over the implementation period on a percentage of completion basis. The increase was principally the result of an increase in the number of ongoing implementations.

Maintenance and support. Maintenance and support revenue increased \$0.7 million to \$5.2 million for the three months ended June 30, 2008 from \$4.5 million for the three months ended June 30, 2007, representing a 16% increase. The increase was the result of completion of several implementations of our software products following which we are able to begin recognizing maintenance and support revenue and an inflationary index increase in the price charged on maintenance renewals.

Total revenue. For the three months ended June 30, 2008, approximately 54% of our total revenue was generated outside the United States, compared with 68% for the three months ended June 30, 2007. For the three months ended June 30, 2008 and 2007, approximately 97% and 96%, respectively, of our airline revenue was generated outside the United States.

Table of Contents*Cost of revenue and gross profit:*

(Dollars in thousands)	For the Three Months Ended June 30,					
	2008			2007		
Amount	As a percentage of related revenue	Amount	As a percentage of related revenue	Variance \$	Variance %	
Cost of license and implementation	\$ 3,596	27%	\$ 3,218	33%	\$ 378	12%
Cost of maintenance and support	1,059	20%	1,105	24%	(46)	(4)%
Total cost of revenue	\$ 4,655	25%	\$ 4,323	30%	\$ 332	8%
Gross profit	\$ 13,957	75%	\$ 10,092	70%	\$ 3,865	38%

Cost of license and implementation. Cost of license and implementation increased \$0.4 million to \$3.6 million for the three months ended June 30, 2008 from \$3.2 million for the three months ended June 30, 2007, representing a 12% increase. The increase in cost of license and implementation is attributable to a \$0.3 million increase in amortized costs related to subscription contracts, a \$0.2 million increase in travel expenses, and a \$0.1 million increase in stock based compensation expenses offset by a \$0.2 million decrease in personnel expenses. License and implementation gross margins increased from 67.5% to 73.1% for the three months ended June 30, 2008 primarily due to improvements in our implementation processes, the standardization of software products and our current mix of business. License and implementation costs may vary from period to period depending on factors including the amount of implementation services required to deploy our products relative to the total contract price.

Cost of maintenance and support. Cost of maintenance and support was flat for each of the three months ended June 30, 2007 and June 30, 2008 at \$1.1 million. Maintenance and support gross margins increased from 75.6% to 79.8% for the three months ended June 30, 2008 due to an increase in maintenance and support revenue as a result of the completion of several implementations of our software products and an increase in the prices charged on maintenance renewals while maintaining a relatively consistent cost of maintenance and support.

Gross profit. Gross profit increased \$3.9 million to \$14.0 million for the three months ended June 30, 2008 from \$10.1 million for the three months ended June 30, 2007, representing a 38% increase. The increase in our overall gross profit was attributable to the improvement in overall revenue and the improvement in our license and implementation and maintenance and support gross margins. License and implementation gross margins may vary from period to period depending on factors, including the amount of implementation services required to deploy our products relative to the total contracted price. Maintenance and support gross margins may vary from period to period depending on factors, including the cost of providing maintenance and support relative to maintenance and support revenue.

*Operating expenses:*



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(Dollars in thousands)	For the Three Months Ended June 30,		2007		Variance \$	Variance %
	2008	As a percentage of total revenue	Amount	As a percentage of total revenue		
Selling, general and administrative	\$ 5,593	30%	\$ 3,777	26%	\$ 1,816	48%
Research and development	5,159	28%	4,324	30%	835	19%
Total operating expenses	\$ 10,752	58%	\$ 8,101	56%	\$ 2,651	33%

Selling, general and administrative expenses. Selling, general and administrative expenses increased \$1.8 million to \$5.6 million for the three months ended June 30, 2008 from \$3.8 million for the three months ended June 30, 2007, representing a 48% increase. The increase in selling, general and administrative expenses is primarily attributable to a \$0.5 million increase in personnel expenses as a result of an increase in personnel, \$0.4 million of expenses associated with being a publicly traded company, \$0.3 million of increase in stock based compensation expenses, \$0.3 million increase in marketing expenses primarily related to our annual pricing excellence conference and \$0.2 million of expenses associated with travel.

Research and development expenses. Research and development expenses increased \$0.8 million to \$5.2 million for the three months ended June 30, 2008 from \$4.3 million for the three months ended June 30, 2007, representing a 19% increase. The increase in research and development expenses is attributable to a \$0.6 million increase in personnel expenses resulting from an increase in our product and product management activities, and a \$0.2 million increase in stock based compensation expenses.

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*Other income (expense):*

(Dollars in thousands)	For the Three Months Ended June 30,		Variance \$	Variance %
	2008 Amount	2007 Amount		
Interest income	\$ 302	\$ 62	\$ 240	387%
Interest expense		(441)	441	
Other income (expense), net	\$ 302	\$ (379)	\$ 681	(180)%

Interest income. Interest income increased \$0.2 million from \$0.1 million for the three months ended June 30, 2007 to \$0.3 million for the three months ended June 30, 2008. Interest income is generated from the investments of cash balances in short term interest bearing obligations with original maturities less than 90 days, primarily money market funds. The increase in interest income is the result of an increase in our average cash balances offset by lower 2008 interest rates.

Interest expense. Interest expense of \$0.4 million for the three months ended June 30, 2007 is the result of interest expense on the \$20.0 million credit facility entered into in March 2007. In July 2007, we used the proceeds from our initial public offering to retire the credit facility.

*Income tax provision:*

(Dollars in thousands)	For the Three Months Ended June 30,	
	2008	2007
Effective tax rate	36%	21%
Income tax provision	\$ 1,266	\$ 344

Income tax provision. Our income tax provision increased \$1.0 million from \$0.3 million for the three months ended June 30, 2007 to \$1.3 million for the three months ended June 30, 2008. The increase is primarily the result of an increase of \$1.9 million in pre-tax income and an increase in our Federal effective tax rate, from 21% to 35%, as a result of the delay in the reinstatement of the R&E tax credit by Congress and the utilization of R&E tax credit carry forwards in the three months ended June 30, 2007.

Our Federal effective tax rate historically has been lower than the statutory rate of 35% largely due to the application of general business tax credits. In December 2007, Congress recessed without reinstating the R&E tax credit. Therefore, the Company has not recorded any tax benefits for the three months ended June 30, 2008 from the R&E tax credit. Since its enactment in 1981, Congress has reinstated on a retroactive basis the R&E tax credit several times. However, unless the credit is reinstated, PROS will continue to record Federal income taxes in 2008 at the enacted Federal rate of 35%, net of other tax credits that may benefit the Company, if any. Should the R&E tax credit be reinstated on a retroactive basis for 2008 the estimated Federal effective tax rate is expected to be 28%.

*Comparison of six months ended June 30, 2008 with six months ended June 30, 2007*

*Revenue:*

(Dollars in thousands)	For the Six Months Ended June 30, 2008		2007		Variance \$	Variance %
	Amount	As a percentage of total revenue	Amount	As a percentage of total revenue		
License and implementation	\$ 26,181	72%	\$ 18,915	68%	\$ 7,266	38%
Maintenance and support	10,351	28%	8,951	32%	1,400	16%
Total	\$ 36,532	100%	\$ 27,866	100%	\$ 8,666	31%

License and implementation. License and implementation revenue increased \$7.3 million to \$26.2 million for the six months ended June 30, 2008 from \$18.9 million for the six months ended June 30, 2007, representing a 38% increase. Generally, revenue is primarily recognized over the implementation period on a percentage of completion basis. The increase was principally the result of an increase in the number of ongoing implementations. Included in the six months ended June 30, 2008

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license and implementation revenue is approximately \$0.6 million of subscription revenue, which was recognized in the three months ended March 31, 2008, associated with a customer that delivered a notice of contract termination in April of 2008. At March 31, 2008, the Company had \$1.1 million of capitalized implementation costs included in other assets, \$0.2 million in accounts receivable and \$6.1 million of long-term deferred revenue related to this terminated contract. These amounts have been netted and are classified as other current liabilities as future recognition of revenue has been discontinued due to the uncertainty of its realization. This amount will continue to be presented in the Unaudited Condensed Consolidated Balance Sheet as other current liabilities until the matter is resolved.

Maintenance and support. Maintenance and support revenue increased \$1.4 million to \$10.4 million for the six months ended June 30, 2008 from \$9.0 million for the six months ended June 30, 2007, representing a 16% increase. The increase was the result of completion of several implementations of our software products following which we are able to begin recognizing maintenance and support revenue and an inflationary index increase in the price charged on maintenance renewals.

