

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

(Mark One)

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

For the Fiscal Year Ended: December 31, 2011

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

For the Transition Period from to

Commission file number 001-34702

**SPS COMMERCE, INC.**

*(Exact Name of Registrant as Specified in its Charter)*

**Delaware**  
*(State or Other Jurisdiction of  
Incorporation or Organization)*

**41-2015127**  
*(I.R.S. Employer  
Identification No.)*

**333 South Seventh Street, Suite 1000, Minneapolis, MN 55402**  
*(Address of Principal Executive Offices, Including Zip Code)*

**(612) 435-9400**  
*(Registrant's Telephone Number, Including Area Code)*

**Securities registered pursuant to Section 12(b) of the Act:**

<u>(Title of each class)</u>	<u>(Name of each exchange on which registered)</u>
Common stock, par value \$0.001 per share	The Nasdaq Stock Market LLC (Nasdaq Global Market)

**Securities registered pursuant to Section 12(g) of the Act:**

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes  No

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§229.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large Accelerated Filer  Accelerated Filer  Non-Accelerated Filer  Smaller Reporting Company   
(Do not check if a smaller reporting company)

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

As of June 30, 2011, the last business day of the registrant's most recently completed second fiscal quarter, the aggregate market value of shares of the registrant's common stock held by non-affiliates of the registrant (based upon the closing sale price of \$17.79 per share on the Nasdaq Global Market on such date) was approximately \$188.2 million.

The number of shares of the registrant's common stock, par value \$0.001 per share, outstanding as of February 24, 2012 was 12,165,315 shares.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the Company's definitive Proxy Statement for the Annual Meeting of Stockholders to be held on May 24, 2012 (the "2012 Proxy Statement"), which is expected to be filed within 120 days after the end of the fiscal year covered by this Annual Report on Form 10-K, are incorporated by reference in Part III of this Annual Report on Form 10-K.

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SPS COMMERCE, INC.  
ANNUAL REPORT ON FORM 10-K

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**SPECIAL NOTE REGARDING FORWARD-LOOKING INFORMATION**

This Annual Report on Form 10-K contains forward-looking statements regarding us, our business prospects and our results of operations that are subject to certain risks and uncertainties posed by many factors and events that could cause our actual business, prospects and results of operations to differ materially from those that may be anticipated by such forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those described under the heading “*Risk Factors*” included in this Annual Report on Form 10-K. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date of this report. In some cases, you can identify forward-looking statements by the following words: “anticipate,” “believe,” “continue,” “could,” “estimate,” “expect,” “intend,” “may,” “ongoing,” “plan,” “potential,” “predict,” “project,” “should,” “will,” “would,” or the negative of these terms or other comparable terminology, although not all forward-looking statements contain these words. We undertake no obligation to revise any forward-looking statements in order to reflect events or circumstances that may subsequently arise. Readers are urged to carefully review and consider the various disclosures made by us in this report and in our other reports filed with the Securities and Exchange Commission that advise interested parties of the risks and factors that may affect our business.

## PART I

### Item 1. *Business*

#### Overview

We are a leading provider of on-demand supply chain management solutions and the Retail Universe community, providing integration, collaboration, connectivity, visibility and data analytics to thousands of customers worldwide. We provide our solutions through SPSCommerce.net, a hosted software suite that improves the way suppliers, retailers, distributors and other customers manage and fulfill orders. Implementing and maintaining supply chain management software is resource intensive and not a core competency for most businesses. SPSCommerce.net uses pre-built integrations to eliminate the need for on-premise software and support staff, which enables our supplier customers to shorten supply cycle times, optimize inventory levels, reduce costs and satisfy retailer requirements. As of December 31, 2011, we had approximately 16,100 customers with contracts to pay us monthly fees, which we refer to as recurring revenue customers. We have also generated revenues by providing supply chain management solutions to an additional 29,000 organizations that, together with our recurring revenue customers, we refer to as our customers. Once connected to our platform, our customers often require integrations to new organizations that represent an expansion of our platform and new sources of revenues for us.

We deliver our solutions to our customers over the Internet using a Software-as-a-Service model. This model enables our customers to easily interact with their trading partners around the world without the local implementation and servicing of software that traditional on-premise solutions require. Our delivery model also enables us to offer greater functionality, integration and reliability with less cost and risk than traditional solutions.

In May 2011, we purchased substantially all of the assets of Direct EDI LLC, a privately-held provider of cloud-based integration solutions for electronic data interchange, which expanded our base of recurring revenue customers. In November 2011, we expanded into the social networking arena with the Retail Universe, a collaborative online website that facilitates relationships and communications with all members of the retail ecosystem.

For 2011, 2010 and 2009, we generated revenues of \$58.0 million, \$44.6 million and \$37.7 million. Our fiscal quarter ended December 31, 2011 represented our 44<sup>th</sup> consecutive quarter of increased revenues. Recurring revenues from recurring revenue customers accounted for 85%, 83% and 80% of our total revenues for 2011, 2010 and 2009. No customer represented over 2% of our revenues for 2011, 2010 or 2009.

#### Our Industry

##### *Supply Chain Management Industry Background*

The supply chain management industry serves thousands of retailers around the world supplied with goods from tens of thousands of suppliers. Additional participants in this market include distributors, third-party logistics providers, manufacturers, fulfillment and warehousing providers and sourcing companies. Supply chain management involves communicating data related to the exchange of goods among these trading partners. At every stage of the supply chain there are inefficient, labor-intensive processes between trading partners with significant documentation requirements, such as the counting, sorting and verifying of goods before shipment, while in transit and upon delivery. Supply chain management solutions must address trading partners' needs for integration, collaboration, connectivity, visibility and data analytics to improve the speed, accuracy and efficiency with which goods are ordered and supplied.

The pervasiveness of the Internet, along with the dramatic declines in the pricing of computing technology and network bandwidth, have enabled companies to adopt on-demand applications at an increasing rate. As familiarity and acceptance of on-demand solutions continues to accelerate, we believe companies, both large and

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small, will continue to turn to on-demand delivery methods similar to ours for their supply chain integration needs, as opposed to traditional on-premise software deployment. Our target market, supply chain integration solutions delivered on a Software-as-a-Service platform, is one of many which comprise the global Software-as-a-Service market.

### ***The Rule Books — Integration Between Retailers and Suppliers***

Retailers impose specific work-flow rules and standards on their trading partners for electronically communicating supply chain information. These “rule books” include specific business processes for suppliers to exchange data and documentation requirements such as invoices, purchase orders and advance shipping notices. Rule books can be hundreds of pages, and retailers frequently have multiple rule books for international requirements or specific fulfillment models. Suppliers working with multiple retailers need to accommodate different rule books for each retailer. These rule books are not standardized between retailers, but vary based on a retailer’s size, industry and technological capabilities. The responsibility for creating information “maps,” which are integration connections between the retailer and the supplier that comply with the retailer’s rule books, resides primarily with the supplier. The cost of noncompliance can be refusal of delivered goods, fines and ultimately a termination of the supplier’s relationship with the retailer. The complexity of retailers’ requirements and consequences of noncompliance create growing demand for specialized supply chain management solutions.

### ***Traditional Supply Chain Management Solutions***

Traditional supply chain management solutions range from non-automated paper or fax solutions to electronic solutions implemented using on-premise licensed software. On-premise licensed software provides connectivity between only one organization and its trading partners and typically requires significant time and technical expertise to configure, deploy and maintain. These software providers primarily link retailers and suppliers through the Electronic Data Interchange protocol that enables the structured electronic transmission of data between organizations. Because of set-up and maintenance costs, technical complexity and a growing volume of requirements from retailers, the traditional software model is not well suited for many suppliers, especially those small and medium in size.

### ***Need for Effective Analysis of Data for Intelligent Decision Making***

Integrating retailers and suppliers is a first step in addressing the complexities in the supply chain ecosystem. As the number and geographic dispersion of trading partners has grown, so too has the volume of data produced by the supply chain. As a result, trading partners want a solution to effectively consolidate, distill and channel information to managers and decision-makers who can use the information to drive efficiency, revenue growth and profitability. The abundance of data produced by these processes, including data for fulfillment, sales and inventory levels, is often inaccessible to trading partners for analysis. The data and related analytics are essential for optimizing the inventory and fulfillment process and will continue to drive demand for supply chain management solutions.

### ***Software-as-a-Service Solutions Provide Flexibility and Effective Management Across the Supply Chain***

A Software-as-a-Service model is well suited for providing supply chain management solutions. On-demand solutions are able to continue utilizing standard connectivity protocols, such as Electronic Data Interchange, but also are able to support other protocols, such as XML, as retailers require. These on-demand solutions connect suppliers and retailers more efficiently than traditional on-premise software solutions by leveraging the integrations created for a single supplier across all participating suppliers.

Software-as-a-Service solutions also allow an organization to connect across the supply chain ecosystem, addressing increased retailer demands, globalization and increased complexity affecting the supply chain. In addition, Software-as-a-Service solutions can integrate supply chain management applications with organizations’ existing enterprise resource planning systems.

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### **SPSCommerce.net: Our Platform**

We operate one of the largest trading partner integration centers through SPSCommerce.net, a hosted software suite that improves the way suppliers, retailers, distributors and other trading partners manage and fulfill orders. More than 45,000 customers across more than 40 countries have used our platform to enhance their trading relationships. SPSCommerce.net fundamentally changes how organizations use electronic communication to manage their supply chains by replacing the collection of traditional, custom-built, point-to-point integrations with a “hub-and-spoke” model whereby a single integration to SPSCommerce.net allows an organization to connect seamlessly to the entire SPSCommerce.net network of trading partners.

SPSCommerce.net combines integrations that comply with numerous rule books for retailers, grocers and distributors with whom we and our customers have done business. SPSCommerce.net does this through a multi-tenant architecture and provides ancillary support services that deliver a comprehensive set of supply chain management solutions to customers. By maintaining current integrations with retailers, SPSCommerce.net obviates the need for suppliers to continually stay up-to-date with the rule book changes required by retailers. Moreover, by leveraging an on-demand delivery model, we eliminate or greatly reduce the burden on suppliers to support and maintain an on-premise software application, thereby reducing ongoing operating costs. As the communication hub for trading partners, we also are able to provide increased visibility and data analytics capabilities for retailers and suppliers across their supply chains, each of which is difficult to gain from traditional, point-to-point integration solutions.

Our platform delivers suppliers and retailers the following solutions:

- *Trading Partner Integration.* Our Trading Partner Integration solution replaces or augments an organization’s existing trading partner electronic communication infrastructure, enabling suppliers to comply with retailers’ rule books and allowing for the electronic exchange of information among numerous trading partners through various protocols.
- *Trading Partner Enablement.* Our Trading Partner Enablement solution helps organizations, typically large retailers, implement new integrations with trading partners to drive automation and electronic communication across their supply chains.
- *Trading Partner Intelligence.* Our Trading Partner Intelligence solution consists of data analytics applications and allows our customers to improve their visibility across, and analysis of, their supply chains. Retailers improve their visibility into supplier performance and their understanding of product sell-through.
- *Other Trading Partner Solutions.* We provide a number of peripheral solutions such as barcode labeling and our scan and pack application, which helps trading partners process information to streamline the picking and packaging process.

### **Our Customer and Sales Sources**

As one of the largest on-demand supply chain management solutions providers, the trading partner relationships that we enable among our retailer, supplier and fulfillment customers naturally lead to new customer acquisition opportunities.

#### *“Network Effect” of SPSCommerce.net*

Once connected to our network, trading partners can exchange electronic supply chain information with each other. Through our platform, we helped over 45,000 customers to communicate electronically with their trading partners. The value of our platform increases with the number of trading partners connected to the platform. The addition of each new customer to our platform allows that new customer to communicate with our existing customers and allows our existing customers to route orders to the new customer. This “network effect”

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of adding an additional customer to our platform creates a significant opportunity for existing customers to realize incremental sales by working with our new trading partners and vice versa. As a result of this increased volume of activity amongst our network participants, we earn additional revenues from these participants.

### **Customer Acquisition Sources**

*Trading Partner Enablement.* When a retailer decides to change the workflow or protocol by which it interacts with its suppliers, the retailer may engage us to work with its supplier base to communicate and test the change in procedure. Performing these programs on behalf of retailers often generates supplier sales leads for us.

*Referrals from Trading Partners.* We also receive sales leads from customers of SPSCommerce.net seeking to communicate electronically with their trading partners. For example, a supplier may refer to us its third-party logistics provider or manufacturer which is not in our network.

*Channel Partners.* In addition to the customer acquisition sources identified above, we market and sell our solutions through a variety of channel partners including software providers, resellers, system integrators and logistics partners. For example, software partners such as NetSuite and their business partner communities generate sales for us as part of broader enterprise resource planning, warehouse management system and/or transportation management system sales efforts. Our logistics partners also drive new sales both by providing leads and by embedding our solutions as part of their service offerings. For example, we have a contractual relationship with a leading global logistics provider where we private label our solutions, which are in turn sold as that company's branded solution.

### **Our Sales Force**

We also sell our solutions through a direct sales force which is organized as follows:

- *Retailer Sales.* We employ a team of sales professionals who focus on selling our Trading Partner Enablement solution to retailers, grocers and distributors.
- *Supplier Sales.* We employ a team of supplier sales representatives based in North America. We also maintain sales offices in China, Hong Kong and Australia.
- *Business Development Efforts.* Our business development organization is tasked with finding new sources of revenue and development of new business opportunities through channel partners, new solutions, geographic expansion and other areas that present opportunity for growth.

### **Our Growth Strategy**

Our objective is to be the leading global provider of supply chain management solutions. Key elements of our strategy include:

- *Further Penetrate Our Current Market.* We believe the global supply chain management market is underpenetrated and, as the supply chain ecosystem becomes more complex and geographically dispersed, the demand for supply chain management solutions will increase, especially among small- and medium-sized businesses. We intend to continue leveraging our relationships with customers and their trading partners to obtain new sales leads.
- *Increase Revenues from Our Customer Base.* We believe our overall customer satisfaction is strong and will lead our customers to further utilize our current solutions as their businesses grow, generating additional revenues for us. We also expect to introduce new solutions to sell to our customers. We believe our position as the incumbent supply chain management solution provider to our customers, our integration into our recurring revenue customers' business systems and the modular nature of our platform are conducive to deploying additional solutions with customers.

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- *Expand Our Distribution Channels.* We intend to grow our business by expanding our network of direct sales representatives to gain new customers. We also believe there are valuable opportunities to promote and sell our solutions through collaboration with other providers.
- *Expand Our International Presence.* We believe our presence in China represents a significant competitive advantage. We plan to increase our international sales efforts to obtain new supplier customers around the world. We intend to leverage our current international presence to increase the number of integrations we have with retailers in foreign markets to make our platform more valuable to suppliers based overseas.
- *Enhance and Expand Our Platform.* We intend to further improve and develop the functionality and features of our platform, including developing new solutions and applications. For example, in 2009, we launched our Trading Partner Intelligence solution, which delivers data analytics applications to suppliers and retailers to improve performance.
- *Selectively Pursue Strategic Acquisitions.* The fragmented nature of our market provides opportunity for selective acquisitions. In 2011, we purchased substantially all of the assets of Direct EDI LLC, a privately-held provider of cloud-based integration solutions for electronic data interchange, which expanded our base of recurring revenue customers. To complement and accelerate our internal growth, we may pursue acquisitions of other supply chain management companies to add customers. We also may pursue acquisitions that allow us to expand into regions or industries where we do not have a significant presence or to offer new functionalities we do not currently provide. We plan to evaluate potential acquisitions of other supply chain management companies primarily based on the number of customers the acquisition would provide relative to the purchase price. We plan to evaluate potential acquisitions to expand into new regions or industries or offer additional functionalities primarily based on the anticipated growth the acquisition would provide, the purchase price and our ability to integrate and operate the acquired business.

## **Technology, Development and Operations**

### ***Technology***

We were an early provider of Software-as-a-Service solutions to the supply chain management industry, launching the first version of our platform in 1997. We use commercially available hardware and a combination of proprietary and commercially available software.

The software we license from third parties is typically licensed to us pursuant to a multi-year or perpetual license that includes a multi-year support services agreement with the third party. Our ability to access upgrades to certain software is conditioned upon our continual maintenance of a support services agreement with the third party between the date of the initial license and the date on which we seek or are required to upgrade the software. Although we believe we could replace the software we currently license from third parties with alternative software, doing so could take time, could result in the temporary unavailability of our platform and increase our costs of operations.

Our scalable, on-demand platform treats all customers as logically separate tenants in central applications and databases. As a result, we spread the cost of delivering our solutions across our customer base. Because we do not manage thousands of distinct applications with their own business logic and database schemes, we believe that we can scale our business faster than traditional software vendors, even those that modified their products to be accessible over the Internet.

### ***Development***

Our research and development efforts focus on improving and enhancing our existing solutions, as well as developing new solutions and applications. Because of our multi-tenant architecture, we provide our customers

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with a single version of our platform, which we believe allows us to maintain relatively low research and development expenses compared to traditional on-premise licensed software solutions that support multiple versions.

### ***Operations***

We host production and back-up servers in two third-party data centers located in Minneapolis and Saint Paul, Minnesota. We operate all of the hardware on which our applications run in the data centers.

We have monitoring software that continually checks our platform and key underlying components at regular intervals for availability and performance, ensuring our platform is available and providing adequate response. We also have a technology operations team that provides system provisioning, management, maintenance, monitoring and back-up.

To facilitate high availability, we operate a multi-tiered system configuration with load-balanced web server pools, replicated database servers and fault-tolerant storage devices. Databases leverage third-party features for near real-time replication across sites.

### **Our Customers**

As of December 31, 2011, we had approximately 16,100 recurring revenue customers and over 45,000 total customers. Our primary source of revenue is from small- to mid-sized suppliers in the consumer packaged goods industry. We also generate revenues from other members of the supply chain ecosystem, including retailers, grocers, distributors, third-party logistics providers and other trading partners. No customer represented over 2% of our revenues in 2011, 2010 or 2009.

### **Competition**

Vendors in the supply chain management industry offer solutions through three delivery methods: on demand, traditional on-premise software and managed services.

The market for on-demand supply chain management solutions is fragmented and rapidly evolving. Software-as-a-Service vendors compete directly with each other based on the following:

- breadth of pre-built connections to retailers, third-party logistics providers and other trading partners;
- history of establishing and maintaining reliable integration connections with trading partners;
- reputation of the Software-as-a-Service vendor in the supply chain management industry;
- price;
- specialization in a customer market segment;
- speed and quality with which the Software-as-a-Service vendor can integrate its customers to their trading partners;
- functionality of the Software-as-a-Service solution, such as the ability to integrate the solution with a customer's business systems;
- breadth of complementary supply chain management solutions the Software-as-a-Service vendor offers; and
- training and customer support services provided during and after a customer's initial integration.

We expect to encounter new and increased competition as this market segment consolidates and matures. Consolidation among Software-as-a-Service vendors could create a direct competitor that is able to compete with



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us more effectively than the numerous, smaller vendors currently offering Software-as-a-Service supply chain management solutions. Increased competition from Software-as-a-Service vendors could reduce our market share, revenues and operating margins or otherwise adversely affect our business.

Software-as-a-Service vendors also compete with traditional on-premise software companies and managed service providers. Traditional on-premise software companies focused on supply chain integration management include Sterling Commerce, a subsidiary of IBM, GXS Corporation, Extol International and Seeburger. These companies offer a “do-it-yourself” approach in which customers purchase, install and manage specialized software, hardware and value-added networks for their supply chain integration needs. This approach requires customers to invest in staff to operate and maintain the software. Traditional on-premise software companies use a single-tenant approach in which information maps to retailers are built for and used by one supplier, as compared to Software-as-a-Service solutions that allow multiple customers to share information maps with a retailer.

Managed service providers focused on the supply chain management market include Sterling Commerce and GXS. These companies combine traditional on-premise software, hardware and value-added networks with professional information technology services to manage these resources. Like traditional on-premise software companies, managed service providers use a single-tenant approach.

Customers of traditional on-premise software companies and managed service providers typically make significant upfront investments in the supply chain management solutions these competitors provide, which can decrease the customers’ willingness to abandon their investments in favor of a Software-as-a-Service solution. Software-as-a-Service supply chain management solutions also are at a relatively early stage of development compared to traditional on-premise software and managed service providers. Software-as-a-Service vendors compete with these better established solutions based on total cost of ownership and flexibility. If suppliers do not perceive the benefits of Software-as-a-Service solutions, or if suppliers are unwilling to abandon their investments in other supply chain management solutions, our business and growth may suffer. In addition, many traditional on-premise software companies and managed service providers have larger customer bases and may be better capitalized than we are, which may provide them with an advantage in developing, marketing or servicing solutions that compete with ours.

### **Intellectual Property and Proprietary Content**

We rely on a combination of copyright, trademark and trade secret laws in the United States as well as confidentiality procedures and contractual provisions to protect our proprietary technology and our brand. We enter into confidentiality and proprietary rights agreements with our employees, consultants and other third parties and control access to software, documentation and other proprietary information. We registered the marks SPSCommerce.net and SPS Commerce in the United States. We do not have any patents or applications for patents. Our trade secrets consist primarily of the software we have developed for our SPSCommerce.net integration center. Our software is also protected under copyright law, but we do not have any registered copyrights.

### **Employees**

As of December 31, 2011, we had 474 employees. We also employ independent contractors to support our operations. We believe that our continued success will depend on our ability to continue to attract and retain skilled technical and sales personnel. We have never had a work stoppage, and none of our employees are represented by a labor union. We believe our relationship with our employees is good.

### **Company Information**

We were originally incorporated as St. Paul Software, Inc., a Minnesota corporation, on January 28, 1987. On May 30, 2001, we reincorporated in Delaware under our current name, SPS Commerce, Inc. Our principal

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executive offices are located at 333 South Seventh Street, Suite 1000, Minneapolis, Minnesota 55402, and our telephone number is (612) 435-9400. Our website address is [www.spscommerce.com](http://www.spscommerce.com). Information on our website does not constitute part of this Annual Report on Form 10-K or any other report we file or furnish with the Securities and Exchange Commission ("SEC"). We provide free access to various reports that we file with or furnish to the SEC through our website as soon as reasonably practicable after they have been filed or furnished. These reports include, but are not limited to, our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and any amendments to these reports. Our SEC reports can be accessed through the investor relations section of our website or through the SEC's website at [www.sec.gov](http://www.sec.gov). Stockholders may also request copies of these documents from:

SPS Commerce, Inc.  
Attention: Investor Relations  
333 South Seventh Street  
Suite 1000  
Minneapolis, MN 55402

### **Executive Officers**

Set forth below are the names, ages and titles of the persons serving as our executive officers.

<u>Name</u>	<u>Age</u>	<u>Position</u>
Archie C. Black	49	Chief Executive Officer and President
Kimberly K. Nelson	44	Executive Vice President and Chief Financial Officer
James J. Frome	47	Executive Vice President and Chief Strategy Officer
Michael J. Gray	52	Executive Vice President of Operations
David J. Novak, Jr.	43	Executive Vice President of Business Development

*Archie C. Black* joined us in 1998 as our Senior Vice President and Chief Financial Officer and served in those capacities until becoming our President and Chief Executive Officer and a director in 2001. Prior to joining us, Mr. Black was a Senior Vice President and Chief Financial Officer at Investment Advisors, Inc. in Minneapolis, Minnesota. Prior to Investment Advisors, he spent three years at Price Waterhouse.

*Kimberly K. Nelson* has served as our Executive Vice President and Chief Financial Officer since November 2007. Prior to joining us, Ms. Nelson served as the Finance Director, Investor Relations for Amazon.com from June 2005 through November 2007. From April 2003 until June 2005, she served as the Finance Director, Worldwide Application for Amazon.com's Technology group. Ms. Nelson also served as Amazon.com's Finance Director, Financial Planning and Analysis from December 2000 until April 2003.

*James J. Frome* has served as our Executive Vice President and Chief Strategy Officer since March 2001. Mr. Frome served as our Vice President of Marketing from July 2000 to March 2001. Prior to joining us, he served as a Divisional Vice President of marketing at Sterling Software, Inc. from 1999 to 2000. Prior to joining Sterling Software, he served as a Senior Product Manager and Director of Product Management at Information Advantage, Inc. from 1993 to 1999.

*Michael J. Gray* has served as our Executive Vice President of Operations since November 2008. Prior to joining us, Mr. Gray served as Chief Technology Officer at IDeaS Revenue Optimization from October 2007 to November 2008. From 2001 to October 2007, Mr. Gray served as Senior Director of Technology at Thomson Corporation (formerly West Publishing). Mr. Gray also served in various leadership and technical position at Thomson Corporation prior to his promotion to Senior Director of Technology.

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David J. Novak, Jr. has served as our Executive Vice President of Business Development since 2007. Prior to joining us, he served as Vice President of Sales, North America-Business Intelligence for Oracle Corporation from January 2006 to June 2007. Prior to Oracle's acquisition of Siebel Systems, Inc. in 2006, he served as Regional Vice President of Sales — Western U.S. and Asia Pacific for Siebel Systems' business intelligence division starting in 2001.

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

*Set forth below and elsewhere in this Annual Report on Form 10-K, and in other documents we file with the Securities and Exchange Commission, are risks and uncertainties that could cause our actual results to differ materially from the results contemplated by the forward-looking statements contained in this Annual Report on Form 10-K and in other written and oral communications from time to time. Our business could be harmed by any of these risks. The trading price of our common stock could decline due to any of these risks. In assessing these risks, you should also refer to the other information contained in this Annual Report on Form 10-K, including our financial statements and related notes.*

***The market for on-demand supply chain management solutions is at an early stage of development. If this market does not develop or develops more slowly than we expect, our revenues may decline or fail to grow and we may incur operating losses.***

We derive, and expect to continue to derive, substantially all of our revenues from providing on-demand supply chain management solutions to suppliers. The market for on-demand supply chain management solutions is in an early stage of development, and it is uncertain whether these solutions will achieve and sustain high levels of demand and market acceptance. Our success will depend on the willingness of suppliers to accept our on-demand supply chain management solutions as an alternative to traditional licensed hardware and software solutions.

Some suppliers may be reluctant or unwilling to use our on-demand supply chain management solutions for a number of reasons, including existing investments in supply chain management technology. Supply chain management functions traditionally have been performed using purchased or licensed hardware and software implemented by each supplier. Because this traditional approach often requires significant initial investments to purchase the necessary technology and to establish systems that comply with retailers' unique requirements, suppliers may be unwilling to abandon their current solutions for our on-demand supply chain management solutions.

Other factors that may limit market acceptance of our on-demand supply chain management solutions include:

- our ability to maintain high levels of customer satisfaction;
- our ability to maintain continuity of service for all users of our platform;
- the price, performance and availability of competing solutions; and
- our ability to assuage suppliers' confidentiality concerns about information stored outside of their controlled computing environments.

If suppliers do not perceive the benefits of our on-demand supply chain management solutions, or if suppliers are unwilling to accept our platform as an alternative to the traditional approach, the market for our solutions might not continue to develop or might develop more slowly than we expect, either of which would significantly adversely affect our revenues and growth prospects.

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***We do not have long-term contracts with our recurring revenue customers, and our success therefore depends on our ability to maintain a high level of customer satisfaction and a strong reputation in the supply chain management industry.***

Our contracts with our recurring revenue customers typically allow the customer to cancel the contract for any reason with 30 days prior notice. Our continued success therefore depends significantly on our ability to meet or exceed our recurring revenue customers' expectations because most recurring revenue customers do not make long-term commitments to use our solutions. In addition, if our reputation in the supply chain management industry is harmed or diminished for any reason, our recurring revenue customers have the ability to terminate their relationship with us on short notice and seek alternative supply chain management solutions. If a significant number of recurring revenue customers seek to terminate their relationship with us, our business, results of operations and financial condition can be adversely affected in a short period of time.

***Continued economic weakness and uncertainty could adversely affect our revenue, lengthen our sales cycles and make it difficult for us to forecast operating results accurately.***

Our revenues depend significantly on general economic conditions and the health of retailers. Economic weakness and constrained retail spending adversely affected revenue growth rates in late 2008 and similar circumstances may result in slower growth, or reductions, in revenues and gross profits in the future. We have experienced, and may experience in the future, reduced spending in our business due to financial turmoil affecting the U.S. and global economy, and other macroeconomic factors affecting spending behavior. Uncertainty about future economic conditions makes it difficult for us to forecast operating results and to make decisions about future investments. In addition, economic conditions or uncertainty may cause customers and potential customers to reduce or delay technology purchases, including purchases of our solutions. Our sales cycle may lengthen if purchasing decisions are delayed as a result of uncertain information technology or development budgets or contract negotiations become more protracted or difficult as customers institute additional internal approvals for information technology purchases. Delays or reductions in information technology spending could have a material adverse effect on demand for our solutions, and consequently our results of operations, prospects and stock price.

***If we are unable to attract new customers, or sell additional solutions, or if our customers do not increase their use of our solutions, our revenue growth and profitability will be adversely affected.***

To increase our revenues and achieve and maintain profitability, we must regularly add new customers, sell additional solutions and our customers must increase their use of the solutions for which they currently subscribe. We intend to grow our business by hiring additional inside sales personnel, developing strategic relationships with resellers, including resellers that incorporate our applications in their offerings, and increasing our marketing activities. In addition, we derived more than 90% of our revenues from sales of our Trading Partner Integration solution in 2011, 2010 and 2009 and have not yet received significant revenues from solutions and applications that we introduced in 2009. If we are unable to hire or retain quality sales personnel, convert companies that have been referred to us by our existing network into paying customers, ensure the effectiveness of our marketing programs, or if our existing or new customers do not perceive our solutions to be of sufficiently high value and quality, we might not be able to increase sales and our operating results will be adversely affected. In addition, if we fail to sell our new solutions to existing or new customers, we will not generate anticipated revenues from these solutions, our operating results will suffer and we might be unable to grow our revenues or achieve or maintain profitability.

***Our quarterly results of operations may fluctuate in the future, which could result in volatility in our stock price.***

Our quarterly revenues and results of operations have varied in the past and may fluctuate as a result of a variety of factors, including the success of our new offerings such as our Trading Partner Intelligence solution. If

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our quarterly revenues or results of operations fluctuate, the price of our common stock could decline substantially. Fluctuations in our results of operations may be due to a number of factors, including, but not limited to, those listed below and identified throughout this “Risk Factors” section:

- our ability to retain and increase sales to customers and attract new customers, including our ability to maintain and increase our number of recurring revenue customers;
- the timing and success of introductions of new solutions or upgrades by us or our competitors;
- the strength of the economy, in particular as it affects the retail sector;
- changes in our pricing policies or those of our competitors;
- competition, including entry into the industry by new competitors and new offerings by existing competitors;
- the amount and timing of our expenses, including stock-based compensation and expenditures related to expanding our operations, supporting new customers, performing research and development, or introducing new solutions; and
- changes in the payment terms for our solutions.

Due to the foregoing factors, and the other risks discussed in this Annual Report on Form 10-K, you should not rely on comparisons of our results of operations as an indication of our future performance.

### ***We have incurred operating losses in the past and may incur operating losses in the future.***

We began operating our supply chain management solution business in 1997. Throughout most of our history, we have experienced net losses and negative cash flows from operations. As of December 31, 2011, we had an accumulated deficit of \$49.1 million. We expect our operating expenses to continue to increase in the future as we expand our operations. If our revenues do not continue to grow to offset these increased expenses, we may not be profitable. We cannot assure you that we will be able to maintain profitability. You should not consider recent revenue growth as indicative of our future performance. In fact, in future periods, we may not have any revenue growth, or our revenues could decline.

### ***Our inability to adapt to rapid technological change could impair our ability to remain competitive.***

The industry in which we compete is characterized by rapid technological change, frequent introductions of new products and evolving industry standards. Our ability to attract new customers and increase revenues from customers will depend in significant part on our ability to anticipate industry standards and to continue to enhance existing solutions or introduce or acquire new solutions on a timely basis to keep pace with technological developments. The success of any enhancement or new solution depends on several factors, including the timely completion, introduction and market acceptance of the enhancement or solution. Any new solution we develop or acquire might not be introduced in a timely or cost-effective manner and might not achieve the broad market acceptance necessary to generate significant revenues. For example, we introduced our Trading Partner Intelligence solution during 2009, but we have not yet received significant revenues from this solution. If any of our competitors implements new technologies before we are able to implement them, those competitors may be able to provide more effective solutions than ours at lower prices. Any delay or failure in the introduction of new or enhanced solutions could adversely affect our business, results of operations and financial condition.

### ***We may experience service failures or interruptions due to defects in the hardware, software, infrastructure, third party components or processes that comprise our existing or new solutions, any of which could adversely affect our business.***

Technology solutions as complex as ours may contain undetected defects in the hardware, software, infrastructure, third party components or processes that are part of the solutions we provide. If these defects lead

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to service failures, we could experience delays or lost revenues during the period required to correct the cause of the defects. We cannot be certain that defects will not be found in new solutions or upgraded solutions, resulting in loss of, or delay in, market acceptance, which could have an adverse effect on our business, results of operations and financial condition.

Because customers use our on-demand supply chain management solutions for critical business processes, any defect in our solutions, any disruption to our solutions or any error in execution could cause recurring revenue customers to cancel their contracts with us, prevent potential customers from joining our network and harm our reputation. Although most of our contracts with our customers limit our liability to our customers for these defects, disruptions or errors, we nonetheless could be subject to litigation for actual or alleged losses to our customers' businesses, which may require us to spend significant time and money in litigation or arbitration or to pay significant settlements or damages. We do not currently maintain any warranty reserves. Defending a lawsuit, regardless of its merit, could be costly and divert management's attention and could cause our business to suffer.