Total revenue. In the six months ended June 30, 2008, approximately 54% of our total revenue was generated outside the United States, compared with 66% for the six months ended June 30, 2007. For the six months ended June 30, 2008 and 2007, approximately 97% and 96%, respectively, of our airline revenue was generated outside the United States.

*Cost of revenue and gross profit:*

(Dollars in thousands)	For the Six Months Ended June 30,					
	2008		2007		Variance \$	Variance %
Amount	As a percentage of related revenue	Amount	As a percentage of related revenue			
Cost of license and implementation	\$ 7,009	27%	\$ 6,407	34%	\$ 602	9%
Cost of maintenance and support	2,239	22%	2,094	23%	145	7%
Total cost of revenue	\$ 9,248	25%	\$ 8,501	31%	\$ 747	9%
Gross profit	\$ 27,284	75%	\$ 19,365	69%	\$ 7,919	41%

Cost of license and implementation. Cost of license and implementation increased \$0.6 million to \$7.0 million for the six months ended June 30, 2008 from \$6.4 million for the six months ended June 30, 2007, representing a 9% increase. The increase in cost of license and implementation is attributable to a \$0.7 million increase in amortized costs related to subscription contracts, a \$0.2 million increase in stock based compensation expenses and a \$0.2 million increase in travel offset by a \$0.5 million decrease in personnel expenses. License and implementation gross margins increased from 66.1% to 73.2% for the six months ended June 30, 2008 primarily due to improvements in our implementation processes, the standardization of software products and our current mix of business. License and implementation costs may vary from period to period depending on factors, including the amount of implementation services required to deploy our products relative to the total contract price.

Cost of maintenance and support. Cost of maintenance and support increased \$0.1 million to \$2.2 million for the six months ended June 30, 2008 from \$2.1 million for the six months ended June 30, 2007, representing a 7% increase. The increase in the cost of maintenance and support is primarily attributable to an increase in average number of support personnel. Maintenance and support margins increased from 76.6% to 78.4% for the six months ended June 30, 2008 due to an increase in maintenance and support revenue as a result of the completion of several implementations of our software products and an increase in the prices charged on maintenance renewals while maintaining a relatively consistent cost of maintenance and support.

Gross profit. Gross profit increased \$8.0 million to \$27.3 million for the six months ended June 30, 2008 from \$19.4 million for the six months ended June 30, 2007, representing a 41% increase. The increase in our overall gross profit was attributable to the improvement in overall revenue and the improvement in our license and implementation and maintenance and support gross margins. License and implementation gross margins may vary from period to period depending on factors, including the amount of implementation services required to deploy our products relative to the total contracted price. Maintenance and support gross margins may vary from period to period depending on factors, including the cost of providing maintenance and support relative to maintenance and support revenue.

Table of Contents*Operating expenses:*

(Dollars in thousands)	For the Six Months Ended June 30,		2007		Variance \$	Variance %
	2008	As a percentage of total revenue	Amount	As a percentage of total revenue		
Selling, general and administrative	\$ 10,718	29%	\$ 6,925	25%	\$ 3,793	55%
Research and development	9,831	27%	8,065	29%	1,766	22%
Total operating expenses	\$ 20,549	56%	\$ 14,990	54%	\$ 5,559	37%

Selling, general and administrative expenses. Selling, general and administrative expenses increased \$3.8 million to \$10.7 million for the six months ended June 30, 2008 from \$6.9 million for the six months ended June 30, 2007, representing a 55% increase. The increase in selling, general and administrative expenses is primarily attributable to a \$1.1 million increase in personnel expenses as a result of an increase in personnel, a \$0.9 million increase in expenses associated with being a publicly traded company, a \$0.7 million increase in stock based compensation expenses, \$0.6 million increase in travel expenses, a \$0.4 million increase in marketing expenses primarily as a result of our annual pricing excellence conference.

Research and development expenses. Research and development expenses increased \$1.7 million to \$9.8 million for the six months ended June 30, 2008 from \$8.1 million for the six months ended June 30, 2007, representing a 22% increase. The increase in research and development expenses is attributable to a \$1.2 million increase in personnel expenses resulting from an increase in our product and product management activities, and a \$0.4 million increase in stock based compensation expenses.

*Other income (expense):*

(Dollars in thousands)	For the Six Months Ended June 30,		Variance \$	Variance %
	2008	2007		
Interest income	\$ 724	\$ 595	\$ 129	22%
Interest expense		(457)	457	
Other income (expense), net	\$ 724	\$ 138	\$ 586	425%

Interest income. Interest income increased \$0.1 million from \$0.6 million for the six months ended June 30, 2007 to \$0.7 million for the six months ended June 30, 2008, representing a 22% increase. Interest income is generated from the investments of cash balances in short term interest bearing obligations with original maturities less than 90 days, primarily money market funds. The increase in interest income is the result of an increase in our average cash balances offset by 2008 lower interest rates.

Interest expense. Interest expense of \$0.5 million for the six months ended June 30, 2007 is the result of interest expense on the \$20.0 million credit facility entered into in March 2007. In July 2007, we used the proceeds from our initial public offering to retire the credit facility.

*Income tax provision:*

(Dollars in thousands)	For the Six Months Ended June 30,			
	2008		2007	
Effective tax rate		36%		21%
Income tax provision	\$	2,646	\$	950

Income tax provision. Our income tax provision increased \$1.7 million from \$1.0 million for the six months ended June 30, 2007 to \$2.7 million for the six months ended June 30, 2008. The increase is primarily the result of an increase of \$2.9 million in pre-tax income and an increase in our Federal effective tax rate, from 21% to 35%, as a result of the delay in the reinstatement of the R&E tax credit by Congress and the utilization of R&E tax credit carry forwards in the six months ended June 30, 2007.

Table of Contents**Liquidity and capital resources**

At June 30, 2008, we had \$48.8 million of cash and cash equivalents and \$37.3 million in working capital as compared to \$44.4 million of cash and cash equivalents and \$33.9 million in working capital at December 31, 2007. The increase in cash and cash equivalents from the year ended December 31, 2007 to the six months ended June 30, 2008 can be attributed to net cash provided by operating activities of \$5.0 million and net cash provided by financing activities of \$0.2 million, offset by net cash used in investing activities of \$0.8 million. Our principal source of liquidity is our net cash flows provided by operating activities. Based on existing cash and cash equivalent balances, and our current estimates of revenues and expenses, we believe that our existing cash and cash equivalents balances and the anticipated net cash flows provided by operating activities will be adequate to finance our operations and anticipated capital expenditures for the foreseeable future.

The following table presents key components of our Unaudited Condensed Consolidated Statements of Cash Flows for the six months ended June 30, 2008 and 2007.

(Dollars in thousands)	For the Six Months Ended June 30,	
	2008	2007
Net cash provided from operating activities	\$ 5,002	\$ 1,137
Net cash used in investing activities	(805)	(696)
Net cash provided by (used in) financing activities	241	(38,813)
Cash and cash equivalents (end of period)	\$ 48,816	\$ 4,168

Sources of cash from operating activities for the six months ended June 30, 2008 consisted of (a) \$4.8 million of net income, (b) \$2.5 million of non-cash expenses comprised of depreciation and stock based compensation expenses related to the issuance of stock options, (c) a \$1.1 million increase in deferred revenue, and (d) a \$0.7 million decrease in prepaid and other expenses. Uses of cash from operating activities for the six months ended June 30, 2008 consisted of (a) a \$2.0 million decrease in accounts payable, accrued liabilities, accrued contract labor and accrued payroll, (b) a \$1.3 million increase in unbilled receivables from software implementations in process (c) a \$0.9 million increase in net accounts receivable.

Net uses of cash from investing activities for the six months ended June 30, 2008 consisted of \$0.8 million of purchases of property and equipment. Net cash provided by financing activities for the six months ended June 30, 2008 consisted of \$0.2 million from the exercise of stock options.

**Contractual obligations**

There have been no significant changes to our operating leases since those reported in our Annual Report on Form 10-K for the year ended December 31, 2007. As of June 30, 2008, we did not have any capital leases.



**Off-balance sheet arrangements**

We do not have any relationships with unconsolidated entities or financial partnerships, such as variable interest entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes.

**Available information**

Our internet website address is <http://www.prospricing.com>. Our current reports on Form 8-K and any amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 are available through the investor relations page of our internet website free of charge as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC. Our internet website and the information contained therein or connected thereto are not intended to be incorporated into this Quarterly Report on Form 10-Q.

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**Recently Issued Accounting Pronouncement**

In May 2008, the Financial Accounting Standards Board ( FASB ) issued Statement of Financial Accounting Standards ( SFAS ) No. 162, *The Hierarchy of Generally Accepted Accounting Principles* ( SFAS No. 162 ). SFAS No. 162 identifies, within the accounting literature established by the FASB, the sources and hierarchy of the accounting principles to be used in the preparation of financial statements of nongovernmental entities that are presented in conformity with GAAP. SFAS No. 162 is effective 60 days following the SEC 's approval of the Public Company Accounting Oversight Board ( PCAOB ) amendments to AU Section 411, *The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles*. The adoption is not expected to have an impact on the Company 's Condensed Consolidated Financial Statements.

**Item 3. Quantitative and qualitative disclosures about market risk**

**Foreign currency risk**

A small percentage of our contracts are denominated in foreign currencies and therefore a portion of our revenue is subject to foreign currency risks. Our cash flows are subject to fluctuations due to changes in foreign currency exchange rates. The effect of an immediate 10% adverse change in exchange rates on foreign denominated receivables as of June 30, 2008 would have resulted in a \$0.1 million loss. To date, we have not entered into any hedging contracts although we may do so in the future. Fluctuations in currency exchange rates could harm our business in the future.

**Interest rate sensitivity**

We had cash and cash equivalents totaling \$48.8 million at June 30, 2008. These amounts have been invested in short-term interest bearing obligations with original maturities less than 90 days, primarily money market funds. Unrestricted cash and cash equivalents are held for working capital purposes. We do not enter into investments for trading or speculative purposes. We believe that we do not have any material exposure to changes in the fair value as a result of changes in interest rates. Declines in interest rates, however, will reduce future investment income. If overall interest rates fell by 10% in second quarter of 2008, our interest income would have had a \$0.1 million decline assuming consistent investment levels.

**Item 4. Controls and procedures**

**Evaluation of disclosure controls and procedures**

Our management evaluated, with the participation of our chief executive officers and our chief financial officer, the effectiveness of our disclosure controls and procedures as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on this evaluation, our

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chief executive officer and our chief financial officer have concluded that our disclosure control and procedures are effective to ensure that information we are required to disclose in reports that we file or submit under the Securities and Exchange Act of 1934 (i) is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms, and (ii) is accumulated and communicated to our management, including our chief executive officer and our chief financial officer, as appropriate to allow timely decisions regarding required disclosure. Our disclosure controls and procedures are designed to provide reasonable assurance that such information is accumulated and communicated to our management.

### **Changes in internal controls over financial reporting**

There have been no changes in the Company's internal control over financial reporting that occurred during the three months ended June 30, 2008 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

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**PART II. Other Information**

**Item 1. Legal proceedings**

In the ordinary course of our business, we regularly become involved in contract and other negotiations and, in more limited circumstances, become involved in legal proceedings, claims and litigation. We periodically assess our liabilities and contingencies in connection with these matters, based upon the latest information available. Should it be probable that we have incurred a loss and the loss, or range of loss, can be reasonably estimated, we will record reserves in the consolidated financial statements. In other instances, because of the uncertainties related to the probable outcome and/or amount or range of loss, we are unable to make a reasonable estimate of a liability, no reserve will be recorded. As additional information becomes available, we adjust our assessment and estimates of such liabilities accordingly. It is possible that the ultimate resolution of our liabilities and contingencies could be at amounts that are different from any recorded reserves and that such differences could be material.

During April 2008, a customer delivered a notice of termination of its contract and filed a breach of contract complaint alleging failure to deliver software the customer purchased. In May 2008, the Company filed a counterclaim. The Company believes the customer's termination is wrongful and intends to vigorously defend this matter and to seek payment of remaining amounts owed under the contract. Given the inherent uncertainties in any litigation, the Company is unable to make any predictions as to the ultimate outcomes and no provision for loss or other costs has been recorded.

Based on our review of the latest information available, we do not believe any liability, in connection with current contract and other negotiations or pending or threatened legal proceedings, claims and litigation would have a material effect on our financial statements.

**Item 1A. Risk factors**

We operate in a dynamic environment that involves numerous risks and uncertainties. The following section describes some of the risks that may adversely affect our business, financial condition or results of operations; these are not necessarily listed in terms of their importance or level of risk.

**Risks relating to our business and industry**

*We focus exclusively on the pricing and revenue optimization software market, and if this market develops more slowly than we expect, our business will be harmed.*

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We derive, and expect to continue to derive, all of our revenue from providing pricing and revenue optimization software products, implementation services and ongoing customer support. The pricing and revenue optimization software market is relatively new and still evolving, and it is uncertain whether this software will achieve and sustain high levels of demand and market acceptance. Our success will depend on the willingness of businesses in the manufacturing, distribution, services, hotel and cruise, and airline industries to implement pricing and revenue optimization software.

Some businesses may be reluctant or unwilling to implement pricing and revenue optimization software for a number of reasons, including failure to understand the potential returns of improving their pricing processes and lack of knowledge about the potential benefits that such software may provide. Even if businesses recognize the need for improved pricing processes, they may not select our pricing and revenue optimization software products because they previously have made investments in internally developed pricing and revenue optimization solutions. Some businesses may elect to improve their pricing processes through solutions obtained from their existing enterprise software providers, whose solutions are designed principally to address one or more functional areas other than pricing. These enterprise solutions may appeal to customers that wish to limit the number of software vendors on which they rely and the number of different types of solutions used to run their businesses.

If businesses do not perceive the benefits of pricing and revenue optimization software, the pricing and revenue optimization software market may not continue to develop or may develop more slowly than we expect, either of which would significantly and adversely affect our revenue and operating results. Because the pricing and revenue optimization software market is developing and the manner of its development is difficult to predict, we may make errors in predicting and reacting to relevant business trends, which could harm our operating results.

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*Any downturn in sales to our target markets of manufacturing, distribution, services, hotel and cruise, and airline would adversely affect our operating results.*

Our success is highly dependent upon our ability to sell our software products to customers in the manufacturing, distribution, services, hotel and cruise, and airline industries. If we are unable to market and sell our software products effectively to customers in these industries, we may not be able to grow our business. It is uncertain whether our software products will achieve and sustain the levels of demand and market acceptance that we anticipate. Such uncertainty is attributable to, among other factors, the following:

- the possibility that it may be more difficult than we currently anticipate to implement our software products in our target industries;
- the possibility that it may be more difficult than we currently anticipate to increase our customer base in our target industries;
- the possibility that it may take more time to train our personnel in the implementation of our software products in our target industries; and
- our limited experience implementing our software products in certain of our target industries.

Revenue from customers in the airline industry accounted for 43%, 44% and 52% of our total revenue in 2007, 2006, and 2005, respectively. Our revenue growth has been derived principally from customers in the manufacturing, distribution, services and hotel and cruise industries, where our products have recently begun to achieve market acceptance. Our revenue growth is highly dependent upon continued growth of market acceptance in all of these industries, and there is no assurance our products will achieve or sustain widespread acceptance among these potential customers. Failure to expand market acceptance of our products in the manufacturing, distribution, services and hotel and cruise industries or to maintain sales in the airline industry would adversely affect our operating results and financial condition.

*A significant or prolonged economic downturn in industries in which we focus, may result in our customers reducing or postponing spending on the products we offer.*

There are a number of factors, other than our performance, that could affect the size, frequency and renewal rates of our customer contracts. For instance, if economic conditions weaken in any industry in which we focus, our customers may reduce or postpone their spending significantly which may, in turn, lower the demand for our products and negatively affect our revenue and profitability. As a way of dealing with a challenging economic environment, customers may change their purchasing strategy. The loss of, or any significant decline in business from, one or more of our major customers likely would lead to a significant decline in our revenue and operating margins, particularly if we are unable to make corresponding reductions in our expenses in the event of any such loss or decline. Moreover, a significant change in the liquidity or

financial position of any of these customers could have a material adverse effect on the collectability of our accounts receivable, liquidity and future operating results.