The insurers under our existing liability insurance policy could deny coverage of a future claim that results from an error or defect in our technology or a resulting disruption in our solutions, or our existing liability insurance might not be adequate to cover all of the damages and other costs of such a claim. Moreover, we cannot assure you that our current liability insurance coverage will continue to be available to us on acceptable terms or at all. The successful assertion against us of one or more large claims that exceeds our insurance coverage, or the occurrence of changes in our liability insurance policy, including an increase in premiums or imposition of large deductible or co-insurance requirements, could have an adverse effect on our business, financial condition and operating results. Even if we succeed in litigation with respect to a claim, we are likely to incur substantial costs and our management's attention will be diverted from our operations.

***Interruptions or delays from third-party data centers could impair the delivery of our solutions and our business could suffer.***

We use two third-party data centers, located in Minneapolis and Saint Paul, Minnesota, to conduct our operations. All of our solutions reside on hardware that we own or lease and operate in these locations. Our operations depend on the protection of the equipment and information we store in these third-party centers against damage or service interruptions that may be caused by fire, flood, severe storm, power loss, telecommunications failures, unauthorized intrusion, computer viruses and disabling devices, denial of service attacks, natural disasters, war, criminal act, military action, terrorist attack and other similar events beyond our control. A prolonged service disruption affecting our solutions for any of the foregoing reasons could damage our reputation with current and potential customers, expose us to liability, cause us to lose recurring revenue customers or otherwise adversely affect our business. We may also incur significant costs for using alternative equipment or taking other actions in preparation for, or in reaction to, events that damage the data centers we use.

Our on-demand supply chain management solutions are accessed by a large number of customers at the same time. As we continue to expand the number of our customers and solutions available to our customers, we may not be able to scale our technology to accommodate the increased capacity requirements, which may result in interruptions or delays in service. In addition, the failure of our third-party data centers to meet our capacity requirements could result in interruptions or delays in our solutions or impede our ability to scale our operations. In the event that our data center arrangements are terminated, or there is a lapse of service or damage to such facilities, we could experience interruptions in our solutions as well as delays and additional expense in arranging new facilities and services.

***A failure to protect the integrity and security of our customers' information could expose us to litigation, materially damage our reputation and harm our business, and the costs of preventing such a failure could adversely affect our results of operations.***

Our business involves the collection and use of confidential information of our customers and their trading partners. We cannot assure you that our efforts to protect this confidential information will be successful. If any

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compromise of this information security were to occur, we could be subject to legal claims and government action, experience an adverse effect on our reputation and need to incur significant additional costs to protect against similar information security breaches in the future, each of which could adversely affect our financial condition, results of operations and growth prospects. In addition, because of the critical nature of data security, any perceived breach of our security measures could cause existing or potential customers not to use our solutions and could harm our reputation.

***Evolving regulation of the Internet may increase our expenditures related to compliance efforts, which may adversely affect our financial condition.***

As Internet commerce continues to evolve, increasing regulation by federal, state or foreign agencies becomes more likely. We are particularly sensitive to these risks because the Internet is a critical component of our on-demand business model. For example, we believe that increased regulation is likely in the area of data privacy, and laws and regulations applying to the solicitation, collection, processing or use of personal or consumer information could affect our customers' ability to use and share data, potentially reducing demand for solutions accessed via the Internet and restricting our ability to store, process and share data with our clients via the Internet. In addition, taxation of services provided over the Internet or other charges imposed by government agencies or by private organizations for accessing the Internet may be imposed. Any regulation imposing greater fees for Internet use or restricting information exchange over the Internet could result in a decline in the use of the Internet and the viability of Internet-based services, which could harm our business.

***If we fail to protect our intellectual property and proprietary rights adequately, our business could be adversely affected.***

We believe that proprietary technology is essential to establishing and maintaining our leadership position. We seek to protect our intellectual property through trade secrets, copyrights, confidentiality, non-compete and nondisclosure agreements, trademarks, domain names and other measures, some of which afford only limited protection. We do not have any patents, patent applications or registered copyrights. Despite our efforts to protect our proprietary rights, unauthorized parties may attempt to copy aspects of our technology or to obtain and use information that we regard as proprietary. We cannot assure you that our means of protecting our proprietary rights will be adequate or that our competitors will not independently develop similar or superior technology or design around our intellectual property. In addition, the laws of some foreign countries do not protect our proprietary rights to as great an extent as the laws of the United States. Intellectual property protections may also be unavailable, limited or difficult to enforce in some countries, which could make it easier for competitors to capture market share. Our failure to protect adequately our intellectual property and proprietary rights could adversely affect our business, financial condition and results of operations.

***An assertion by a third party that we are infringing its intellectual property could subject us to costly and time-consuming litigation or expensive licenses and our business might be harmed.***

The Internet supply chain management and technology industries are characterized by the existence of a large number of patents, copyrights, trademarks and trade secrets and by frequent litigation based on allegations of infringement or other violations of intellectual property rights. As we seek to extend our solutions, we could be constrained by the intellectual property rights of others.

We might not prevail in any intellectual property infringement litigation given the complex technical issues and inherent uncertainties in such litigation. Defending such claims, regardless of their merit, could be time-consuming and distracting to management, result in costly litigation or settlement, cause development delays, or require us to enter into royalty or licensing agreements. If our solutions violate any third-party proprietary rights, we could be required to withdraw those solutions from the market, re-develop those solutions or seek to obtain licenses from third parties, which might not be available on reasonable terms or at all. Any efforts to re-develop our solutions, obtain licenses from third parties on favorable terms or license a substitute technology might not be

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successful and, in any case, might substantially increase our costs and harm our business, financial condition and operating results. Withdrawal of any of our solutions from the market might harm our business, financial condition and operating results.

In addition, we incorporate open source software into our platform. Given the nature of open source software, third parties might assert copyright and other intellectual property infringement claims against us based on our use of certain open source software programs. The terms of many open source licenses to which we are subject have not been interpreted by U.S. or foreign courts, and there is a risk that those licenses could be construed in a manner that imposes unanticipated conditions or restrictions on our ability to commercialize our solutions. In that event, we could be required to seek licenses from third parties in order to continue offering our solutions, to re-develop our solutions or to discontinue sales of our solutions, or to release our proprietary software code under the terms of an open source license, any of which could adversely affect our business.

***We rely on third party hardware and software that could take a significant time to replace or upgrade.***

We rely on hardware and software licensed from third parties to offer our on-demand supply chain management solutions. This hardware and software, as well as maintenance rights for this hardware and software, may not continue to be available to us on commercially reasonable terms, or at all. If we lose the right to use or upgrade any of these licenses, our customers could experience delays or be unable to access our solutions until we can obtain and integrate equivalent technology. There might not always be commercially reasonable hardware or software alternatives to the third-party hardware and software that we currently license. Any such alternatives could be more difficult or costly to replace than the third-party hardware and software we currently license, and integration of the alternatives into our platform could require significant work and substantial time and resources. Any delays or failures associated with our platform could injure our reputation with customers and potential customers and result in an adverse effect on our business, results of operations and financial condition.

***Our new products and changes to existing products could fail to attract or retain users or generate revenue.***

Our ability to retain, increase and engage our customers and to increase our revenues will depend heavily on our ability to create successful new products. We may introduce significant changes to our existing products or develop and introduce new and unproven products which include or use technologies with which we have little or no prior development or operating experience. If new or enhanced products fail to engage customers, we may fail to attract or retain customers or to generate sufficient revenues, operating margin, or other value to justify our investments and our business may be adversely affected. In the future, we may invest in new products and initiatives to generate revenue, but there is no guarantee these approaches will be successful. If we are not successful with new approaches to monetization, we may not be able to maintain or grow our revenues as anticipated or recover any associated development costs, and our financial results could be adversely affected.

***Our business is dependent on our ability to maintain and scale our technical infrastructure, and any significant disruption in our service could damage our reputation, result in a potential loss of users and engagement, and adversely affect our financial results.***

Our reputation and ability to attract, retain and serve our customers is dependent upon the reliable performance of SPSCommerce.net and our underlying technical infrastructure. As our user base and the amount and types of information shared on SPSCommerce.net continue to grow, we will need an increasing amount of technical infrastructure, including network capacity and computing power, to continue to satisfy the needs of our users. It is possible that we may fail to effectively scale and grow our technical infrastructure to accommodate these increased demands.

***Our software is highly technical, and if it contains undetected errors, our business could be adversely affected.***

Our products incorporate software that is highly technical and complex. Our software has contained, and may now or in the future contain, undetected errors, bugs or vulnerabilities. Some errors in our software code



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may only be discovered after the code has been released. Any errors, bugs or vulnerabilities discovered in our code after release could result in damage to our reputation, loss of customers, loss of revenue or liability for damages, any of which could adversely affect our business and financial results.

***Computer malware, viruses, hacking and phishing attacks, and spamming could harm our business and results of operations.***

Computer malware, viruses, and computer hacking and phishing attacks have become more prevalent in our industry, have occurred on our systems in the past, and may occur on our systems in the future. Because of our significant presence in the retail industry, we believe that we are a particularly attractive target for such attacks. Though it is difficult to determine what, if any, harm may directly result from any specific interruption or attack, any failure to maintain performance, reliability, security and availability of our products and technical infrastructure to the satisfaction of our users may harm our reputation and our ability to retain existing customers and attract new customers.

***We may pursue acquisitions and our potential inability to successfully integrate newly acquired companies or businesses could adversely affect our financial results.***

We may pursue acquisitions of other companies or their businesses in the future. If we complete acquisitions, we face many risks commonly encountered with growth through acquisitions. These risks include:

- incurring significantly higher than anticipated capital expenditures and operating expenses;
- failing to assimilate the operations and personnel of the acquired company or business;
- disrupting our ongoing business;
- dissipating our management resources;
- failing to maintain uniform standards, controls and policies; and
- impairing relationships with employees and customers as a result of changes in management.

Fully integrating an acquired company or business into our operations may take a significant amount of time. We cannot assure you that we will be successful in overcoming these risks or any other problems encountered with acquisitions. To the extent we do not successfully avoid or overcome the risks or problems related to any acquisitions, our results of operations and financial condition could be adversely affected. Future acquisitions also could impact our financial position and capital needs, and could cause substantial fluctuations in our quarterly and yearly results of operations. Acquisitions could include significant goodwill and intangible assets, which may result in future impairment charges that would reduce our stated earnings.

***Our ability to use our U.S. net operating loss carryforwards might be limited.***

As of December 31, 2011, we had net operating loss carryforwards of \$51.1 million for U.S. federal tax purposes and \$22.5 million for state tax purposes. These loss carryforwards expire between 2012 and 2031. To the extent these net operating loss carryforwards are available, we intend to use them to reduce the corporate income tax liability associated with our operations. Section 382 of the U.S. Internal Revenue Code generally imposes an annual limitation on the amount of net operating loss carryforwards that might be used to offset taxable income when a corporation has undergone significant changes in stock ownership. We have performed a Section 382 analysis for the time period from our inception through December 8, 2010. During this time period it was determined that we had six separate ownership changes under Section 382. We have not updated the Section 382 analysis subsequent to December 8, 2010; however, we believe there have not been any events subsequent to that date that would impact the analysis. We believe that approximately \$17.6 million of federal losses and \$13.0 million of state losses will expire unused due to Section 382 limitations. The maximum annual limitation under Section 382 is approximately \$990,000. The limitation could be further restricted if ownership

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changes occur in future years. To the extent our use of net operating loss carryforwards is significantly limited, our taxable income could be subject to corporate income tax earlier than it would if we were able to use net operating loss carryforwards, which could result in lower profits.

***The markets in which we participate are highly competitive, and our failure to compete successfully would make it difficult for us to add and retain customers and would reduce or impede the growth of our business.***

The markets for supply chain management solutions are increasingly competitive and global. We expect competition to increase in the future both from existing competitors and new companies that may enter our markets. Increased competition could result in pricing pressure, reduced sales, lower margins or the failure of our solutions to achieve or maintain broad market acceptance. We face competition from:

- Software-as-a-Service providers that deliver business-to-business information systems using a multi-tenant approach;
- traditional on-premise software providers; and
- managed service providers that combine traditional on-premise software with professional information technology services.

To remain competitive, we will need to invest continuously in software development, marketing, customer service and support and product delivery infrastructure. However, we cannot assure you that new or established competitors will not offer solutions that are superior to or lower in price than ours. We may not have sufficient resources to continue the investments in all areas of software development and marketing needed to maintain our competitive position. In addition, some of our competitors are better capitalized than us, which may provide them with an advantage in developing, marketing or servicing new solutions. Increased competition could reduce our market share, revenues and operating margins, increase our costs of operations and otherwise adversely affect our business.

***Mergers or other strategic transactions involving our competitors could weaken our competitive position, which could harm our operating results.***

Our industry is highly fragmented, and we believe it is likely that our existing competitors will continue to consolidate or will be acquired. For example, in June 2010, GXS Corporation and Inovis, two large, on-premise software companies, merged to create an e-commerce business that is much larger than ours. In addition, some of our competitors may enter into new alliances with each other or may establish or strengthen cooperative relationships with systems integrators, third-party consulting firms or other parties. Any such consolidation, acquisition, alliance or cooperative relationship could lead to pricing pressure and our loss of market share and could result in a competitor with greater financial, technical, marketing, service and other resources, all of which could have a material adverse effect on our business, operating results and financial condition.

***If we fail to retain our Chief Executive Officer and other key personnel, our business would be harmed and we might not be able to implement our business plan successfully.***

Given the complex nature of the technology on which our business is based and the speed with which such technology advances, our future success is dependent, in large part, upon our ability to attract and retain highly qualified managerial, technical and sales personnel. In particular, Archie C. Black, our Chief Executive Officer and President, Kimberly K. Nelson, our Executive Vice President and Chief Financial Officer, James J. Frome, our Executive Vice President and Chief Strategy Officer, Michael J. Gray, our Executive Vice President of Operations, and David J. Novak, Jr., our Executive Vice President of Business Development, are critical to the management of our business and operations. Competition for talented personnel is intense, and we cannot be certain that we can retain our managerial, technical and sales personnel or that we can attract, assimilate or retain such personnel in the future. Our inability to attract and retain such personnel could have an adverse effect on our business, results of operations and financial condition.

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***Our continued growth could strain our personnel resources and infrastructure, and if we are unable to implement appropriate controls and procedures to manage our growth, we will not be able to implement our business plan successfully.***

We have experienced a period of rapid growth in our headcount and operations. To the extent that we are able to sustain such growth, it will place a significant strain on our management, administrative, operational and financial infrastructure. Our success will depend in part upon the ability of our senior management to manage this growth effectively. To do so, we must continue to hire, train and manage new employees as needed. If our new hires perform poorly, or if we are unsuccessful in hiring, training, managing and integrating these new employees, or if we are not successful in retaining our existing employees, our business would be harmed. To manage the expected growth of our operations and personnel, we will need to continue to improve our operational, financial and management controls and our reporting systems and procedures. The additional headcount we are adding will increase our cost base, which will make it more difficult for us to offset any future revenue shortfalls by reducing expenses in the short term. If we fail to successfully manage our growth, we will be unable to execute our business plan.

***Our failure to maintain adequate internal control over financial reporting in accordance with Section 404 of the Sarbanes-Oxley Act of 2002 or to prevent or detect material misstatements in our annual or interim financial statements in the future could result in inaccurate financial reporting, or could otherwise harm our business.***

Ensuring that we have internal financial and accounting controls and procedures adequate to produce accurate financial statements on a timely basis is a costly and time-consuming effort that needs to be re-evaluated frequently. The Sarbanes-Oxley Act requires, among other things, that we maintain effective internal control over financial reporting and disclosure controls and procedures. In particular, we are required to perform annual system and process evaluation and testing of our internal control over financial reporting to allow management and our independent registered public accounting firm to report on the effectiveness of our internal control over financial reporting, as required by Section 404 of the Sarbanes-Oxley Act. There can be no assurance that material weaknesses will not be identified in the future. Furthermore, implementing any appropriate future changes to our internal control over financial reporting may entail substantial costs in order to modify our existing accounting systems, may take a significant period of time to complete and may distract our officers, directors and employees from the operation of our business. If we are not able to comply with the requirements of Section 404 in the future, or if material weaknesses are identified, the market price of our common stock could decline.

***Our failure to raise additional capital or generate cash flows necessary to expand our operations and invest in new technologies could reduce our ability to compete successfully and adversely affect our results of operations.***

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

- develop and enhance our solutions;
- continue to expand our technology development, sales and marketing organizations;
- hire, train and retain employees; or
- respond to competitive pressures or unanticipated working capital requirements.

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Our inability to do any of the foregoing could reduce our ability to compete successfully and adversely affect our results of operations.