***Our software products require implementation projects that are subject to significant risks and delays, the materialization of which could negatively impact the effectiveness of our solutions, resulting in harm to our reputation, business and financial performance.***

The implementation of our software products can involve complex, large-scale projects that require substantial support operations, significant resources and reliance on certain factors that may not be under our control. For example, the success of our implementation projects is heavily dependent upon the quality of data used by our software products, the commitment of customers' resources and personnel to the projects and the stability, functionality and scalability of the customer's information technology infrastructure. If weaknesses or problems in infrastructure or data or our customers' commitment and investment in personnel and resources exist, we may not be able to correct or compensate for such weaknesses. In addition, implementation of our software products can be highly complex and require substantial efforts and cooperation on the part of our customers and us. If we are unable to successfully manage the implementation of our software products such that those products do not meet customer needs or expectations, we may become involved in disputes with our customers and our business, reputation and financial performance may be significantly harmed. We recognize our license and implementation revenues as implementation services are performed. Any delays in an implementation project or changes in the scope or timing of an implementation project

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would delay or alter the corresponding revenue recognition and could adversely affect our operating results. If an implementation project for a large customer is substantially delayed or cancelled, our ability to recognize the associated revenue and our operating results would be adversely affected.

***Our revenue recognition is primarily based upon our ability to estimate the efforts required to complete our implementation projects, which may be difficult to estimate.***

We generally recognize revenue from our software licenses and implementation services over the period during which such services are performed using the percentage-of-completion method. The length of this period depends on the number of licensed software products and the scope and complexity of the customer's deployment requirements. Under the percentage-of-completion method, the revenue we recognize during a reporting period is based on the percentage of man-days incurred during the reporting period as compared to the estimated total man-days required to implement our software products. If we are unable to accurately estimate the overall total man-days required to implement our software products, such inaccuracies could have a material effect on the timing of our revenue. Any change in the timing of revenue recognition as a result of inaccurate estimates could adversely impact our quarterly or annual operating results.

***Failure to sustain our historical maintenance and support renewal rates and pricing would adversely affect our operating result.***

Maintenance and support agreements are typically for a term of one to two years. Historically, maintenance and support revenue has represented a significant portion of our total revenue, including approximately 30%, 36% and 43% of our total revenue in 2007, 2006 and 2005, respectively. If our customers choose not to renew their maintenance and support agreements with us on favorable terms or at all, our business, operating results and financial condition could be harmed.

***We might not be able to manage our future growth efficiently or profitably.***

We experienced significant growth in 2006 and 2007 and are planning for this growth trend to continue. In response to such growth, we will likely need to expand the size of our sales and marketing, research and development and general and administrative staffs, grow our related operations and strengthen our financial and accounting controls. There is no assurance that our infrastructure will be sufficiently scalable to manage our growth. For example, our anticipated growth may result in a significant increase in demand for our implementation personnel to implement our solutions. If we are unable to address these additional demands on our resources, our operating results and growth might suffer. Even if we are able to hire additional personnel, there is no guarantee such personnel will be as highly qualified as our existing personnel. As a result, certain implementations of our solution may not meet our customers' expectations and our reputation could be harmed and our business and operating results adversely affected. Also, if we continue to expand our operations, management might not be effective in expanding our physical facilities and our systems, procedures or controls might not be adequate to support such expansion. Further, to the extent we invest in additional resources to support further growth and growth in our revenue does not ensue, our operating results would be adversely affected. Our inability to manage our growth could harm our business.

***Deterioration of general U. S. and global economic conditions could adversely affect our sales and operating results.***



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We believe the implementation of our software products, which is often accompanied by hardware purchases and other capital commitments, involves significant capital expenditure by our customers. As a result, customers are likely to reduce or defer their spending on technology in the event of economic instability or downturn. In addition, weak and uncertain U. S. and global economic conditions could impair our customers' ability to pay for our products or services. Any of these factors could adversely impact our business, quarterly or annual operating results and financial condition.

Periodic declines or fluctuations in the U.S. Dollar, corporate profits, lower spending, the impact of conflicts throughout the world, terrorist acts, natural disasters, volatile energy costs, the outbreak of communicable diseases and other geopolitical factors have had, and may continue to have, a negative impact on the U.S. and global economies. Our customers continue to experience consolidation in their industries which may result in project delays or cancellations. We are unable to predict the strength or duration of current market conditions or effects of consolidation. Uncertainties in anticipated spending levels or further consolidation may adversely affect our business, financial condition and results of operations.

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***We might not generate increased business from our current customers, which could limit our revenue in the future.***

We sell our software products to both new customers and existing customers. Many of our existing customers initially purchase our software products for a specific business segment or a specific geographic location within their organization and later purchase additional software products for the same or other business segments and geographic locations within their organization. These customers might not choose to make additional purchases of our software products or to expand their existing software products to other business segments. In addition, as we deploy new applications and features for our software products or introduce new software products, our current customers could choose not to purchase these new offerings. If we fail to generate additional business from our existing customers, our revenue could grow at a slower rate or even decrease.

***We are subject to a lengthy sales cycle and delays or failures to complete sales may harm our business and cause our revenue and operating income to decline in the future.***

Our sales cycle may take several months to over a year. To sell our products successfully and obtain an executed contract, we generally have to educate our potential customers about the use and benefits of our products, which can require significant time, expense and capital without the ability to realize revenue, if any. During this sales cycle, we may expend substantial resources with no assurance that a sale will ultimately result. The length of a customer's sales cycle depends on a number of factors, many of which we may not be able to control. These factors include the customer's product and technical requirements and the level of competition we face for that customer's business. Any unexpected lengthening of the sales cycle would negatively affect the timing of our revenue, and hinder our revenue growth. Furthermore, a delay in our ability to obtain a signed agreement or other persuasive evidence of an arrangement or to complete certain contract requirements in a particular quarter could reduce our revenue in that quarter. Overall, any significant failure to generate revenue or delays in recognizing revenue after incurring costs related to our sales or services process could have a material adverse effect on our business, financial condition and results of operations.

***If our cost estimates for fixed-fee arrangements do not accurately anticipate the cost and complexity of implementing our software products, our profitability could be reduced and we could experience losses on these arrangements.***

Substantially all of our license and implementation arrangements are priced on a fixed-fee basis. If we underestimate the amount of effort required to implement our software products, our profitability could be reduced. Moreover, if the actual costs of completing the implementation exceed the agreed upon fixed price, we would incur a loss on the arrangement.

***Our revenue recognition policy may cause any decreases in sales not to be reflected in our revenue immediately.***

The period over which we recognize license and implementation revenue for an implementation depends on the number of licensed software products and the scope and complexity of the customer's deployment requirements and ranges from six months to several years. As a result, a substantial majority of our revenue is recognized on arrangements that were executed in previous periods. Any shortfall in new sales of our software products may not be reflected in our revenue for several quarters, and as such the adverse impact on our business may not be readily apparent.

*If Congress fails to reinstate the general business tax credit on similar terms as previous years, our results of operations could be adversely affected.*

Our historical results of operations have benefited from the tax credit incentives under the U.S. research and experimentation ( R&E ) tax credit extended to taxpayers engaged in qualified research and experimental activities while carrying on a trade or business. In December 2007, Congress recessed without reinstating the R&E tax credit. Since its enactment in 1981, Congress has reinstated on a retroactive basis the R&E tax credit several times; however, if the tax credit is not reinstated this will increase our effective tax rate. For the year ended December 31, 2007 our effective tax rate was approximately 20% excluding the impact of the reversal of a valuation allowance. If the tax credit is not reinstated during 2008; PROS will have to record its Federal income tax provision at a higher than historical tax rate which could adversely affect our results of operations.

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***We incur significant increased costs as a result of operating as a public company, and our management will be required to devote substantial time to new compliance initiatives.***

As a public company, we incur significant legal, accounting and other expenses that we did not incur as a private company. Securities and Exchange Commission ( SEC ) and the New York Stock Exchange ( NYSE ) rules and regulations impose heightened requirements on public companies, including requiring changes in corporate governance practices. Our management and other personnel devote a substantial amount of time to these compliance initiatives. We may also need to hire additional finance and administrative personnel to support our compliance requirements. Moreover, these rules and regulations increase our legal and financial costs and make some activities more time-consuming.