***Because our long-term success depends, in part, on our ability to expand the sales of our solutions to customers located outside of the United States, our business will be susceptible to risks associated with international operations.***

We have limited experience operating in foreign jurisdictions. Customers in countries outside of North America accounted for 2% of our revenues for 2011, 2010 and 2009. We also undertake software development activities in the Ukraine. Our inexperience in operating our business outside of North America increases the risk that our current and any future international expansion efforts will not be successful. Conducting international operations subjects us to new risks that, generally, we have not faced in the United States, including:

- fluctuations in currency exchange rates;
- unexpected changes in foreign regulatory requirements;
- longer accounts receivable payment cycles and difficulties in collecting accounts receivable;
- difficulties in managing and staffing international operations;
- potentially adverse tax consequences, including the complexities of foreign value added tax systems and restrictions on the repatriation of earnings;
- localization of our solutions, including translation into foreign languages and associated expenses;
- the burdens of complying with a wide variety of foreign laws and different legal standards, including laws and regulations related to privacy;
- increased financial accounting and reporting burdens and complexities;
- political, social and economic instability abroad, terrorist attacks and security concerns in general; and
- reduced or varied protection for intellectual property rights in some countries.

The occurrence of any one of these risks could negatively affect our international business and, consequently, our results of operations generally. Additionally, operating in international markets also requires significant management attention and financial resources. We cannot be certain that the investment and additional resources required in establishing, acquiring or integrating operations in other countries will produce desired levels of revenues or profitability.

### ***Our stock price may be volatile.***

Shares of our common stock were sold in our April 2010 initial public offering at a price of \$12.00 per share, and, through December 31, 2011, our common stock has traded as high as \$27.89 per share and as low as \$8.45 per share. An active, liquid and orderly market for our common stock may not develop or be sustained, which could depress the trading price of our common stock. Some of the factors that may cause the market price of our common stock to fluctuate include:

- fluctuations in our quarterly financial results or the quarterly financial results of companies perceived to be similar to us;
- fluctuations in our recorded revenue, even during periods of significant sales order activity;
- changes in estimates of our financial results or recommendations by securities analysts;
- failure of any of our solutions to achieve or maintain market acceptance;
- changes in market valuations of similar companies;

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- success of competitive products or services;
- changes in our capital structure, such as future issuances of securities or the incurrence of debt;
- announcements by us or our competitors of significant solutions, contracts, acquisitions or strategic alliances;
- regulatory developments in the United States, foreign countries or both;
- litigation involving our company, our general industry or both;
- additions or departures of key personnel;
- investors' general perception of us; and
- changes in general economic, industry and market conditions.

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

### ***Future sales of our common stock by our existing stockholders could cause our stock price to decline.***

If our stockholders sell substantial amounts of our common stock in the public market, the market price of our common stock could decrease significantly. The perception in the public market that our stockholders might sell shares of our common stock could also depress the market price of our common stock. As of December 31, 2011, we had approximately 660,000 shares of our common stock issuable under approved equity compensation plans which are covered by effective registration statements. Furthermore, certain holders of our common stock have the right to demand that we file registration statements, or request that their shares be covered by a registration statement that we are otherwise filing, with respect to the shares of our common stock held by them, and have the right to include those shares in any registration statement that we file with the SEC, subject to exceptions, which would enable those shares to be sold in the public market.

### ***Our charter documents and Delaware law may inhibit a takeover that stockholders consider favorable.***

Provisions of our certificate of incorporation and bylaws and applicable provisions of Delaware law may delay or discourage transactions involving an actual or potential change in our control or change in our management, including transactions in which stockholders might otherwise receive a premium for their shares, or transactions that our stockholders might otherwise deem to be in their best interests. These provisions:

- permit our board of directors to issue up to 5,000,000 shares of preferred stock, with any rights, preferences and privileges as our board may designate, including the right to approve an acquisition or other change in our control;
- provide that the authorized number of directors may be changed by resolution of the board of directors;
- divide our board of directors into three classes;
- provide that all vacancies, including newly created directorships, may, except as otherwise required by law, be filled by the affirmative vote of a majority of directors then in office, even if less than a quorum;
- provide that stockholders seeking to present proposals before a meeting of stockholders or to nominate candidates for election as directors at a meeting of stockholders must provide notice in writing in a timely manner, and also specify requirements as to the form and content of a stockholder's notice; and
- do not provide for cumulative voting rights.

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In addition, Section 203 of the Delaware General Corporation Law generally limits our ability to engage in any business combination with certain persons who own 15% or more of our outstanding voting stock or any of our associates or affiliates who at any time in the past three years have owned 15% or more of our outstanding voting stock. These provisions may have the effect of entrenching our management team and may deprive you of the opportunity to sell your shares to potential acquirers at a premium over prevailing prices. This potential inability to obtain a control premium could reduce the price of our common stock.

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

We currently intend to retain all future earnings for the operation and expansion of our business and, therefore, do not anticipate declaring or paying cash dividends on our common stock in the foreseeable future. Any payment of cash dividends on our common stock will be at the discretion of our board of directors and will depend upon our results of operations, earnings, capital requirements, financial condition, future prospects, contractual restrictions and other factors deemed relevant by our board of directors. Therefore, you should not expect to receive dividend income from shares of our common stock.

**Item 1B. *Unresolved Staff Comments***

None.

**Item 2. *Properties***

Our corporate headquarters, including our principal administrative, marketing, sales, technical support and research and development facilities, are located in Minneapolis, MN where we lease approximately 71,000 square feet under an agreement that expires on October 31, 2012.

In February 2012, we executed a new lease agreement for our current headquarters location which commences on November 1, 2012 and expires on April 30, 2020. The new lease, initially covering approximately 94,000 square feet, includes an automatic expansion of space by approximately 24,000 square feet on or about September 1, 2013, as well as a right of first offer to lease certain additional space, and two options to extend the term of the lease for three years at a market rate determined in accordance with the lease.

We believe that our current facilities are suitable and adequate to meet our current needs, and that suitable additional or substitute space will be available as needed to accommodate expansion of our operations.

**Item 3. *Legal Proceedings***

We are not currently subject to any material legal proceedings. From time to time, we have been named as a defendant in legal actions arising from our normal business activities, none of which has had a material effect on our business, results of operations or financial condition. We believe that we have obtained adequate insurance coverage or rights to indemnification in connection with potential legal proceedings that may arise.

**Item 4. *Mine Safety Disclosures***

Not applicable.

**PART II**

**Item 5. Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities**

*Market Information.* Our common stock has traded on the Nasdaq Global Market under the symbol “SPSC” since April 22, 2010, the date of our initial public offering. Prior to that time, there was no public market for our common stock. The following table sets forth, for the periods indicated, the high and low sales prices for our common stock as reported on the Nasdaq Global Market.

	<u>High</u>	<u>Low</u>
Fiscal 2010		
Second Quarter (from April 22, 2010)	\$14.50	\$10.90
Third Quarter	\$12.83	\$ 8.45
Fourth Quarter	\$15.98	\$11.59
Fiscal 2011		
First Quarter	\$17.30	\$13.59
Second Quarter	\$18.50	\$13.65
Third Quarter	\$18.99	\$15.48
Fourth Quarter	\$27.89	\$15.04

*Stockholders of Record.* As of February 24, 2012, we had 88 stockholders of record of our common stock, excluding holders whose stock is held either in nominee name and/or street name brokerage accounts.

*Dividends.* We have not historically paid dividends on our common stock. We intend to retain our future earnings, if any, to finance the expansion and growth of our business, and we do not expect to pay cash dividends on our common stock in the foreseeable future. Payment of future cash dividends, if any, will be at the discretion of our board of directors after taking into account various factors, including our financial condition, operating results, current and anticipated cash needs, outstanding indebtedness and plans for expansion and restrictions imposed by lenders, if any.

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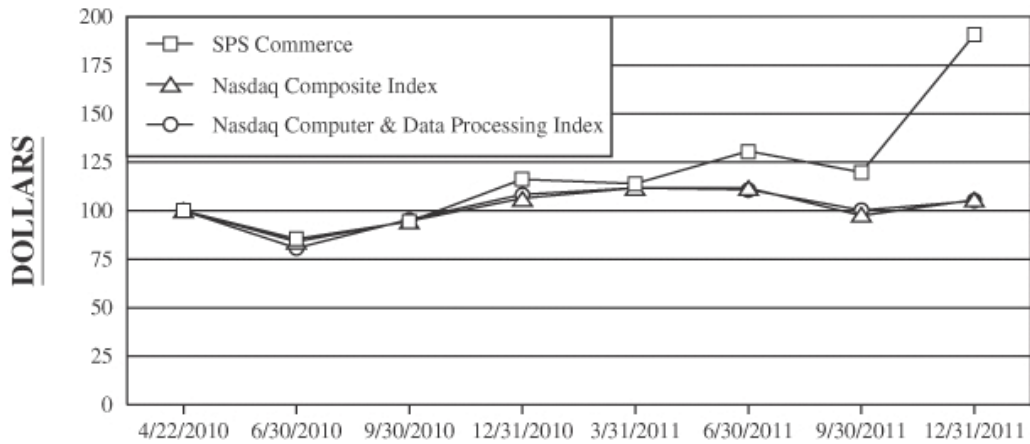
**Stock Performance Graph and Cumulative Total Return**

Notwithstanding any statement to the contrary in any of our previous or future filings with the Securities and Exchange Commission, or SEC, the following information relating to the price performance of our common stock shall not be deemed to be “filed” with the SEC or to be “soliciting material” under the Securities Exchange Act of 1934, as amended, or the Exchange Act, and it shall not be deemed to be incorporated by reference into any of our filings under the Securities Act or the Exchange Act, except to the extent we specifically incorporate it by reference into such filing.

The graph below compares the cumulative total stockholder return of our common stock with that of the Nasdaq Composite Index and the Nasdaq Computer & Data Processing Index from April 22, 2010 (the date on which our common stock commenced trading on the Nasdaq Global Market) through December 31, 2011. The graph assumes that \$100 was invested in shares of our common stock, the Nasdaq Composite Index and the Nasdaq Computer & Data Processing Index at the close of market on April 22, 2010, and that dividends, if any, were reinvested. The comparisons in this graph are based on historical data and are not intended to forecast or be indicative of future performance of our common stock.

**Comparison of Cumulative Total Returns of SPS Commerce, Inc., Nasdaq Composite Index and Nasdaq Computer & Data Processing Index**

	SPS Commerce	Nasdaq Composite Index	Nasdaq Computer & Data Processing Index
4/22/2010	100.0	100.0	100.0
6/30/2010	85.4	84.1	80.8
9/30/2010	94.3	94.6	95.4
12/31/2010	116.2	106.3	108.3
3/31/2011	114.0	111.7	111.7
6/30/2011	130.8	111.6	110.8
9/30/2011	119.8	97.5	100.3
12/31/2011	190.8	105.4	105.0





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**Unregistered Sales of Equity Securities**

None.

**Use of Proceeds from Sales of Registered Securities**

On April 27, 2010, we completed the initial public offering of our common stock pursuant to our Registration Statement on Form S-1 (File No. 333-163476), which was declared effective by the Securities and Exchange Commission on April 21, 2010. Our initial public offering involved the sale of 4,711,198 shares of common stock at an offering price of \$12.00 per share. We issued and sold 3,114,504 shares, including 614,504 shares sold pursuant to the exercise in full of the underwriters' over-allotment option, and the selling stockholders sold 1,596,694 shares. We received proceeds of approximately \$33.0 million, after payment of underwriting discounts and commissions and legal, accounting and other fees incurred in connection with the offering. On April 30, 2010, approximately \$555,000 of the net proceeds was used to repay principal and interest on certain outstanding equipment loans. On May 18, 2011, we used approximately \$10.8 million of the net proceeds for the acquisition of Direct EDI.

On December 8, 2010, we completed a stock offering of 115,000 shares of common stock at an offering price of \$12.25 per share and received proceeds of approximately \$1.0 million, after payment of underwriting discounts and commissions and legal, accounting and other fees incurred in connection with the offering. The offering was made pursuant to our Registration Statement on Form S-1 (File No. 333-170544), which was declared effective by the Securities and Exchange Commission on December 2, 2010.

We have used and intend to continue to use the remaining net proceeds from these offerings for working capital and other general corporate purposes, including to finance our growth, develop new software and fund capital expenditures. Additionally, we may choose to expand our current business through acquisitions of other complementary businesses, products, services, or technologies. Pending such uses, we plan to invest the net proceeds in interest-bearing bank accounts and short-term investment grade securities.

There have been no material differences in the actual use of proceeds from our IPO as compared to the planned use of proceeds as described in the final prospectus filed with the Securities and Exchange Commission pursuant to Rule 424(b).

**Stock Repurchases**

None.

**Item 6. Selected Financial Data**

The following selected financial data should be read together with our audited financial statements and the related notes and with "*Management's Discussion and Analysis of Financial Condition and Results of Operations*" which are included elsewhere in this Annual Report on Form 10-K. Our historical results are not necessarily indicative of results to be expected for any future period.

The statements of operations data for each of the years ended December 31, 2011, 2010 and 2009; the balance sheet data as of December 31, 2011 and 2010; and the operating data relating to Adjusted EBITDA and non-GAAP income (loss) per diluted share for each of the years ended December 31, 2011, 2010 and 2009 have been derived from our audited annual financial statements which are included in this Annual Report on Form 10-K.

The statements of operations data for the years ended December 31, 2008 and 2007; the balance sheet data as of December 31, 2009, 2008 and 2007; and the operating data relating to Adjusted EBITDA and non-GAAP income (loss) per diluted share for each of the years ended December 31, 2008 and 2007 have been derived from our audited annual financial statements which are not included in this Annual Report on Form 10-K.

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Adjusted EBITDA and non-GAAP income (loss) per diluted share are non-GAAP financial measures. We believe that these non-GAAP measures provide useful information to management and investors regarding certain financial and business trends relating to our financial condition and results of operations. Our management uses these non-GAAP measures to compare the company's performance to that of prior periods for trend analyses and planning purposes. Adjusted EBITDA is also used for purposes of determining executive and senior management incentive compensation. These measures are also presented to our board of directors.

These non-GAAP measures should not be considered a substitute for, or superior to, financial measures calculated in accordance with generally accepted accounting principles in the United States. These non-GAAP financial measures exclude significant expenses and income that are required by GAAP to be recorded in the company's financial statements and are subject to inherent limitations. Investors should review the reconciliations of these non-GAAP financial measures to the comparable GAAP financial measures that are included below.

The operating data relating to recurring revenue customers for all periods presented is unaudited and has been derived from our internal records of our operations.

	Year Ended December 31,				
	2011	2010	2009	2008	2007
	(In thousands, except per share data)				
<b>Statements of Operations Data</b>					
Revenues	\$57,969	\$44,597	\$37,746	\$30,697	\$25,198
Cost of revenues(1)	15,366	12,626	11,715	9,258	6,379
Gross profit	42,603	31,971	26,031	21,439	18,819
<b>Operating expenses</b>					
Sales and marketing(1)	23,836	16,601	13,506	12,493	11,636
Research and development(1)	5,838	4,349	4,305	3,640	3,546
General and administrative(1)	11,151	7,985	6,339	6,716	5,458
Amortization of intangible assets(2)	643	—	—	—	—
Total operating expenses	41,468	28,935	24,150	22,849	20,640
Income (loss) from operations	1,135	3,036	1,881	(1,410)	(1,821)
<b>Other income (expense)</b>					
Interest expense	—	(74)	(270)	(419)	(439)
Interest income	89	158	—	—	—
Other income (expense)	(140)	(144)	(358)	28	120
Total other expense	(51)	(60)	(628)	(391)	(319)
Income (loss) before income taxes	1,084	2,976	1,253	(1,801)	(2,140)
Income tax (expense) benefit(3)	12,619	(92)	(91)	(94)	(16)
Net income (loss)	\$13,703	\$ 2,884	\$ 1,162	\$ (1,895)	\$ (2,156)
<b>Net income (loss) per share</b>					
Basic	\$ 1.15	\$ 0.36	\$ 3.53	\$ (6.45)	\$ (11.65)
Diluted	\$ 1.08	\$ 0.25	\$ 0.13	\$ (6.45)	\$ (11.65)
<b>Weighted average common shares outstanding</b>					
Basic	11,960	8,036	329	294	185
Diluted	12,744	11,596	9,268	294	185

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	As of December 31,				
	2011	2010	2009	2008	2007
	(In thousands)				
<b>Balance Sheet Data</b>					
Cash, cash equivalents and short-term investments	\$31,985	\$40,473	\$ 5,931	\$ 3,715	\$ 6,117
Working capital	36,773	42,552	4,973	3,995	4,535
Total assets	77,618	57,880	21,919	19,197	20,687
Long-term liabilities	6,599	5,283	5,317	5,950	5,550
Total debt(4)	—	122	2,694	4,471	4,992
Total redeemable convertible preferred stock	—	—	65,778	65,964	65,964
Total stockholders' equity (deficit)	59,553	43,508	(60,466)	(61,844)	(60,111)

	Year Ended December 31,				
	2011	2010	2009	2008	2007
	(Unaudited, adjusted EBITDA in thousands)				
<b>Operating Data</b>					
Adjusted EBITDA(5)	\$ 5,410	\$ 5,175	\$ 3,206	\$ 763	\$ 103
Non-GAAP income (loss) per diluted share(6)	\$ 0.26	\$ 0.31	\$ 0.17	\$ (3.23)	\$ (7.41)
Recurring revenue customers(7)	16,129	12,399	11,003	10,076	9,496

- (1) Includes stock-based compensation expense as follows (in thousands):

	Year Ended December 31,				
	2011	2010	2009	2008	2007
Cost of revenues	\$ 255	\$103	\$ 53	\$ 19	\$ 2
Sales and marketing	471	211	91	60	33
Research and development	56	20	4	4	2
General and administrative	986	416	80	74	9
Total	<u>\$1,768</u>	<u>\$750</u>	<u>\$228</u>	<u>\$157</u>	<u>\$46</u>

- (2) For 2009, 2008 and 2007, amortization of intangible assets was \$155,000, \$788,000 and \$740,000, respectively, and was included in general and administrative expense. There was no related amortization expense in 2010.
- (3) In 2011, we determined it was more-likely-than-not that we would be able to realize a substantial portion of our deferred tax assets and, therefore, we recorded an income tax benefit of \$12.8 million for the reversal of the valuation allowance on these deferred tax assets.
- (4) Total debt consists of our current and long-term capital lease obligations, current and long-term equipment and term loans, line of credit and interest payable.

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- (5) EBITDA consists of net income (loss) plus depreciation and amortization, interest expense, interest income and income tax expense (benefit). Adjusted EBITDA consists of EBITDA plus our non-cash, stock-based compensation expense. We use Adjusted EBITDA as a measure of operating performance because it assists us in comparing performance on a consistent basis, as it removes from our operating results the impact of our capital structure. We believe Adjusted EBITDA is useful to an investor in evaluating our operating performance because it is widely used to measure a company's operating performance without regard to items such as depreciation and amortization, which can vary depending upon accounting methods and the book value of assets, and to present a meaningful measure of corporate performance exclusive of our capital structure and the method by which assets were acquired. The following table provides a reconciliation of net income (loss) to Adjusted EBITDA (in thousands):

	Year Ended December 31,				
	2011	2010	2009	2008	2007
Net income (loss)	\$ 13,703	\$2,884	\$1,162	\$(1,895)	\$(2,156)
Depreciation and amortization	2,647	1,533	1,455	1,988	1,758
Interest expense	—	74	270	419	439
Interest income	(89)	(158)	—	—	—
Income tax expense (benefit)	(12,619)	92	91	94	16
EBITDA	3,642	4,425	2,978	606	57
Stock-based compensation expense	1,768	750	228	157	46
Adjusted EBITDA	\$ 5,410	\$5,175	\$3,206	\$ 763	\$ 103

- (6) Non-GAAP income (loss) per share consists of net income (loss) plus non-cash, stock-based compensation expense and amortization expense related to intangible assets minus the deferred tax asset valuation allowance reversal divided by the weighted average number of shares of common stock outstanding during each period. We believe non-GAAP income (loss) per share is useful to an investor because it is widely used to measure a company's operating performance. The following table provides a reconciliation of net income (loss) to non-GAAP income (loss) per share (in thousands, except per share amounts):

	Year Ended December 31,				
	2011	2010	2009	2008	2007
Net income (loss)	\$ 13,703	\$ 2,884	\$1,162	\$(1,895)	\$(2,156)
Deferred tax asset valuation allowance reversal	(12,802)	—	—	—	—
Stock-based compensation expense	1,768	750	228	157	46
Amortization of intangible assets	643	—	155	788	740
Non-GAAP income (loss)	\$ 3,312	\$ 3,634	\$1,545	\$ (950)	\$(1,370)
Non-GAAP income (loss) per share					
Basic	\$ 0.28	\$ 0.45	\$ 4.70	\$ (3.23)	\$ (7.41)
Diluted	\$ 0.26	\$ 0.31	\$ 0.17	\$ (3.23)	\$ (7.41)
Shares used to compute non-GAAP income (loss) per share					
Basic	11,960	8,036	329	294	185
Diluted	12,744	11,596	9,268	294	185

- (7) This reflects the number of recurring revenue customers at the end of the period. Recurring revenue customers are customers with contracts to pay us monthly fees. A minority portion of our recurring revenue customers consists of separate units within a larger organization. We treat each of these units, which may include divisions, departments, affiliates and franchises, as distinct customers. Our contracts with our recurring revenue customers typically allow the customer to cancel the contract for any reason with 30 days prior notice.

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**Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations**

*The following discussion and analysis of our financial condition and results of operations should be read together with the section titled "Selected Financial Data" and our audited financial statements and related notes which are included elsewhere in this Annual Report on Form 10-K. Our actual results could differ materially from those anticipated in the forward-looking statements included in this discussion as a result of certain factors, including, but not limited to, those discussed in "Risk Factors" included elsewhere in this Annual Report on Form 10-K.*

**Overview**

We are a leading provider of on-demand supply chain management solutions, providing integration, collaboration, connectivity, visibility and data analytics to thousands of trading partners worldwide. We provide our solutions through SPSCommerce.net, a hosted software suite that improves the way suppliers, retailers, distributors and other trading partners manage and fulfill orders. We deliver our solutions to our customers over the Internet using a Software-as-a-Service model.

SPSCommerce.net fundamentally changes how organizations use electronic communication to manage a supply chain by replacing the collection of traditional, custom-built, point-to-point integrations with a "hub-and-spoke" model whereby a single integration to SPSCommerce.net allows an organization to connect seamlessly to the entire SPSCommerce.net network of trading partners.

We plan to grow our business by further penetrating the supply chain management market, increasing revenues from our customers as their businesses grow, expanding our distribution channels, expanding our international presence and developing new solutions and applications. We also intend to selectively pursue acquisitions that will add customers, allow us to expand into new regions or industries or allow us to offer new functionalities.

On May 18, 2011, we purchased substantially all of the assets of Direct EDI LLC, a privately-held provider of cloud-based integration solutions for electronic data interchange, which expanded our base of recurring revenue customers. See Note B to our consolidated financial statements included in this Annual Report on Form 10-K for additional information regarding the acquisition of Direct EDI.

For 2011, 2010 and 2009, we generated revenues of \$58.0 million, \$44.6 million and \$37.7 million. Our fiscal quarter ended December 31, 2011 represented our 44th consecutive quarter of increased revenues. Recurring revenues from recurring revenue customers accounted for 85%, 83% and 80% of our total revenues for 2011, 2010 and 2009. No customer represented over 2% of our revenues for 2011, 2010 or 2009.

**Key Financial Terms and Metrics**

***Sources of Revenues***

*Trading Partner Integration.* Our revenues primarily consist of monthly revenues from our customers for our Trading Partner Integration solution. Our revenues for this solution consist of a monthly subscription fee and a transaction-based fee. We also receive set-up fees for initial integration solutions we provide our customers. Most of our customers have contracts with us that may be terminated by the customer by providing 30 days prior notice. Over 90% of our revenues for 2009, 2010 and 2011 were derived from Trading Partner Integration.

*Trading Partner Enablement.* Our Trading Partner Enablement solution helps organizations, typically large retailers, to implement new integrations with trading partners. This solution ranges from Electronic Data Interchange testing and certification to more complex business workflow automation and results in a one-time payment to us.

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*Trading Partner Intelligence.* Our Trading Partner Intelligence solution consists of data analytics applications which allow our customers to improve their visibility across, and analysis of, their supply chains. Through interactive data analysis, our retailer customers improve their visibility into supplier performance and their understanding of product sell-through. Our revenues for this solution primarily consist of a monthly subscription fee.

*Other Trading Partner Solutions.* The remainder of our revenues is derived from solutions that allow our customers to perform tasks such as barcode labeling or picking-and-packaging information tracking as well as purchases of miscellaneous supplies. These revenues are primarily transaction-based.

### **Cost of Revenues and Operating Expenses**

*Overhead Allocation.* We allocate overhead expenses such as rent, certain employee benefit costs, office supplies and depreciation of general office assets to cost of revenues and operating expenses categories based on headcount.

*Cost of Revenues.* Cost of revenues primarily consists of personnel costs such as wages and benefits related to implementation teams, customer support personnel and application support personnel. Cost of revenues also includes our cost of network services, which is primarily data center costs for the locations where we keep the equipment that serves our customers, and connectivity costs that facilitate electronic data transmission between our customers and their trading partners.

*Sales and Marketing Expenses.* Sales and marketing expenses consist primarily of personnel costs for our sales, marketing and product management teams, commissions earned by our sales personnel and marketing costs. In order to grow our business, we will continue to add resources to our sales and marketing efforts over time.

*Research and Development Expenses.* Research and development expenses consist primarily of personnel costs for development and maintenance of existing solutions. This group also is responsible for enhancing existing solutions and applications as well as internal tools and developing new information maps that integrate our customers to their trading partners in compliance with those trading partners' requirements.

*General and Administrative Expenses.* General and administrative expenses consist primarily of personnel costs for finance, human resources and internal information technology support, as well as legal, accounting and other fees, such as credit card processing fees. Since becoming a public company in April 2010, we have incurred additional general and administrative expenses associated with being a public company, including higher legal, audit and insurance fees.

### **Other Metrics**

*Recurring Revenue Customers.* As of December 31, 2011, we had approximately 16,100 customers with contracts to pay us monthly fees, which we refer to as recurring revenue customers. We report recurring revenue customers at the end of a period. A minority portion of our recurring revenue customers consists of separate units within a larger organization. We treat each of these units, which may include divisions, departments, affiliates and franchises, as distinct customers.

*Average Recurring Revenues Per Recurring Revenue Customer.* We calculate average recurring revenues per recurring revenue customer for a period by dividing the recurring revenues from recurring revenue customers for the period by the average of the beginning and ending number of recurring revenue customers for the period. For interim periods, we annualize this number by multiplying the quotient by the quotient of 12 divided by the number of months in the period. We anticipate that average recurring revenues per recurring revenue customer will continue to increase as we increase the number of solutions we offer and increase the penetration of those solutions across our customer base.

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**Recurring Revenue.** For 2011, 2010 and 2009, revenues from fixed monthly subscription and transaction-based fees, which we refer to as recurring revenue, accounted for 85%, 83% and 80% of our total revenues. More than 90% of the recurring revenues for 2011, 2010 and 2009 related to our Trading Partner Integration solution. Our revenues are not concentrated with any customer, as no customer represented over 2% of our revenues for 2011, 2010 or 2009.

**Non-GAAP Financial Measures.** To supplement our financial statements, we also provide investors with Adjusted EBITDA and non-GAAP income (loss) per share, both of which are non-GAAP financial measures. We believe that these non-GAAP measures provide useful information to management and investors regarding certain financial and business trends relating to our financial condition and results of operations. Our management uses these non-GAAP measures to compare the company's performance to that of prior periods for trend analyses and planning purposes. Adjusted EBITDA is also used for purposes of determining executive and senior management incentive compensation. These measures are also presented to our board of directors.

These non-GAAP measures should not be considered a substitute for, or superior to, financial measures calculated in accordance with generally accepted accounting principles in the United States. These non-GAAP financial measures exclude significant expenses and income that are required by GAAP to be recorded in the company's financial statements and are subject to inherent limitations. Investors should review the reconciliations of non-GAAP financial measures to the comparable GAAP financial measures that are included in this "Management's Discussion and Analysis of Financial Condition and Results of Operations."

### **Critical Accounting Policies and Estimates**

The discussion of our financial condition and results of operations is based upon our financial statements, which are prepared in accordance with accounting principles generally accepted in the United States, or GAAP. The preparation of these financial statements requires us to make estimates, judgments and assumptions that affect the reported amounts of assets, liabilities, revenues, costs and expenses and related disclosures. On an ongoing basis, we evaluate our estimates and assumptions. We base our estimates of the carrying value of certain assets and liabilities on historical experience and on various other assumptions that we believe to be reasonable. Our actual results may differ from these estimates under different assumptions or conditions.

We believe that of our significant accounting policies, which are described in the notes to our financial statements, the following accounting policies involve a greater degree of judgment, complexity and effect on materiality. A critical accounting policy is one that is both material to the presentation of our financial statements and requires us to make difficult, subjective or complex judgments for uncertain matters that could have a material effect on our financial condition and results of operations. Accordingly, these are the policies we believe are the most critical to aid in fully understanding and evaluating our financial condition and results of operations.

#### ***Revenue Recognition***

We generate revenues by providing a number of solutions to our customers. These solutions include Trading Partner Integration, Trading Partner Enablement and Trading Partner Intelligence. All of our solutions are hosted applications that allow customers to meet their supply chain management requirements. Revenues from our Trading Partner Integration and Trading Partner Intelligence solutions are generated through set-up fees and a recurring monthly hosting fee. Revenues from our Trading Partner Enablement solutions are generally one-time service fees.

Revenues are recorded in accordance with Staff Accounting Bulletin 104, *Revenue Recognition in Financial Statements* and Accounting Standards Update ("ASU") 2009-13, *Multiple-Deliverable Revenue Arrangements*, when all of the following criteria are met: (1) persuasive evidence of an arrangement exists, (2) delivery has occurred, (3) the fee is fixed and determinable, and (4) collectability is probable. If collection is not considered probable, revenues are recognized when the fees are collected. The services related to these fees have standalone value which is determined using vendor specific objective evidence ("VSOE").

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Fees related to our Trading Partner Integration and Trading Partner Intelligence solutions consist of two revenue sources: set-up fees and recurring monthly hosting fees. All set-up fees are deferred and recognized ratably over the expected life of the customer relationship, which is generally two years. We continue to evaluate and adjust the length of these amortization periods as more experience is gained with customer renewals, contract cancellations and technology changes requested by our customers. It is possible that, in the future, the estimates of expected customer lives may change and, if so, the periods over which such subscription set-up fees and costs are amortized will be adjusted. Any such change in estimated expected customer lives will affect our future results of operations. Set-up fees are further broken down as initial set-up fees and add-on set-up fees. Add-on set-up fees, which are nonrefundable, and our Trading Partner Integration revenues represent arrangements providing standalone value for our customers. Because these revenues are not dependent on the delivery of any future performance and the arrangement includes VSOE for pricing, ASU 2009-13 has not impacted how we separate and price these two elements. Initial setup fees are nonrefundable upfront fees that do not have standalone value and are not part of the multiple element arrangement. These fees are deferred and recognized over the customer relationship period as discussed above.

The recurring monthly fee is comprised of both fixed and transaction based fees that provide standalone value and are recognized as incurred. From time-to-time, we may provide discounts on set-up fees; however it is not possible to allocate the discount on the set-up fees because the contract period is unknown and the complete value of the deliverables is unknown. Variables preventing allocation include the variability of the recurring revenue due to transaction levels and the ability of customers to cancel the contract upon 30 days' notice. If estimation of the customer relationship became necessary, we would rely on the existing customer relationship period that set-up fees are currently being recognized over, resulting in no change in the revenues recognized.

### ***Allowance for Doubtful Accounts***

We maintain an allowance for doubtful accounts for estimated losses resulting from our customers' inability to pay us. The provision is based on our historical experience and for specific customers that, in our opinion, are likely to default on our receivables from them. In order to identify these customers, we perform ongoing reviews of all customers that have breached their payment terms, as well as those that have filed for bankruptcy or for whom information has become available indicating a significant risk of non-recoverability. In addition, we have experienced significant growth in the number of our customers, and we have less payment history to rely upon with these customers. We rely on historical trends of bad debt as a percentage of total revenues and apply these percentages to the accounts receivable associated with new customers and evaluate these customers over time. To the extent that our future collections differ from our assumptions based on historical experience, the amount of our bad debt and allowance recorded may be different.

### ***Income Taxes***

We account for income taxes using the liability method, which requires that deferred tax assets and liabilities be recognized using enacted tax rates for the effect of temporary differences between the book and tax basis of recorded assets and liabilities. Under this method, deferred tax assets are reduced by a valuation allowance if it is more likely than not that some portion or all of the deferred tax assets will not be realized. The realization of the deferred tax assets is evaluated quarterly by assessing the valuation allowance and by adjusting the amount of the allowance, if necessary, based on projections of future taxable income.

We recognize the financial statement benefit of a tax position only after determining that the relevant tax authority would more likely than not sustain the position following an audit. For tax positions meeting the more likely than not threshold, the amount recognized in the financial statements is the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement with the relevant tax authority.

### ***Stock-Based Compensation***

Stock-based compensation is measured at the grant date, based on the fair value of the award, and is recognized as an expense over the vesting period of the grant. Determining the appropriate fair value model and



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calculating the fair value of stock-based payment awards require the use of highly subjective assumptions, including the expected life of the stock-based payment awards and stock price volatility. We use the Black-Scholes option pricing model to value our option grants and determine the related compensation expense. The assumptions used in calculating the fair value of stock-based payment awards represent management's best estimates, but the estimates involve inherent uncertainties and the application of management judgment. As a result, if factors change and we use different assumptions, our stock-based compensation expense could be materially different in the future. We expect to continue to grant stock-based awards in the future, and to the extent that we do, our actual stock-based compensation expense recognized in future periods will likely increase.