In addition, we are required to maintain effective internal controls for financial reporting and disclosure controls and procedures. In particular, we will be required to perform system and process evaluation and testing of our internal controls over financial reporting to allow management to report on, and our independent registered public accounting firm to report on, the effectiveness of our internal controls over financial reporting, as required by Section 404 of the Sarbanes-Oxley Act. Our testing, or the subsequent testing by our independent registered public accounting firm, may reveal deficiencies or material weaknesses in our internal controls over financial reporting. Our compliance with Section 404 will require that we incur substantial accounting expense and expend significant management efforts. We currently do not have an internal audit group, and we may need to hire additional accounting and financial staff with appropriate public company experience and technical accounting knowledge. Moreover, if we are not able to comply with the requirements of Section 404 in a timely manner, or if we or our independent registered public accounting firm identifies deficiencies or material weaknesses in our internal controls over financial reporting, the market price of our stock could decline and we could be subject to sanctions or investigations by the NYSE, SEC or other regulatory authorities, which would require additional financial and management resources.

***Competition from vendors of pricing solutions and enterprise applications as well as from companies internally developing their own solutions could adversely affect our ability to sell our software products and could result in pressure to price our software products in a manner that reduces our margins and harms our operating results.***

The pricing and revenue optimization software market is competitive, fragmented and rapidly evolving. Our software products compete with solutions developed internally by businesses as well as solutions offered by competitors. Our principal competition consists of:

- pricing and revenue optimization software vendors, including a number of vendors that provide pricing and revenue optimization software for specific industries; and
- large enterprise application providers that have developed offerings that include pricing and revenue optimization functionality.

We expect additional competition from other established and emerging companies to the extent the pricing and revenue optimization software market continues to develop and expand. We also expect competition to increase as a result of the entrance of new competitors in the market and industry consolidation, including through a merger or partnership of two or more of our competitors or the acquisition of a competitor by a larger company. Many of our current and potential competitors have larger installed bases of users, longer operating histories and greater name

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recognition than we have. In addition, many of these companies have significantly greater financial, technical, marketing, service and other resources than we have. As a result, these companies may be able to respond more quickly to new or emerging technologies and changes in customer demands and to devote greater resources to the development, promotion and sale of their products than we can.

Competition could seriously impede our ability to sell additional software products and related services on terms favorable to us. Businesses may continue to enhance their internally developed solutions, rather than investing in commercially-available solutions such as ours. Our current and potential competitors may develop and market new technologies that render our existing or future products obsolete, unmarketable or less competitive. In addition, if these competitors develop products with similar or superior functionality to our products, or if they offer products with similar functionality at a substantially lower price than our products, we may need to decrease the prices for our products in order to remain competitive. If we are unable to maintain our current product, services and maintenance pricing due to competitive pressures, our margins will be reduced and our operating results will be adversely affected. We cannot assure you that we will be able to compete successfully against current or future competitors or that competitive pressures will not materially and adversely affect our business, financial condition and operating results.

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*If we fail to develop or acquire new pricing and revenue optimization functionality to enhance our existing software products, we will not be able to achieve our anticipated level of growth.*

The pricing and revenue optimization software market is characterized by:

- rapid technological developments;
- newly emerging and changing customer requirements; and
- frequent product introductions, updates and functional enhancements.

We must introduce new pricing and revenue optimization functionality that enhances our existing software products in order to meet our business plan, maintain or improve our competitive position, keep pace with technological developments, satisfy increasing customer requirements and increase awareness of pricing and revenue optimization software generally and of our software products in particular. Any new functionality we develop may not be introduced in a timely manner and may not achieve market acceptance sufficient to generate material revenue. Furthermore, we believe our competitors are heavily investing in research and development, and they may develop and market new solutions that will compete with, and may reduce the demand for, our software products. We cannot assure you that we will be successful in developing or otherwise acquiring, marketing and licensing new functionality, or delivering updates and upgrades that meet changing industry standards and customer demands. In addition, we may experience difficulties that could delay or prevent the successful development, marketing and licensing of such functionality. If we are unable to develop or acquire new functionality, enhance our existing software products or adapt to changing industry requirements to meet market demand, we may not be able to achieve our anticipated level of growth and our revenue and operating results would be adversely affected.

In addition, because our software products are intended to operate on a variety of technology platforms, we must continue to modify and enhance our software products to keep pace with changes in these platforms. Any inability of our software products to operate effectively with existing or future platforms could reduce the demand for our software products, result in customer dissatisfaction and limit our revenue.

*Defects or errors in our software products could harm our reputation, impair our ability to sell our products and result in significant costs to us.*

Our pricing and revenue optimization software products are complex and may contain undetected defects or errors. Several of our products have recently been developed and may therefore be more likely to contain undetected defects or errors. In addition, we frequently develop enhancements to our software products that may contain defects. We have not suffered significant harm from any defects or errors to date, but we have found defects in our software products from time to time. We may discover additional defects in the future, and such defects could be material. We may not be able to detect and correct defects or errors before the final implementation of our software products. Consequently, we or our customers may discover defects or errors after our software products have been implemented. We have in the past issued, and may in the

future need to issue, corrective releases of our products to correct defects or errors. The occurrence of any defects or errors could result in:

- lost or delayed market acceptance and sales of our software products;
- delays in payment to us by customers;
- injury to our reputation;
- diversion of our resources;
- legal claims, including product liability claims, against us;
- increased maintenance and support expenses; and
- increased insurance costs.

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Our license agreements with our customers typically contain provisions designed to limit our liability for defects and errors in our software products and damages relating to such defects and errors, but these provisions may not be enforced by a court or otherwise effectively protect us from legal claims. Our liability insurance may not be adequate to cover all of the costs resulting from these legal claims. Moreover, we cannot assure you that our current liability insurance coverage will continue to be available on acceptable terms. In addition, the insurer may deny coverage on any future claim. The successful assertion against us of one or more large claims that exceeds available insurance coverage, or the occurrence of changes in our insurance policies, including premium increases or the imposition of large deductible or co-insurance requirements, could have a material adverse effect on our business and operating results. Furthermore, even if we prevail in any litigation, we are likely to incur substantial costs and our management's attention will be diverted from our operations.

***If we fail to retain our key personnel or if we fail to attract additional qualified personnel, we will not be able to achieve our anticipated level of growth and our operating results could be adversely affected.***

Our future success depends upon the continued service of our executive officers and other key sales, development, science and professional services staff. The loss of the services of our executive officers and other key personnel would harm our operations. In addition, our future success will depend in large part on our ability to attract a sufficient number of highly qualified personnel, and there can be no assurance that we will be able to do so. In particular, given the highly sophisticated pricing science included in our products, the pool of scientists and software developers qualified to work on our products is limited. In addition, the implementation of our software products requires highly-qualified personnel, and hiring and retaining such personnel to support our growth may be challenging. Competition for such qualified personnel is intense, and we compete for these individuals with other companies that have greater financial, technical, marketing, service and other resources than we do. If we fail to retain our key personnel and attract new personnel, we will not be able to achieve our anticipated level of growth and our operating results could be adversely affected.

***Intellectual property litigation and infringement claims may cause us to incur significant expense or prevent us from selling our software products.***

Our industry is characterized by the existence of a large number of patents, trademarks and copyrights and by frequent litigation based on allegations of infringement or other violations of intellectual property rights. A third party may assert that our technology violates its intellectual property rights, or we may become the subject of a material intellectual property dispute. Pricing and revenue optimization solutions may become increasingly subject to infringement claims as the number of commercially available pricing and revenue optimization solutions increases and the functionality of these solutions overlaps. Future litigation may involve patent holding companies or other adverse patent owners who have no relevant product revenue and against whom our own potential patents may therefore provide little or no deterrence. Regardless of the merit of any particular claim that our technology violates the intellectual property rights of others, responding to such claims may require us to:

- incur substantial expenses and expend significant management efforts to defend such claims;
- pay damages, potentially including treble damages, if we are found to have willfully infringed such parties' patents or copyrights;



- cease making, licensing or using products that are alleged to incorporate the intellectual property of others;
- distract management and other key personnel from performing their duties for us;
- enter into potentially unfavorable royalty or license agreements in order to obtain the right to use necessary technologies; and
- expend additional development resources to redesign our products.

Any license required as a result of litigation under any patent may not be made available on commercially acceptable terms, if at all. In addition, some licenses may be nonexclusive, and therefore our competitors may have access to the same technology licensed to us. If we fail to obtain a required license or are unable to design around a patent, we may be unable to effectively develop or market our products, which could limit our ability to generate revenue or maintain profitability.

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We may also be required to indemnify our customers for their use of the intellectual property associated with our current product suite or for other third-party products that are incorporated into our solutions and that infringe the intellectual property rights of others. If we are unable to resolve our legal obligations by settling or paying an infringement claim or a related indemnification claim as described above, we may be required to compensate our customers under the contractual arrangement with the customers. Some of our intellectual property indemnification obligations are contractually capped at a very high amount or not capped at all.