Prior to becoming a public entity, historic volatility was not available for our shares. As a result, we estimated volatility based on a peer group of companies, which collectively provided a reasonable basis for estimating volatility. We intend to continue to consistently use the same group of publicly traded peer companies to determine volatility in the future until sufficient information regarding volatility of our share price becomes available or the selected companies are no longer suitable for this purpose.

### ***Significant Factors Used in Determining Fair Value of Our Common Stock***

The fair value of the shares of common stock that underlie the stock options we have granted has historically been determined by our audit committee or board of directors based upon information available to it at the time of grant. Because, prior to our initial public offering, there was no public market for our common stock, our audit committee or board of directors determined the fair value of our common stock by utilizing, among other things, recent or contemporaneous valuation information available as of December 31, 2007 and for each quarter end thereafter until we completed our initial public offering on April 22, 2010. The valuation information included reviews of our business and general economic, market and other conditions that could be reasonably evaluated at that time, including our financial results, business agreements, intellectual property and capital structure. The valuation information also included a thorough review of the conditions of the industry in which we operate and the markets that we serve. Our audit committee or board of directors conducted an analysis of the fair market value of our company considering two widely accepted valuation approaches: (1) market approach and (2) income approach. These valuation approaches are based on a number of assumptions, including our future revenues and industry, general economic, market and other conditions that could reasonably be evaluated at the time of the valuation.

Under the market approach, the guideline market multiple methodology was applied, which involved the multiplication of revenues by risk-adjusted multiples. Multiples were determined through an analysis of certain publicly traded companies, which were selected on the basis of operational and economic similarity with our principal business operations. Revenue multiples were calculated for the comparable companies based upon daily trading prices. A comparative risk analysis between our and the public companies formed the basis for the selection of appropriate risk-adjusted multiples for our company. The risk analysis incorporated factors that relate to, among other things, the nature of the industry in which we and other comparable companies are engaged. Under the income approach, we applied the discounted cash flow methodology, which involved estimating the present value of the projected cash flows to be generated from the business and theoretically available to the capital providers of our company. A discount rate was applied to the projected future cash flows to reflect all risks of ownership and the associated risks of realizing the stream of projected cash flows. Since the cash flows were projected over a limited number of years, a terminal value was computed as of the end of the last period of projected cash flows. The terminal value was an estimate of the value of the enterprise on a going concern basis as of that future point in time. Discounting each of the projected future cash flows and the terminal value back to the present and summing the results yielded an indication of value for the enterprise. Our board of directors and audit committee took these two approaches into consideration when establishing the fair value of our common stock.

For the period subsequent to December 31, 2009, and through April 22, 2010, all stock option grants were valued at the price to the public of our common stock for our initial public offering. Subsequent to our initial public offering, all grants have been valued at the closing sale price of our common stock on the Nasdaq Global Market on the date of grant.

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**Valuation of Goodwill and Purchased Intangible Assets**

Goodwill represents the excess of the purchase price over the fair value of identifiable net assets acquired in a business combination. Assets acquired may include identifiable intangible assets, such as subscriber relationships, which are recognized separately from goodwill. We have determined the fair value and useful lives of intangible assets with the assistance of an independent third-party valuation firm using certain estimates and assumptions.

We test goodwill for impairment annually at December 31, or more frequently if events or changes in circumstances indicate that the asset might be impaired. The impairment test is conducted by comparing the fair value of the net assets with the carrying value of the reporting unit. Fair value is determined using the direct market observation of market price and outstanding equity of the reporting unit at December 31. If the carrying value of the goodwill exceeds the fair value of the reporting unit, goodwill may be impaired. If this occurs, the fair value is then allocated to its assets and liabilities in a manner similar to a purchase price allocation in order to determine the implied fair value of goodwill. This implied fair value is then compared to the carrying amount of goodwill and, if it is less, we would recognize an impairment loss. For the years ended December 31, 2009 and prior, the impairment test compared the carrying value of the company to the fair value of the company, which was based on an analysis of the discounted future cash flows. The methodology for evaluating the fair value of the company was changed with the completion of our initial public offering to use the per share prices as a direct market observable measure. There has been no impairment of our goodwill to date.

**Results of Operations**

**Year Ended December 31, 2011 Compared to Year Ended December 31, 2010**

The following table presents our results of operations for the periods indicated (dollars in thousands):

	Year Ended December 31,				Change	
	2011		2010		\$	%
	% of revenue		% of revenue			
Revenues	\$57,969	100.0%	\$44,597	100.0%	\$13,372	30.0%
Cost of revenues	15,366	26.5	12,626	28.3	2,740	21.7
Gross profit	42,603	73.5	31,971	71.7	10,632	33.3
Operating expenses						
Sales and marketing	23,836	41.1	16,601	37.2	7,235	43.6
Research and development	5,838	10.1	4,349	9.8	1,489	34.2
General and administrative	11,151	19.2	7,985	17.9	3,166	39.6
Amortization of intangible assets	643	1.1	—	—	643	*
Total operating expenses	41,468	71.5	28,935	64.9	12,533	43.3
Income from operations	1,135	2.0	3,036	6.8	(1,901)	(62.6)
Other income (expense)						
Interest expense	—	—	(74)	(0.2)	74	(100.0)
Interest income	89	0.2	158	0.4	(69)	(43.7)
Other expense	(140)	(0.2)	(144)	(0.3)	4	(2.8)
Total other expense, net	(51)	(0.1)	(60)	(0.1)	9	(15.0)
Income before income taxes	1,084	1.9	2,976	6.7	(1,892)	(63.6)
Income tax benefit (expense)	12,619	21.8	(92)	(0.2)	12,711	*
Net income	\$13,703	23.6	\$ 2,884	6.5	10,819	*

Due to rounding, totals may not equal the sum of the line items in the table above

\* Percentage is not meaningful

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*Revenues.* Revenues for 2011 increased \$13.4 million, or 30%, to \$58.0 million from \$44.6 million for 2010. Our fiscal quarter ended December 31, 2011 represented our 44th consecutive quarter of increased revenues. The increase in revenues resulted primarily from a 30% increase in recurring revenue customers to 16,129 at December 31, 2011 from 12,399 at December 31, 2010, as well as an 8% increase in average recurring revenues per recurring revenue customer to \$3,440 from \$3,176. The increase in average recurring revenues per recurring revenue customer was primarily attributable to increased fees resulting from increased usage of our solutions by our recurring revenue customers. Recurring revenues from recurring revenue customers accounted for 85% of our total revenues for 2011, compared to 83% for 2010. We anticipate that the number of recurring revenue customers and the recurring revenues per recurring revenue customer will continue to increase as we increase the number of solutions we offer and increase the penetration of those solutions across our customer base.

*Cost of Revenues.* Cost of revenues for 2011 increased \$2.7 million, or 22%, to \$15.4 million from \$12.6 million for 2010. The increase in costs was primarily attributable to higher costs of personnel and resale of adapters, as well as increased occupancy, network services, stock-based compensation and depreciation expenses. As a percentage of revenues, cost of revenues was 27% for 2011, compared to 28% for 2010. Increased revenues allowed us to leverage our personnel and infrastructure costs and decrease our cost of revenues as a percentage of total revenues. Going forward, we anticipate that cost of revenues will increase in absolute dollars as we continue to build our business.

*Sales and Marketing Expenses.* Sales and marketing expenses for 2011 increased \$7.2 million, or 44%, to \$23.8 million from \$16.6 million for 2010. The increase in sales and marketing expenses was due to higher commissions earned by sales personnel from new business, as well as increased personnel and promotional costs in 2011. As a percentage of revenues, sales and marketing expenses were 41% for 2011 and 37% for 2010. As we work to grow our business, we will continue to add resources to our sales and marketing efforts over time, and we expect that these expenses will increase in absolute dollars.

*Research and Development Expenses.* Research and development expenses for 2011 were \$5.8 million, an increase of \$1.5 million, or 34%, from \$4.3 million for 2010. The increase in research and development expenses was primarily due to higher personnel costs. As a percentage of revenues, research and development expenses were 10% for each of 2011 and 2010. We expect research and development expenses will increase in absolute dollars as we continue to enhance and expand our solutions and applications.

*General and Administrative Expenses.* For 2011, general and administrative expenses increased \$3.2 million, or 40%, to \$11.2 million from \$8.0 million for 2010. The increase in general and administrative expenses was due to increased personnel costs as well as increased stock-based compensation, legal, credit card and occupancy expenses. As a percentage of revenues, general and administrative expenses were 19% for 2011, compared to 18% for 2010. Going forward, we expect that general and administrative expenses will increase in absolute dollars as we grow our business.

*Other Income (Expense).* There was no interest expense for 2011, compared to \$74,000 for 2010. The decrease in interest expense was due to the repayment of all outstanding indebtedness under our credit facility in 2010. Interest income was \$89,000 for 2011, compared to \$158,000 for 2010. Other expense was \$140,000 for 2011 and \$144,000 for 2010.

*Income Tax Benefit (Expense).* For 2011, we recorded an income tax benefit of \$12.6 million, primarily resulting from the reversal of a substantial portion of the valuation allowance on our deferred tax assets. See Note I to our consolidated financial statements, included in this Annual Report on Form 10-K, for additional information regarding income taxes. For 2010, we recorded income tax expense of \$92,000. Our provision for income taxes includes estimated federal alternative minimum taxes, state income and franchise taxes, as well as deferred tax expense resulting from the book and tax basis difference in goodwill from a prior asset acquisition.

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*Adjusted EBITDA.* Adjusted EBITDA, which is a non-GAAP measure of financial performance, consists of net income plus depreciation and amortization, interest expense, interest income, income tax benefit (expense) and non-cash, stock-based compensation expense. We use Adjusted EBITDA as a measure of operating performance because it assists us in comparing performance on a consistent basis, as it removes from our operating results the impact of our capital structure. We believe Adjusted EBITDA is useful to an investor in evaluating our operating performance because it is widely used to measure a company's operating performance without regard to items such as depreciation and amortization, which can vary depending upon accounting methods and the book value of assets, and to present a meaningful measure of corporate performance exclusive of our capital structure and the method by which assets were acquired.

The following table provides a reconciliation of net income to Adjusted EBITDA (in thousands):

	Year Ended December 31,	
	2011	2010
Net income	\$ 13,703	\$ 2,884
Depreciation and amortization	2,647	1,533
Interest expense	—	74
Interest income	(89)	(158)
Income tax (benefit) expense	(12,619)	92
EBITDA	3,642	4,425
Stock-based compensation expense	1,768	750
Adjusted EBITDA	<u>\$ 5,410</u>	<u>\$ 5,175</u>

*Non-GAAP Income per Share.* Non-GAAP income per share, which is also a non-GAAP measure of financial performance, consists of net income plus non-cash, stock-based compensation expense and amortization expense related to intangible assets minus the deferred tax valuation allowance reversal divided by the weighted average number of shares of common stock outstanding during each period. We believe non-GAAP income per share is useful to an investor because it is widely used to measure a company's operating performance.

The following table provides a reconciliation of net income to non-GAAP income per share (in thousands, except per share amounts):

	Year Ended December 31,	
	2011	2010
Net income	\$ 13,703	\$ 2,884
Deferred tax asset valuation allowance reversal	(12,802)	—
Stock-based compensation expense	1,768	750
Amortization of intangible assets	643	—
Non-GAAP income	<u>\$ 3,312</u>	<u>\$ 3,634</u>
Non-GAAP income per share		
Basic	\$ 0.28	\$ 0.45
Diluted	\$ 0.26	\$ 0.31
Shares used to compute non-GAAP income per share		
Basic	11,960	8,036
Diluted	12,744	11,596

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**Year Ended December 31, 2010 Compared to Year Ended December 31, 2009**

The following table presents our results of operations for the periods indicated (dollars in thousands):

	Year Ended December 31,				Change	
	2010		2009		\$	%
		% of revenue		% of revenue		
Revenues	\$44,597	100.0%	\$37,746	100.0%	\$6,851	18.2%
Cost of revenues	12,626	28.3	11,715	31.0	911	7.8
Gross profit	<u>31,971</u>	71.7	<u>26,031</u>	69.0	5,940	22.8
Operating expenses						
Sales and marketing	16,601	37.2	13,506	35.8	3,095	22.9
Research and development	4,349	9.8	4,305	11.4	44	1.0
General and administrative	7,985	17.9	6,339	16.8	1,646	26.0
Total operating expenses	<u>28,935</u>	64.9	<u>24,150</u>	64.0	4,785	19.8
Income from operations	3,036	6.8	1,881	5.0	1,155	61.4
Other income (expense)						
Interest expense	(74)	(0.2)	(270)	(0.7)	196	(72.6)
Interest income	158	0.4	—	—	158	*
Other expense	(144)	(0.3)	(358)	(0.9)	214	*
Total other expense, net	<u>(60)</u>	(0.1)	<u>(628)</u>	(1.7)	568	(90.4)
Income tax expense	(92)	(0.2)	(91)	(0.2)	(1)	1.1
Net income	<u>\$ 2,884</u>	6.5	<u>\$ 1,162</u>	3.1	1,722	148.2

Due to rounding, totals may not equal the sum of the line items in the table above

\* Percentage is not meaningful

**Revenues.** Revenues for 2010 increased \$6.9 million, or 18%, to \$44.6 million from \$37.7 million for 2009. Our fiscal quarter ended December 31, 2010 represented our 40th consecutive quarter of increased revenues. The increase in revenues resulted primarily from a 13% increase in recurring revenue customers to 12,399 at December 31, 2010 from 11,003 at December 31, 2009, as well as a 10% increase in average recurring revenues per recurring revenue customer to \$3,176 from \$2,879. The increase in average recurring revenues per recurring revenue customer was primarily attributable to increased fees resulting from increased usage of our solutions by our recurring revenue customers. Recurring revenues from recurring revenue customers accounted for 83% of our total revenues for 2010, compared to 80% for 2009.

**Cost of Revenues.** Cost of revenues for 2010 increased \$900,000, or 8%, to \$12.6 million from \$11.7 million for 2009. The increase in costs was primarily attributable to higher costs of personnel, network services and depreciation. As a percentage of revenues, cost of revenues was 28% for 2010, compared to 31% for 2009. Increased revenues allowed us to leverage our personnel and infrastructure costs and decrease our cost of revenues as a percentage of total revenues.

**Sales and Marketing Expenses.** Sales and marketing expenses for 2010 increased \$3.1 million, or 23%, to \$16.6 million from \$13.5 million for 2009. The increase in sales and marketing expenses was due to higher commissions earned by sales personnel from new business, as well as increased personnel and promotional costs in 2010. As a percentage of revenues, sales and marketing expenses were 37% for 2010 and 36% for 2009.

**Research and Development Expenses.** Research and development expenses for 2010 were \$4.3 million, which was comparable to 2009. As a percentage of revenues, research and development expenses were 10% for 2010, compared to 11% for 2009. Increased revenues contributed to the decrease in research and development expenses as a percentage of revenues.

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*General and Administrative Expenses.* For 2010, general and administrative expenses increased \$1.7 million, or 26%, to \$8.0 million from \$6.3 million for 2009. The increase in general and administrative expenses was due to increased expenses related to being a public company, including legal and accounting fees. As a percentage of revenues, general and administrative expenses were 18% for 2010, compared to 17% for 2009.

*Other Income (Expense).* Interest expense for 2010 decreased \$196,000, or 73%, to \$74,000 from \$270,000 for 2009. The decrease in interest expense was principally due to reduced equipment borrowings and the repayment of all outstanding indebtedness under our credit facility in 2010. Interest income for 2010 was \$158,000 as the result of interest earned on the net cash proceeds from our initial public offering in April 2010. Other expense for 2010 was \$144,000 compared to \$358,000 for 2009. The other income (expense) change was driven primarily by updating the value of outstanding preferred stock warrants to fair market value as required by generally accepted accounting principles. We expect that there will be no further income or expense related to these warrants as they were converted to common stock warrants with the completion of our initial public offering on April 22, 2010.

*Income Tax Expense.* Income tax expense was \$92,000 for 2010 compared to \$91,000 for 2009. Our provision for income taxes includes estimated federal alternative minimum taxes, state income and franchise taxes, as well as deferred tax expense resulting from the book and tax basis difference in goodwill from a prior asset acquisition.

*Adjusted EBITDA.* Adjusted EBITDA, which is a non-GAAP measure of financial performance, consists of net income plus depreciation and amortization, interest expense, interest income, income tax expense and non-cash, stock-based compensation expense. We use Adjusted EBITDA as a measure of operating performance because it assists us in comparing performance on a consistent basis, as it removes from our operating results the impact of our capital structure. We believe Adjusted EBITDA is useful to an investor in evaluating our operating performance because it is widely used to measure a company's operating performance without regard to items such as depreciation and amortization, which can vary depending upon accounting methods and the book value of assets, and to present a meaningful measure of corporate performance exclusive of our capital structure and the method by which assets were acquired.