***If we fail to protect our proprietary rights and intellectual property adequately, our business and prospects may be harmed.***

Our success will depend in part on our ability to protect our proprietary methodologies and intellectual property. We rely upon a combination of trade secrets, confidentiality policies, nondisclosure and other contractual arrangements, and patent, copyright and trademark laws to protect our intellectual property rights. We cannot, however, be sure that steps we take to protect our proprietary rights will prevent misappropriation of our intellectual property, or the development and marketing of similar and competing products and services by third parties.

We rely, in some circumstances, on trade secrets to protect our technology. Trade secrets, however, are difficult to protect. In addition, our trade secrets may otherwise become known or be independently discovered by competitors, and in such cases, we could not assert such trade secret rights against such parties. We seek to protect our proprietary technology and processes, in part, by confidentiality agreements with our employees, consultants, customers, scientific advisors and other contractors. These agreements may be breached, and we may not have adequate remedies for any breach. To the extent that our employees, consultants or contractors use intellectual property owned by others in their work for us, disputes may arise as to the rights in related or resulting know-how and inventions.

As of the date of this filing, we have 2 issued U.S. patents and 5 pending U.S. patent applications. We have not pursued patent protection in any foreign countries. Our pending patent applications may not result in issued patents. The patent position of technology-oriented companies, including ours, is generally uncertain and involves complex legal and factual considerations. The standards that the United States Patent and Trademark Office uses to grant patents are not always applied predictably or uniformly and can change. Accordingly, we do not know the degree of future protection for our proprietary rights or the breadth of claims allowed in any patents that may be issued to us or to others. If any of our patent applications issue, they may not contain claims sufficiently broad to protect us against third parties with similar technologies or products, or provide us with any competitive advantage. Moreover, once they have been issued, our patents and any patent for which we have licensed or may license rights may be challenged, narrowed, invalidated or circumvented. If our patents are invalidated or otherwise limited, other companies will be better able to develop products that compete with ours, which could adversely affect our competitive business position, business prospects and financial condition.

Patent applications in the U.S. are typically not published until 18 months after filing, or in some cases not at all, and publications of discoveries in industry-related literature lag behind actual discoveries. We cannot be certain that we were the first to make the inventions claimed in our pending patent applications or that we were the first to file for patent protection. Additionally, the process of obtaining patent protection is expensive and time-consuming, and we may not be able to prosecute all necessary or desirable patent applications at a reasonable cost or in a timely manner. As a result, we may not be able to obtain adequate patent protection.

In addition, despite our efforts to protect our proprietary rights, unauthorized parties may be able to obtain and use information that we regard as proprietary. The issuance of a patent does not guarantee that it is valid or enforceable. As such, even if we obtain patents, they may not be valid or enforceable against third parties. In addition, the issuance of a patent does not guarantee that we have a right to practice the patented invention. Third parties may have blocking patents that could be used to prevent us from marketing or practicing our potentially patented products. As a result, we may be required to obtain licenses under these third-party patents. If licenses are not available to us on acceptable

terms, or at all, we will not be able to make and sell our software products and competitors would be more easily able to compete with us.

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***We use open source software in our products that may subject our software products to general release or require us to re-engineer our products, which may cause harm to our business.***

We use open source software in our products and may use more open source software in the future. From time to time, there have been claims challenging the ownership of open source software against companies that incorporate open source software into their products. As a result, we could be subject to suits by parties claiming ownership of what we believe to be open source software. Some open source licenses contain requirements that we make available source code for modifications or derivative works we create based upon the open source software and that we license such modifications or derivative works under the terms of a particular open source license or other license granting third parties certain rights of further use. If we combine our proprietary software products with open source software in a certain manner, we could, under certain of the open source licenses, be required to release the source code of our proprietary software products. In addition to risks related to license requirements, usage of open source software can lead to greater risks than use of third party commercial software, as open source licensors generally do not provide warranties or controls on origin of the software. In addition, open source license terms may be ambiguous and many of the risks associated with usage of open source cannot be eliminated, and could, if not properly addressed, negatively affect our business. If we were found to have inappropriately used open source software, we may be required to re-engineer our products, to discontinue the sale of our products in the event re-engineering cannot be accomplished on a timely basis or take other remedial action that may divert resources away from our development efforts, any of which could adversely affect our business, operating results and financial condition.

***We utilize third-party software that we incorporate into our software products, and impaired relations with these third parties, defects in third-party software or a third party's inability or failure to enhance their software over time could adversely affect our operating performance and financial condition.***

We incorporate and include third-party software into our software products. If our relations with any of these third parties are impaired, or if we are unable to obtain or develop a replacement for the software, our business could be harmed. The operation of our products could be impaired if errors occur in the third-party software that we utilize. It may be more difficult for us to correct any defects in third-party software because the software is not within our control. Accordingly, our business could be adversely affected in the event of any errors in this software. There can be no assurance that these third parties will continue to invest the appropriate levels of resources in their products and services to maintain and enhance the capabilities of their software.

***A weakening economy and changing business conditions could result in substantial defaults by the Company's customers on the Company's accounts receivable could have a significant negative impact on the Company's business, results of operations, financial condition or liquidity.***

A significant portion of the Company's working capital consists of accounts receivable from customers. If customers responsible for a significant amount of accounts receivable were to become insolvent or otherwise unable to pay for products and services, or were to become unwilling or unable to make payments in a timely manner, the Company's business, results of operations, financial condition or liquidity could be adversely affected.

***New accounting standards or interpretations of existing accounting standards, including those related to revenue recognition, could adversely affect our operating results.***

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Accounting Principles Generally Accepted ( GAAP ) in the United States are subject to interpretation by the Financial Accounting Standards Board, the American Institute of Certified Public Accountants, the SEC and various bodies formed to promulgate and interpret appropriate accounting principles. A change in principles or interpretations, in particular those related to revenue recognition, could have an adverse effect on our reported financial results.

*Our international sales subject us to risks that may adversely affect our operating results.*

Over the last several years, we derived a significant portion of our revenue from customers outside the United States. In 2007, 2006, and 2005, approximately 63%, 63% and 60% of our total revenue, respectively, was derived from outside the United States. We may not be able to maintain or increase international market demand for our products. Managing overseas growth could require significant resources and management attention and may subject us to new or larger levels of regulatory, economic, tax and political risks. Among the risks we believe are most likely to affect us with respect to our international sales and operations are:

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- economic conditions in various parts of the world;
- unexpected changes in regulatory requirements;
- less protection for intellectual property rights in some countries;
- new and different sources of competition;
- multiple, conflicting and changing tax laws and regulations that may affect both our international and domestic tax liabilities and result in increased complexity and costs;
- if we were to establish international offices, the difficulty of managing and staffing such international offices and the increased travel, infrastructure and legal compliance costs associated with multiple international locations;
- difficulties in enforcing contracts and collecting accounts receivable, especially in developing countries;
- if contracts become denominated in local currency, fluctuations in exchange rates; and
- tariffs and trade barriers, import/export controls and other regulatory or contractual limitations on our ability to sell or develop our products in certain foreign markets.

If we continue to expand our business globally, our success will depend, in large part, on our ability to anticipate and effectively manage these and other risks associated with our international operations. Our failure to manage any of these risks successfully could harm our international operations and reduce our international sales, adversely affecting our business, operating results and financial condition.

*We may enter into acquisitions that may be difficult to integrate, fail to achieve our strategic objectives, disrupt our business, dilute stockholder value or divert management attention.*

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We currently do not have any agreements with respect to any acquisitions, but in the future we may pursue acquisitions of businesses, technologies and products that we intend to complement our existing business, products and technologies. We cannot assure you that any acquisition we make in the future will provide us with the benefits we anticipated in entering into the transaction. Acquisitions are typically accompanied by a number of risks, including:

- difficulties in integrating the operations and personnel of the acquired companies;
- difficulties in maintaining acceptable standards, controls, procedures and policies;
- potential disruption of ongoing business and distraction of management;
- inability to maintain relationships with customers of the acquired business;
- impairment of relationships with employees and customers as a result of any integration of new management and other personnel;
- difficulties in incorporating acquired technology and rights into our products and services;
- unexpected expenses resulting from the acquisition; and
- potential unknown liabilities associated with acquired businesses.

In addition, acquisitions may result in the incurrence of debt, restructuring charges and write-offs, such as write-offs of acquired in-process research and development. Acquisitions may also result in goodwill and other intangible assets that are subject to impairment tests, which could result in future impairment charges. Furthermore, if we finance acquisitions by issuing convertible debt or equity securities, our existing stockholders may be diluted and earnings per share may decrease. To the extent

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we finance future acquisitions with debt, such debt could include financial or operational covenants that restrict our business operations.

We may enter into negotiations for acquisitions that are not ultimately consummated. Those negotiations could result in diversion of management time and significant out-of-pocket costs. If we fail to evaluate and execute acquisitions successfully, we may not be able to achieve our anticipated level of growth and our business and operating results could be adversely affected.

*Our operations might be affected by the occurrence of a natural disaster or other catastrophic event in Houston, Texas.*

Our headquarters are located in Houston, Texas, from which we base our operations. Although we have contingency plans in effect for natural disasters or other catastrophic events, these events, including terrorist attacks and natural disasters such as hurricanes, could disrupt our operations. Even though we carry business interruption insurance and typically have provisions in our contracts that protect us in certain events, we might suffer losses as a result of business interruptions that exceed the coverage available under our insurance policies or for which we do not have coverage. For example, even a temporary disruption to our business operations may create a negative perception in the marketplace. Any natural disaster or catastrophic event affecting us could have a significant negative impact on our operations.

*Our ability to raise capital in the future may be limited, and our failure to raise capital when needed could prevent us from executing our growth strategy.*

We believe that our existing cash and cash equivalents and our cash flow from future operating activities will be sufficient to meet our anticipated cash needs for the foreseeable future. The timing and amount of our working capital and capital expenditure requirements may vary significantly depending on numerous factors, including the other risk factors described in this Form 10-Q. In addition, we may require additional financing to fund the purchase price of future acquisitions. Additional financing may not be available on terms favorable to us, or at all. Any additional capital raised through the sale of equity or convertible debt securities may dilute your percentage ownership of our common stock. Furthermore, any new debt or equity securities we issue could have rights, preferences and privileges superior to our common stock. Capital raised through debt financings could require us to make periodic interest payments and could impose potentially restrictive covenants on the conduct of our business.

**Risks relating to ownership of our common stock**

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

The market price for our common stock has been and is likely to continue to be volatile, in part because our shares have only recently been traded publicly. Volatility could make it difficult to trade shares of our common stock at predictable prices or times.



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Many factors could cause the market price of our common stock to be volatile, including the following:

- variations in our quarterly or annual operating results;
- decreases in market valuations of comparable companies;
- fluctuations in stock market prices and volumes;
- decreases in financial estimates by equity research analysts;
- announcements by our competitors of significant contracts, new products or product enhancements, acquisitions, distribution partnerships, joint ventures or capital commitments;
- departure of key personnel;
- changes in governmental regulations and standards affecting the software industry and our products;

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- sales of common stock or other securities by us in the future;
- damages, settlements, legal fees and other costs related to litigation, claims and other contingencies; and
- other risks described elsewhere in this section.

In the past, securities class action litigation often has been initiated against a company following a period of volatility in the market price of the company's securities. If class action litigation is initiated against us, we will incur substantial costs and our management's attention will be diverted from our operations. All of these factors could cause the market price of our stock to decline, and you may lose some or all of your investment.

***Shares of our common stock are relatively illiquid***

Our common stock is thinly traded and we have a relatively small public float. Our common stock may be less liquid than the stock of companies with a broader public ownership. In addition, trading of a large volume of our common stock may also have a significant impact on its trading price.

***If equity research analysts cease to publish research or reports about us or if they issue unfavorable commentary or downgrade our common stock, the price of our common stock could decline.***

The trading market for our common stock relies in part on the research and reports that equity research analysts publish about us and our business. The price of our stock could decline if one or more equity research analysts downgrade our stock or if those analysts issue other unfavorable commentary or cease publishing reports about our business.

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

Our Certificate of Incorporation and by-laws and Section 203 of the Delaware General Corporation Law contain provisions that might enable our management to resist a takeover of our company. These provisions include the following:

- the division of our board of directors into three classes to be elected on a staggered basis, one class each year;
- a prohibition on actions by written consent of our stockholders;
- the elimination of the right of stockholders to call a special meeting of stockholders;
- a requirement that stockholders provide advance notice of any stockholder nominations of directors or any proposal of new business to be considered at any meeting of stockholders;
- a requirement that a supermajority vote be obtained to amend or repeal certain provisions of our certificate of incorporation; and
- the ability of our board of directors to issue preferred stock without stockholder approval.

In addition, because we are incorporated in Delaware, we are governed by the provisions of Section 203 of the Delaware General Corporation Law, which limits the ability of stockholders owning in excess of 15% of our outstanding voting stock to merge or combine with us. Although we believe these provisions collectively provide for an opportunity to obtain higher bids by requiring potential acquirors to negotiate with our board of directors, they would apply even if an offer were considered beneficial by some stockholders. In addition, these provisions may frustrate or prevent any attempts by our stockholders to replace or remove our current management by making it more difficult for stockholders to replace members of our board of directors, which is responsible for appointing the members of our management.

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*We do not intend to pay dividends on our common stock in the foreseeable future.*

We do not anticipate paying any cash dividends on our common stock in the foreseeable future. We currently anticipate that we will retain all of our available cash, if any, for use as working capital and for other general corporate purposes. Any payment of future dividends will be at the discretion of our board of directors and will depend upon, among other things, our earnings, financial condition, capital requirements, level of indebtedness, statutory and contractual restrictions applying to the payment of dividends and other considerations that the board of directors deems relevant. Investors seeking cash dividends should not purchase our common stock.

**Item 2. Unregistered sales of equity securities and use of proceeds.**

None

**Item 3. Defaults upon senior securities.**

None

**Item 4. Submission of matters to a vote of security holders.**

Our stockholders voted on two items at the 2008 Annual Meeting of Stockholders held on May 16, 2008:

- 1.) the election of three directors for a three year term expiring 2011; and
- 2.) the ratification of PricewaterhouseCoopers LLP as our independent registered public accounting firm.

**The nominees for directors were elected based upon the following votes:**

Name	Votes For	Votes Withheld
Timothy V. Williams	23,274,687	1,242,209
Greg B. Petersen	23,273,287	1,243,609

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Mariette M. Woestemeyer	17,198,766	7,318,130
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Harry S. Gruner and Kurt R. Jagers continued their terms as Class II directors, with terms expiring in 2009, and Albert E. Winemiller and Ronald F. Woestemeyer continued their terms as Class III directors, with terms expiring in 2010.

**Ratification of PricewaterhouseCoopers LLP as our independent registered public accounting firm was approved as follows:**