The following table provides a reconciliation of net income to Adjusted EBITDA (in thousands):

	Year Ended December 31,	
	2010	2009
Net income	\$2,884	\$1,162
Depreciation and amortization	1,533	1,455
Interest expense	74	270
Interest income	(158)	—
Income tax expense	92	91
EBITDA	4,425	2,978
Stock-based compensation expense	750	228
Adjusted EBITDA	<u>\$5,175</u>	<u>\$3,206</u>

*Non-GAAP Income per Share.* Non-GAAP income per share, which is also a non-GAAP measure of financial performance, consists of net income plus non-cash, stock-based compensation expense and amortization expense related to intangible assets divided by the weighted average number of shares of common stock outstanding during each period. We believe non-GAAP income per share is useful to an investor because it is widely used to measure a company's operating performance.

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The following table provides a reconciliation of net income to non-GAAP income per share (in thousands, except per share amounts):

	Year Ended December 31,	
	2010	2009
Net income	\$ 2,884	\$1,162
Stock-based compensation expense	750	228
Amortization of intangible assets	—	155
Non-GAAP income	<u>\$ 3,634</u>	<u>\$1,545</u>
Non-GAAP income per share		
Basic	\$ 0.45	\$ 4.70
Diluted	\$ 0.31	\$ 0.17
Shares used to compute non-GAAP income per share		
Basic	8,036	329
Diluted	11,596	9,268

## Liquidity and Capital Resources

At December 31, 2011, our principal sources of liquidity were cash and cash equivalents totaling \$32.0 million and accounts receivable, net of allowance for doubtful accounts, of \$8.0 million compared to cash and cash equivalents of \$40.5 million and accounts receivable, net of allowance for doubtful accounts, of \$5.6 million at December 31, 2010. Our working capital as of December 31, 2011 was \$36.8 million compared to working capital of \$42.6 million as of December 31, 2010. We bill our recurring revenue customers in arrears for monthly service fees and initial integration set-up fees. As a result, the amount of our accounts receivable at the end of a period is driven significantly by our revenues from recurring revenue customers for the last month of the period, and our cash flows from operations are affected by our collection of amounts due from customers for services that resulted in the recognition of revenues in a prior period.

The decrease in working capital from December 31, 2010 to December 31, 2011 resulted primarily from the following:

- \$8.5 million decrease in cash and cash equivalents, due primarily to \$10.8 million of cash used for the acquisition of Direct EDI in May 2011;
- \$2.4 million increase in net accounts receivable, due to new business in 2011;
- \$1.0 million increase in deferred costs, current for expenses related to increased implementation resources and commission payments for new business;
- \$783,000 increase in deferred income taxes, current as a result of the reversal of a substantial portion of the valuation allowance on our deferred tax assets;
- \$891,000 increase in prepaid expenses and other current assets, primarily related to the renewals of insurance coverage and a prepaid service contract;
- \$122,000 decrease in capital lease obligations, current, as all of our outstanding capital leases were repaid;
- \$413,000 increase in accounts payable, primarily due to timing of payments for equipment purchases, professional services and rent;
- \$1.5 million increase in accrued compensation and benefits, due to increases in salary, vacation and commission accruals;
- \$290,000 increase in accrued expenses and other current liabilities, primarily due to an increase in accruals for professional services; and
- \$255,000 increase in current deferred revenue, due to new business in 2011.

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***Net Cash Flows from Operating Activities***

Net cash provided by operating activities was \$4.5 million for 2011 compared to \$4.9 million for 2010. The \$10.8 million increase in net income was more than offset by the impact of deferred income taxes, the changes in non-cash expenses, including depreciation, amortization, and stock-based compensation, and the changes in working capital accounts as discussed above.

Net cash provided by operating activities was \$4.9 million for 2010 compared to \$5.2 million for 2009. The approximate \$1.7 million increase in net income was more than offset by the changes in non-cash expenses, including depreciation, amortization, and stock-based compensation, and the changes in working capital accounts.

***Net Cash Flows from Investing Activities***

For 2011, net cash used in investing activities was \$13.4 million, including \$10.8 million for the acquisition of Direct EDI and \$2.6 million for capital expenditures.

For 2010 and 2009, net cash used in investing activities was \$1.8 million and \$1.0 million, respectively, all for capital expenditures. Capital expenditures in 2010 included a significant purchase of middleware and database licenses. In general, our various capital expenditures are for supporting our existing customer base, growth in new business, and internal use such as equipment for our employees.

***Net Cash Flows from Financing Activities***

Net cash provided by financing activities was \$452,000 for 2011, representing cash received from the exercise of stock options offset by payments of capital lease obligations and stock offering costs.

Net cash provided by financing activities was \$31.4 million for 2010, representing the approximate \$34.0 million of net proceeds from our initial and secondary public offerings slightly offset by \$2.6 million of net repayments on our outstanding indebtedness.

Net cash used in financing activities was \$1.9 million for 2009. We used these funds to pay \$1.3 million in equipment loans and capital lease obligations and to pay \$679,000 toward the term loan from our Owens Direct acquisition.

***Credit Facility***

On September 30, 2011, we entered into a revolving credit agreement with JPMorgan Chase Bank, N.A. The revolving credit agreement provides for a \$20 million revolving credit facility that we may draw upon from time to time, subject to certain terms and conditions, and will mature on September 30, 2016. Proceeds from the credit facility are anticipated to be used for acquisitions and our capital needs.

Interest on amounts borrowed under the credit facility is based on (i) an Adjusted LIBO Rate (as defined in the revolving credit agreement) plus an applicable margin of 175 to 225 basis points based on our net working capital, or (ii) JPMorgan's prime rate (provided it is not less than the Adjusted One Month LIBO Rate (as defined in the revolving credit agreement)) plus an applicable margin of -25 to 25 basis points based on our net working capital. Interest is payable monthly in arrears. Availability under the credit facility is subject to a borrowing base equal to the sum of 250% of our eligible monthly recurring revenue (as defined in the revolving credit agreement) and all borrowings are due in full no later than the maturity date of the agreement.

The revolving credit agreement contains customary representations, warranties, covenants and events of default, including, but not limited to financial covenants requiring us to maintain a fixed charge coverage ratio of





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*consensus of the FASB Emerging Issues Task Force.* This guidance modifies the fair value requirements of ASC subtopic 605-25, *Revenue Recognition-Multiple Element Arrangements*, by allowing the use of the “best estimate of selling price” in addition to Vendor Specific Objective Evidence (“VSOE”) and third-party evidence (“TPE”) for determining the selling price of a deliverable. A vendor is now required to use its best estimate of the selling price when VSOE or TPE of the selling price cannot be determined. In addition, the residual method of allocating arrangement consideration is no longer permitted.

In October 2009, the FASB issued ASU No. 2009-14, *Software (ASC Topic 985), Certain Revenue Arrangements That Include Software Elements*, a *consensus of the FASB Emerging Issues Task Force.* This guidance modifies the scope of ASC subtopic 965-605, *Software-Revenue Recognition*, to exclude from its requirements (a) non-software components of tangible products and (b) software components of tangible products that are sold, licensed or leased with tangible products when the software components and non-software components of the tangible product function together to deliver the tangible product’s essential functionality.

ASU No. 2009-13 and ASU No. 2009-14 both require expanded qualitative and quantitative disclosures and are effective for fiscal years beginning on or after June 15, 2010. We have adopted these updates and they did not have a material impact on our financial statements.

In December 2010, the FASB issued ASU No. 2010-29, *Business Combinations (ASC Topic 805), Disclosure of Supplementary Pro Forma Information for Business Combinations.* ASU No. 2010-29 amends the disclosure requirements for supplementary pro forma information for business combinations. This update addresses the diversity in practice about the interpretation of the pro forma revenue and earnings disclosure requirements for business combinations. The update specifies that if a public entity presents comparative financial statements, the entity should disclose revenue and earnings of the combined entity as though the business combination(s) that occurred during the current year had occurred as of the beginning of the comparable prior annual reporting period only. It also expands the supplemental pro forma disclosures to include a description of the nature and amount of material, nonrecurring pro forma adjustments directly attributable to the business combination included in the reported pro forma revenue and earnings. This update is effective prospectively for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2010. We have adopted this update and, with the acquisition of Direct EDI in May 2011, the required supplementary pro forma information is presented in Note B to our consolidated financial statements included in this Annual Report on Form 10-K.

### **Item 7A. Quantitative and Qualitative Disclosures About Market Risk**

*Interest Rate Sensitivity Risk.* For fixed rate debt, interest rate changes affect the fair value of financial instruments but do not impact earnings or cash flows. Conversely, for floating rate debt, interest rate changes generally do not affect the fair market value but do impact future earnings and cash flows, assuming other factors are held constant. The principal objectives of our investment activities are to preserve principal, provide liquidity and maximize income consistent with minimizing risk of material loss. The recorded carrying amounts of cash and cash equivalents approximate fair value due to their short maturities. We did not have any outstanding debt as of December 31, 2011 and 2010. We therefore do not have any material risk to interest rate fluctuations unless we borrow under our credit facility.

*Foreign Currency Exchange Risk.* Our results of operations and cash flows are not materially affected by fluctuations in foreign currency exchange rates.

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**Item 8. *Financial Statements and Supplementary Data***

**SPS Commerce, Inc. Consolidated Financial Statements**

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**Report of Independent Registered Public Accounting Firm**

Board of Directors and Stockholders  
SPS Commerce, Inc.

We have audited the accompanying consolidated balance sheets of SPS Commerce, Inc. (a Delaware corporation) and subsidiaries (the "Company") as of December 31, 2011 and 2010, and the related consolidated statements of operations, redeemable convertible preferred stock and stockholders' equity (deficit), and cash flows for each of the three years in the period ended December 31, 2011. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of SPS Commerce, Inc. and subsidiaries as of December 31, 2011 and 2010, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2011, in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of December 31, 2011, based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated March 9, 2012, expressed an unqualified opinion thereon.

/S/ GRANT THORNTON LLP

Minneapolis, Minnesota  
March 9, 2012

**Report of Independent Registered Public Accounting Firm**

Board of Directors and Stockholders  
SPS Commerce, Inc.

We have audited SPS Commerce, Inc. (a Delaware Corporation) and subsidiaries' (the "Company") internal control over financial reporting as of December 31, 2011, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for maintaining effective internal control over financial reporting and for their assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Annual Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, SPS Commerce, Inc. and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2011, based on criteria established in *Internal Control — Integrated Framework* issued by COSO.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of SPS Commerce, Inc. and subsidiaries as of December 31, 2011 and 2010, and the related consolidated statements of operations, redeemable convertible preferred stock and stockholders' equity (deficit), and cash flows for each of the three years in the period ended December 31, 2011 and our report dated March 9, 2012 expressed an unqualified opinion.

/s/ GRANT THORNTON LLP

Minneapolis, Minnesota  
March 9, 2012

**SPS COMMERCE, INC.**  
**CONSOLIDATED BALANCE SHEETS**  
(In thousands, except share amounts)

	December 31,	
	2011	2010
<b>ASSETS</b>		
<b>CURRENT ASSETS</b>		
Cash and cash equivalents	\$ 31,985	\$ 40,473
Accounts receivable, less allowance for doubtful accounts of \$222 and \$209, respectively	7,958	5,574
Deferred costs, current	5,748	4,720
Deferred income taxes, current	783	—
Prepaid expenses and other current assets	1,765	874
Total current assets	48,239	51,641
PROPERTY AND EQUIPMENT, net	3,382	2,760
GOODWILL	5,853	1,166
INTANGIBLE ASSETS, net	5,767	290
<b>OTHER ASSETS</b>		
Deferred costs, net of current portion	2,510	1,943
Deferred income taxes, net of current portion	11,787	—
Other non-current assets	80	80
	<u>\$ 77,618</u>	<u>\$ 57,880</u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES</b>		
Capital lease obligations, current	\$ —	\$ 122
Accounts payable	1,411	998
Accrued compensation and benefits	5,118	3,577
Accrued expenses and other current liabilities	1,097	807
Deferred revenue, current	3,840	3,585
Total current liabilities	11,466	9,089
<b>OTHER LIABILITIES</b>		
Deferred revenue, less current portion	6,599	5,002
Other non-current liabilities	—	281
Total liabilities	<u>18,065</u>	<u>14,372</u>
<b>COMMITMENTS and CONTINGENCIES</b>		
<b>STOCKHOLDERS' EQUITY</b>		
Preferred stock, \$0.001 par value; 5,000,000 shares authorized; 0 shares issued and outstanding	—	—
Common stock, \$0.001 par value; 55,000,000 shares authorized; 12,138,858 and 11,849,572 shares issued and outstanding, respectively	12	12
Additional paid-in capital	108,606	106,264
Accumulated deficit	(49,065)	(62,768)
Total stockholders' equity	<u>59,553</u>	<u>43,508</u>
	<u>\$ 77,618</u>	<u>\$ 57,880</u>

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

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**SPS COMMERCE, INC.**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
(In thousands, except per share amounts)

	Year Ended December 31,		
	2011	2010	2009
Revenues	\$57,969	\$44,597	\$37,746
Cost of revenues	15,366	12,626	11,715
Gross profit	<u>42,603</u>	<u>31,971</u>	<u>26,031</u>
Operating expenses			
Sales and marketing	23,836	16,601	13,506
Research and development	5,838	4,349	4,305
General and administrative	11,151	7,985	6,339
Amortization of intangible assets	643	—	—
Total operating expenses	<u>41,468</u>	<u>28,935</u>	<u>24,150</u>
Income from operations	1,135	3,036	1,881
Other income (expense)			
Interest expense	—	(74)	(270)
Interest income	89	158	—
Other expense	(140)	(144)	(358)
Total other expense, net	<u>(51)</u>	<u>(60)</u>	<u>(628)</u>
Income before income taxes	1,084	2,976	1,253
Income tax benefit (expense)	<u>12,619</u>	<u>(92)</u>	<u>(91)</u>
Net income	<u>\$13,703</u>	<u>\$ 2,884</u>	<u>\$ 1,162</u>
Net income per share			
Basic	\$ 1.15	\$ 0.36	\$ 3.53
Diluted	\$ 1.08	\$ 0.25	\$ 0.13
Weighted average common shares used to compute net income per share			
Basic	11,960	8,036	329
Diluted	12,744	11,596	9,268

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

SPS COMMERCE, INC.