Votes For	Votes Against	Abstain
24,498,960	17,841	95

**Item 5. Other information.**

None

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**Item 6. Exhibits.**

Index to Exhibits

- 3.1 Amended and Restated Certificate of Incorporation (incorporated by reference to Exhibit 3.1.1 of the Registrant's Form S-1 Registration Statement (Registration No. 333-141884), declared effective by the Securities and Exchange Commission on June 27, 2007).
- 3.2 Amended and Restated Bylaws (incorporated by reference to Exhibit 3.2 of the Registrant's Form 8-K filed with the Securities and Exchange Commission on January 7, 2008).
- 4.1 Specimen certificate for shares of common stock (incorporated by reference to the exhibit of the same number to the Registrant's Form S-1 Registration Statement (Registration No. 333-141884), declared effective by the Securities and Exchange Commission on June 27, 2007).
- 10.1 1997 Stock Option Plan, as amended to date, and form of stock option agreement (incorporated by reference to the exhibit of the same number to the Registrant's Form S-1 Registration Statement (Registration No. 333-141884), declared effective by the Securities and Exchange Commission on June 27, 2007).
- 10.2 1999 Equity Incentive Plan, as amended to date, and form of stock option agreement (incorporated by reference to the exhibit of the same number to the Registrant's Form S-1 Registration Statement (Registration No. 333-141884), declared effective by the Securities and Exchange Commission on June 27, 2007).
- 10.3 2007 Equity Incentive Plan and form of stock option agreement (incorporated by reference to the exhibit of the same number to the Registrant's Form S-1 Registration Statement (Registration No. 333-141884), declared effective by the Securities and Exchange Commission on June 27, 2007).
- 10.4 Stock Purchase and Stockholders Agreement, dated June 8, 1998, by and among Registrant (as successor in interest to PROS Strategic Solutions, Inc.) and certain stockholders (incorporated by reference to the exhibit of the same number to the Registrant's Form S-1 Registration Statement (Registration No. 333-141884), declared effective by the Securities and Exchange Commission on June 27, 2007).
- 10.4.1 Amendment to Stock Purchase and Stockholders Agreement dated March 26, 2007 by and among Registrant (as successor in interest to PROS Strategic Solutions, Inc.) and certain stockholders (incorporated by reference to the exhibit of the same number to the Registrant's Form S-1 Registration Statement (Registration No. 333-141884), declared effective by the Securities and Exchange Commission on June 27, 2007).
- 10.5 Amended and Restated Stockholders' Agreement, dated June 8, 1998, by and among Registrant (as successor in interest to PROS Strategic Solutions, Inc.) and certain stockholders (incorporated by reference to the exhibit of the same number to the Registrant's Form S-1 Registration Statement (Registration No. 333-141884), declared effective by the Securities and Exchange Commission on June 27, 2007).
- 10.5.1 First Amendment to Amended and Restated Stockholders' Agreement, dated April 8, 1999, by and among Registrant (as successor in interest to PROS Strategic Solutions, Inc.) and certain stockholders (incorporated by reference to the exhibit of the same number to the Registrant's Form S-1 Registration Statement (Registration No. 333-141884), declared effective by the Securities and Exchange Commission on June 27, 2007).
- 10.6 Registration Rights Agreement, dated May 25, 1999, by and between Registrant (as successor in interest to PROS Strategic Solutions, Inc.) and David Samuel Coats (incorporated by reference to the exhibit of the same number to the Registrant's Form S-1 Registration Statement (Registration No. 333-141884), declared effective by the Securities and Exchange Commission on June 27, 2007).
- 10.7 Registration Rights Agreement, dated April 13, 2000, by and between Registrant (as successor in interest to PROS Strategic Solutions, Inc.) and Robert Salter (incorporated by reference to the exhibit of the same number to the Registrant's Form S-1 Registration Statement (Registration No. 333-141884), declared effective by the Securities and Exchange Commission on June 27, 2007).
- 10.8 Registration Rights Agreement, dated June 8, 2007, by and among Registrant, Mariette M. Woestemeyer and Ronald F. Woestemeyer (incorporated by reference to the exhibit of the same number to the Registrant's Form S-1 Registration Statement (Registration No. 333-141884), declared effective by the Securities and Exchange Commission on June 27, 2007).
- 10.9 Redemption Agreement, dated March 26, 2007, by and among Registrant and the holders of the Company's redeemable preferred stock (incorporated by reference to the exhibit of the same



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- number to the Registrant's Form S-1 Registration Statement (Registration No. 333-141884), declared effective by the Securities and Exchange Commission on June 27, 2007).
- 10.10 Office Lease, dated January 31, 2001, by and between PROS Revenue Management L.P. and Houston Community College System (incorporated by reference to the exhibit of the same number to the Registrant's Form S-1 Registration Statement (Registration No. 333-141884), declared effective by the Securities and Exchange Commission on June 27, 2007).
  - 10.10.1 First Amendment to Office Lease, dated May 31, 2006, by and between PROS Revenue Management L.P. and Houston Community College System (incorporated by reference to the exhibit of the same number to the Registrant's Form S-1 Registration Statement (Registration No. 333-141884), declared effective by the Securities and Exchange Commission on June 27, 2007).
  - 10.11 Employment Agreement, dated September 30, 2005, by and between PROS Revenue Management L.P. and Albert Winemiller (incorporated by reference to the exhibit of the same number to the Registrant's Form S-1 Registration Statement (Registration No. 333-141884), declared effective by the Securities and Exchange Commission on June 27, 2007).
  - 10.11.1 Immediately Exercisable Stock Option Grant, dated April 2, 2007, by and between Registrant and Albert Winemiller (incorporated by reference to the exhibit of the same number to the Registrant's Form S-1 Registration Statement (Registration No. 333-141884), declared effective by the Securities and Exchange Commission on June 27, 2007).
  - 10.11.2 Amendment No.1 to Employment Agreement, dated April 2, 2007, by and between Registrant and Albert Winemiller (incorporated by reference to the exhibit of the same number to the Registrant's Form S-1 Registration Statement (Registration No. 333-141884), declared effective by the Securities and Exchange Commission on June 27, 2007).
  - 10.12 Employment Agreement, dated September 30, 2005, by and between PROS Revenue Management L.P. and Charles Murphy (incorporated by reference to the exhibit of the same number to the Registrant's Form S-1 Registration Statement (Registration No. 333-141884), declared effective by the Securities and Exchange Commission on June 27, 2007).
  - 10.12.1 Immediately Exercisable Incentive Stock Option Grant, dated September 30, 2005, by and between Registrant and Charles Murphy (incorporated by reference to the exhibit of the same number to the Registrant's Form S-1 Registration Statement (Registration No. 333-141884), declared effective by the Securities and Exchange Commission on June 27, 2007).
  - 10.12.2 Immediately Exercisable Stock Option Grant, dated April 2, 2007, by and between Registrant and Charles Murphy (incorporated by reference to the exhibit of the same number to the Registrant's Form S-1 Registration Statement (Registration No. 333-141884), declared effective by the Securities and Exchange Commission on June 27, 2007).
  - 10.12.3 Amendment No.1 to Employment Agreement, dated April 2, 2007, by and between Registrant and Charles Murphy (incorporated by reference to the exhibit of the same number to the Registrant's Form S-1 Registration Statement (Registration No. 333-141884), declared effective by the Securities and Exchange Commission on June 27, 2007).
  - 10.13 Employment Agreement, dated January 15, 1999, by and between PROS Revenue Management L.P. and Ronald Woestemeyer (incorporated by reference to the exhibit of the same number to the Registrant's Form S-1 Registration Statement (Registration No. 333-141884), declared effective by the Securities and Exchange Commission on June 27, 2007).
  - 10.13.1 Amendment No. 1 to Employment Agreement, dated February 2, 2004, by and between PROS Revenue Management L.P. and Ronald Woestemeyer (incorporated by reference to the exhibit of the same number to the Registrant's Form S-1 Registration Statement (Registration No. 333-141884), declared effective by the Securities and Exchange Commission on June 27, 2007).
  - 10.14 Form of Indemnification Agreement entered into among Registrant, its affiliates and its directors and officers (incorporated by reference to the exhibit number 10.16 to the Registrant's Form S-1 Registration Statement (Registration No. 333-141884), declared effective by the Securities and Exchange Commission on June 27, 2007).
  - 10.15 Voting Agreement dated March 26, 2007, by and among TA/Advent VIII, L.P., Advent Atlantic and Pacific III, L.P., TA Venture Investors L.P. and TA Executives Fund LLC, JMI Equity Fund, III, L.P. and Ronald and Mariette Woestemeyer (incorporated by reference to the exhibit number 10.18 to the Registrant's Form S-1 Registration Statement (Registration No. 333-141884), declared effective by the Securities and Exchange Commission on June 27, 2007).



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- 10.16# Employment Agreement, dated April 24, 2008, by and between PROS Revenue Management L.P. and Jeff Robinson Senior Vice-President Pricing Solutions.
- 10.17# Employment Agreement, dated April 24, 2008, by and between PROS Revenue Management L.P. and Andres Reiner Senior Vice-President Product Development.
  - 21.1 List of Subsidiaries (incorporated by reference to the exhibit of the same number to the Registrant's Form S-1 Registration Statement (Registration No. 333-141884), declared effective by the Securities and Exchange Commission on June 27, 2007).
- 31.1# Certification of Chief Executive Officer Pursuant to Exchange Act Rule 13a-14(a) or 15d-14(a), as Adopted Pursuant to Section 302 of the Sarbanes Oxley Act of 2002.
- 31.2# Certification of Chief Financial Officer Pursuant to Exchange Act Rule 13a-14(a) or 15d-14(a), as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1# Certifications of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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# Filed with this report.

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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.

PROS HOLDINGS, INC.

Date August 7, 2008

By:

*/s/ Albert E. Winemiller*  
Albert E. Winemiller  
President and Chief Executive Officer

Date: August 7, 2008

By:

*/s/ Charles H. Murphy*  
Charles H. Murphy  
Executive Vice President and Chief Financial Officer