CONSOLIDATED STATEMENTS OF REDEEMABLE CONVERTIBLE PREFERRED STOCK AND STOCKHOLDERS' EQUITY (DEFICIT)

(In thousands, except share amounts)

	Redeemable Convertible Preferred Stock							Stockholders' Equity (Deficit)				Total Stockholders' Equity (Deficit)
	Series A		Series B		Series C			Common Stock		Additional Paid-in Capital	Accumulated Deficit	
	Shares	Amount	Shares	Amount	Shares	Amount	Total	Shares	Amount			
Balances, January 1, 2009	1,154,151	\$ 37,676	5,759,246	\$ 20,844	1,251,559	\$ 7,444	\$ 65,964	331,145	\$ —	\$ 4,970	\$ (66,814)	\$ (61,844)
Stock-based compensation	—	—	—	—	—	—	—	—	—	228	—	228
Exercise of stock options	—	—	—	—	—	—	—	15,640	—	2	—	2
Repurchase of redeemable convertible preferred and common stock	—	—	(71,130)	(186)	—	—	(186)	(19,672)	—	(14)	—	(14)
Net income	—	—	—	—	—	—	—	—	—	—	1,162	1,162
Balances, December 31, 2009	1,154,151	37,676	5,688,116	20,658	1,251,559	7,444	65,778	327,113	—	5,186	(65,652)	(60,466)
Stock-based compensation	—	—	—	—	—	—	—	—	—	750	—	750
Exercise of warrants	—	—	—	—	—	—	—	49,224	—	—	—	—
Exercise of stock options	—	—	—	—	—	—	—	149,905	—	43	—	43
Conversion of redeemable convertible preferred stock	(1,154,151)	(37,676)	(5,688,116)	(20,658)	(1,251,559)	(7,444)	(65,778)	8,093,826	8	65,770	—	65,778
Conversion of warrants to purchase redeemable convertible preferred stock	—	—	—	—	—	—	—	—	—	596	—	596
Initial public offering, net of costs	—	—	—	—	—	—	—	3,114,504	3	32,899	—	32,902
Secondary stock offering, net of costs	—	—	—	—	—	—	—	115,000	—	1,020	—	1,020
Net income	—	—	—	—	—	—	—	—	—	—	2,884	2,884
Other	—	—	—	—	—	—	—	—	1	—	—	1
Balances, December 31, 2010	—	—	—	—	—	—	—	11,849,572	12	106,264	(62,768)	43,508
Stock-based compensation	—	—	—	—	—	—	—	—	—	1,768	—	1,768
Exercise of stock options	—	—	—	—	—	—	—	289,286	—	621	—	621
Stock offering costs	—	—	—	—	—	—	—	—	—	(108)	—	(108)
Excess tax benefit of stock options exercised	—	—	—	—	—	—	—	—	—	61	—	61
Net income	—	—	—	—	—	—	—	—	—	—	13,703	13,703
Balances, December 31, 2011	—	\$ —	—	\$ —	—	\$ —	\$ —	12,138,858	\$ 12	\$ 108,606	\$ (49,065)	\$ 59,553

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



**SPS COMMERCE, INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(In thousands)

	Year Ended December 31,		
	2011	2010	2009
Cash flows from operating activities			
Net income	\$ 13,703	\$ 2,884	\$ 1,162
Reconciliation of net income to net cash provided by operating activities			
Deferred income taxes	(12,708)	—	28
Depreciation and amortization of property and equipment	2,004	1,533	1,445
Amortization of intangible assets	643	—	—
Provision for doubtful accounts	425	274	439
Stock-based compensation	1,768	750	228
Change in carrying value of preferred stock warrants	—	27	381
Other	—	1	10
Changes in assets and liabilities, net of effect of acquisition			
Accounts receivable	(2,810)	(1,081)	(641)
Deferred costs	(1,595)	(919)	(98)
Prepaid expenses and other current assets	(882)	567	(655)
Other assets	(10)	(17)	(6)
Accounts payable	413	(347)	541
Accrued compensation and benefits	1,541	572	1,121
Accrued expenses and other current liabilities	140	(480)	359
Deferred revenue	1,853	1,155	844
Net cash provided by operating activities	<u>4,485</u>	<u>4,919</u>	<u>5,158</u>
Cash flows from investing activities			
Acquisition of Direct EDI	(10,841)	—	—
Purchases of property and equipment	(2,584)	(1,772)	(1,000)
Net cash used in investing activities	<u>(13,425)</u>	<u>(1,772)</u>	<u>(1,000)</u>
Cash flows from financing activities			
Borrowings on line of credit	—	4,450	16,325
Payments on line of credit	—	(5,950)	(16,125)
Payments on equipment loans	—	(732)	(730)
Payments on term loan	—	—	(679)
Payments of capital lease obligations	(122)	(338)	(534)
Net proceeds from initial public offering	—	32,902	—
Net proceeds from secondary stock offering	—	1,020	—
Stock offering costs	(108)	—	—
Net proceeds from exercise of options to purchase common stock	621	43	2
Excess tax benefit from exercise of stock options	61	—	—
Purchase of preferred and common stock	—	—	(201)
Net cash provided by (used in) financing activities	<u>452</u>	<u>31,395</u>	<u>(1,942)</u>
Net increase (decrease) in cash and cash equivalents	(8,488)	34,542	2,216
Cash and cash equivalents at beginning of period	40,473	5,931	3,715
Cash and cash equivalents at end of period	<u>\$ 31,985</u>	<u>\$40,473</u>	<u>\$ 5,931</u>
Supplemental disclosure of cash flow information			
Cash paid for interest	\$ 3	\$ 62	\$ 285

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

**SPS COMMERCE, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE A — General**

***Business Description***

We are a leading provider of on-demand supply chain management solutions, providing integration, collaboration, connectivity, visibility and data analytics to thousands of customers worldwide. We provide our solutions through SPSCommerce.net, a hosted software suite that improves the way suppliers, retailers, distributors and other customers manage and fulfill orders. We deliver our solutions to our customers over the Internet using a Software-as-a-Service model and derive the majority of our revenues from thousands of monthly recurring subscriptions from businesses that utilize our solutions.

***Basis of Presentation***

The accompanying consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (“GAAP”) and include the accounts of SPS Commerce, Inc. and its subsidiaries. All significant intercompany accounts and transactions have been eliminated in the consolidated financial statements.

Certain reclassifications have been made to present prior year’s cash flow statement and footnote information consistently with the current year presentation.

***Use of Estimates***

Preparing financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

***Business Combinations***

We recognize separately from goodwill the fair value of the assets acquired and the liabilities assumed at the acquisition date. Goodwill as of the acquisition date is measured as the excess of consideration transferred and the net of the acquisition date amounts of the assets acquired and the liabilities assumed. Assets acquired include tangible and intangible assets. We determine the value and useful lives of purchased intangible assets with the assistance of an independent third-party valuation firm using certain estimates and assumptions.

While we use estimates and assumptions that we believe are reasonable as a part of the purchase price allocation process to accurately value the assets acquired and the liabilities assumed at the acquisition date, they are inherently uncertain and subject to refinement. As a result, during the measurement period, which may be up to one year from the acquisition date, we may record adjustments to the fair value of the assets acquired and the liabilities assumed based on new information about facts and circumstances that existed as of the acquisition date. Any such adjustments would be recorded as an offset to goodwill. Upon the conclusion of the measurement period or final determination of the fair values, whichever comes first, any subsequent adjustments would be recorded in our consolidated statements of operations.

***Segment Information***

We operate in and report on one segment, supply chain management solutions.

**SPS COMMERCE, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

***Risk and Uncertainties***

We rely on hardware and software licensed from third parties to offer our on-demand solutions. Our management believes alternate sources are available; however, disruption or termination of these relationships could adversely affect our operating results in the near term.

***Fair Value of Financial Instruments***

The carrying amounts of our financial instruments, which include cash and cash equivalents, accounts receivable, accounts payable and other accrued expenses, approximates fair value due to their short maturities. Based on borrowing rates currently available to us for loans with similar terms, the carrying value of our outstanding debt and capital lease obligations, if any, approximates fair value.

***Concentration of Credit Risk***

Financial instruments that potentially subject us to concentrations of credit risk consist principally of temporary cash investments in financial institutions in excess of federally insured limits and trade accounts receivable. Temporary cash investments are held with financial institutions that we believe are subject to minimal risk.

***Cash and Cash Equivalents***

Cash and cash equivalents consist of cash and highly liquid investments with original maturities when purchased of less than 90 days.

***Accounts Receivable***

Accounts receivable are initially recorded upon the sale of solutions to customers. Credit is granted in the normal course of business without collateral. Accounts receivable are stated net of allowances for doubtful accounts, which represent estimated losses resulting from the inability of customers to make the required payments. Accounts that are outstanding longer than the contractual terms are considered past due. When determining the allowances for doubtful accounts, we take several factors into consideration including the overall composition of the accounts receivable aging, our prior history of accounts receivable write-offs, the type of customers and our day-to-day knowledge of specific customers. We write off accounts receivable when they become uncollectible. Changes in the allowances for doubtful accounts are recorded as bad debt expense and are included in general and administrative expense in our consolidated statements of operations.

***Property and Equipment***

Property and equipment, including assets acquired under capital lease obligations, are stated at cost, net of accumulated depreciation and amortization. Depreciation and amortization are computed using the straight-line method over the shorter of the estimated useful lives of the individual assets or the lease term. The estimated useful lives are:

- Computer equipment and purchased software: 2 to 5 years
- Office equipment and furniture: 5 to 7 years
- Leasehold improvements: 2 to 7 years

**SPS COMMERCE, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

Significant additions or improvements extending asset lives beyond one year are capitalized, while repairs and maintenance are charged to expense as incurred. The assets and related accumulated depreciation and amortization accounts are adjusted for asset retirements and disposals with the resulting gain or loss included in net income (loss).

***Research and Development***

Costs incurred to develop software applications used in our on-demand supply chain management solutions may be capitalized. Capitalizable costs consist of (a) certain external direct costs of materials and services incurred in developing or obtaining internal-use computer software and (b) payroll and payroll-related costs for employees who are directly associated with, and who devote time to, the project. These costs generally consist of internal labor during configuration, coding and testing activities. Research and development costs incurred during the preliminary project stage, or costs incurred for data conversion activities, training, maintenance and general and administrative or overhead costs, are expensed as incurred. Costs that cannot be separated between the maintenance of, and relatively minor upgrades and enhancements to, internal-use software are also expensed as incurred. Capitalization begins when (a) the preliminary project stage is complete, (b) management with the relevant authority authorizes and commits to the funding of the software project, (c) it is probable the project will be completed, (d) the software will be used to perform the functions intended, and (e) certain functional and quality standards have been met. Historically, no projects have had material costs beyond the preliminary project stage.

Our research and development efforts during 2011, 2010 and 2009 were primarily maintenance and data conversion activities related to our on-demand supply chain management solutions. As such, we did not capitalize any research and development costs during 2011, 2010 or 2009.

***Goodwill***

Goodwill represents the excess of the purchase price over the fair value of identifiable net assets acquired in business combinations. We test goodwill for impairment annually at December 31, or more frequently if events or changes in circumstances indicate that the asset might be impaired. The impairment test is conducted by comparing the fair value of the net assets with the carrying value of the reporting unit. Fair value is determined using the direct market observation of market price and outstanding equity of the reporting unit at December 31. If the carrying value of the goodwill exceeds the fair value of the reporting unit, goodwill may be impaired. If this occurs, the fair value is then allocated to its assets and liabilities in a manner similar to a purchase price allocation in order to determine the implied fair value of goodwill. This implied fair value is then compared to the carrying amount of goodwill and, if it is less, we would recognize an impairment loss. For the year ended December 31, 2009, the impairment test compared the carrying value of the company to the fair value of the company, which was based on an analysis of the discounted future cash flows. The methodology for evaluating the fair value of the company was changed with the completion of our initial public offering to use the per share prices as a direct market observable measure. There has been no impairment of our goodwill to date.

***Intangible Assets***

Assets acquired in business combinations may include identifiable intangible assets such as subscriber relationships and non-competition agreements. We recognize separately from goodwill the fair value of the identifiable intangible assets acquired. We have determined the fair value and useful lives of our purchased intangible assets with the assistance of an independent third-party valuation firm using certain estimates and assumptions.

SPS COMMERCE, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The purchased intangible assets are being amortized on a straight-line basis over their estimated useful lives, which is three to seven years for subscriber relationships and two to three years for non-competition agreements. We also have non-competition agreements from a previous acquisition that are amortized on a straight-line basis over the term of the agreements, which begins with the termination of employment of the respective employee(s).

***Impairment of Long-Lived Assets***

We review our long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. The carrying amount of a long-lived asset is not recoverable if it exceeds the sum of the undiscounted cash flows expected to result from the use and eventual disposition of the asset at the date it is tested for recoverability, whether in use or under development. An impairment loss is measured as the amount by which the carrying amount of a long-lived asset exceeds its fair value. There has been no impairment of our long-lived assets to date.

***Revenue Recognition***

We generate revenues by providing a number of solutions to our customers. These solutions include Trading Partner Integration, Trading Partner Enablement and Trading Partner Intelligence. All of our solutions are hosted applications that allow customers to meet their supply chain management requirements. Revenues from our Trading Partner Integration and Trading Partner Intelligence solutions are generated through set-up fees and a recurring monthly hosting fee. Revenues from our Trading Partner Enablement solutions are generally one-time service fees. Sales taxes are presented on a net basis within revenue.

Revenues are recorded in accordance with Staff Accounting Bulletin 104, *Revenue Recognition in Financial Statements* and Accounting Standards Update (“ASU”) 2009-13, *Multiple-Deliverable Revenue Arrangements*, when all of the following criteria are met: (1) persuasive evidence of an arrangement exists, (2) delivery has occurred, (3) the fee is fixed and determinable, and (4) collectability is probable. If collection is not considered probable, revenues are recognized when the fees are collected. The services related to these fees have standalone value which is determined using vendor specific objective evidence (“VSOE”).

Fees related to our Trading Partner Integration and Trading Partner Intelligence solutions consist of two revenue sources: set-up fees and recurring monthly hosting fees. All set-up fees are deferred and recognized ratably over the expected life of the customer relationship, which is generally two years. We continue to evaluate and adjust the length of these amortization periods as more experience is gained with customer renewals, contract cancellations and technology changes requested by our customers. It is possible that, in the future, the estimates of expected customer lives may change and, if so, the periods over which such subscription set-up fees and costs are amortized will be adjusted. Any such change in estimated expected customer lives will affect our future results of operations. Set-up fees are further broken down as initial set-up fees and add-on set-up fees. Add-on set-up fees, which are nonrefundable, and our Trading Partner Integration revenues represent arrangements providing standalone value for our customers. Because these revenues are not dependent on the delivery of any future performance and the arrangement includes VSOE for pricing, ASU 2009-13 has not impacted how we separate and price these two elements. Initial setup fees are nonrefundable upfront fees that do not have standalone value and are not part of the multiple element arrangement. These fees are deferred and recognized over the customer relationship period as discussed above.

The recurring monthly fee is comprised of both fixed and transaction based fees that provide standalone value and are recognized as incurred. From time-to-time, we may provide discounts on set-up fees; however it is not possible to allocate the discount on the set-up fees because the contract period is unknown and the complete

**SPS COMMERCE, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

value of the deliverables is unknown. Variables preventing allocation include the variability of the recurring revenue due to transaction levels and the ability of customers to cancel the contract upon 30 days' notice. If estimation of the customer relationship became necessary, we would rely on the existing customer relationship period that set-up fees are currently being recognized over, resulting in no change in the revenues recognized.

***Stock-Based Compensation***

We recognize the cost of all share-based payments to employees, including grants of employee stock options, in the financial statements based on the grant date fair value of those awards. This cost is recognized over the period for which an employee is required to provide service in exchange for the award. Benefits associated with tax deductions in excess of recognized compensation expense are reported as a cash flow from financing activities.

We estimate the fair value of options granted using the Black-Scholes option pricing model. The estimation of stock awards that will ultimately vest requires judgment, and to the extent actual results differ from our estimates, such amounts will be recorded as an adjustment in the period estimates are revised. In valuing share-based awards, significant judgment is required in determining the expected volatility of common stock and the expected term individuals will hold their share-based awards prior to exercising. Expected volatility of the stock is based on a peer group in the industry in which we do business because we do not have sufficient historical volatility data for our own common stock. The expected term of the options is based on the simplified method which does not consider historical or expected employee exercise behavior.

***Advertising Costs***

Advertising costs are charged to expense as incurred. Advertising costs were approximately \$93,000, \$94,000 and \$56,000 for the years ended December 31, 2011, 2010 and 2009, respectively. Advertising costs are included in operating expenses in our consolidated statements of operations.

***Income Taxes***

We account for income taxes using the liability method, which requires recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the financial statements. Under this method, deferred tax assets and liabilities are determined based on the difference between the financial statement and tax bases of assets and liabilities, using enacted tax rates in effect for the year in which the differences are expected to reverse. Deferred tax assets are reduced by a valuation allowance to the extent that utilization is not presently more likely than not.

We recognize the financial statement benefit of a tax position only after determining that the relevant tax authority would more likely than not sustain the position following an audit. For tax positions meeting the more-likely-than-not threshold, the amount recognized in the financial statements is the largest benefit that has a greater than 50 percent likelihood of being realized upon ultimate settlement with the relevant tax authority.

***Net Income per Share***

Basic net income per share has been computed using the weighted average number of shares of common stock outstanding during each period. Diluted net income per share also includes the impact of our outstanding potential common shares, such as options, warrants and redeemable convertible preferred stock. Potential common shares that are anti-dilutive are excluded from the calculation of diluted net income per share.

**SPS COMMERCE, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

***Recent Accounting Pronouncements***

In October 2009, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2009-13, *Revenue Recognition* (ASC Topic 605), *Multiple-Deliverable Revenue Arrangements, a consensus of the FASB Emerging Issues Task Force*. This guidance modifies the fair value requirements of ASC subtopic 605-25, *Revenue Recognition-Multiple Element Arrangements*, by allowing the use of the “best estimate of selling price” in addition to Vendor Specific Objective Evidence (“VSOE”) and third-party evidence (“TPE”) for determining the selling price of a deliverable. A vendor is now required to use its best estimate of the selling price when VSOE or TPE of the selling price cannot be determined. In addition, the residual method of allocating arrangement consideration is no longer permitted.

In October 2009, the FASB issued ASU No. 2009-14, *Software* (ASC Topic 985), *Certain Revenue Arrangements That Include Software Elements, a consensus of the FASB Emerging Issues Task Force*. This guidance modifies the scope of ASC subtopic 965-605, *Software-Revenue Recognition*, to exclude from its requirements (a) non-software components of tangible products and (b) software components of tangible products that are sold, licensed or leased with tangible products when the software components and non-software components of the tangible product function together to deliver the tangible product’s essential functionality.

ASU No. 2009-13 and ASU No. 2009-14 both require expanded qualitative and quantitative disclosures and are effective for fiscal years beginning on or after June 15, 2010. We have adopted these updates and they did not have a material impact on our financial statements.

In December 2010, the FASB issued ASU No. 2010-29, *Business Combinations* (ASC Topic 805), *Disclosure of Supplementary Pro Forma Information for Business Combinations*. ASU No. 2010-29 amends the disclosure requirements for supplementary pro forma information for business combinations. This update addresses the diversity in practice about the interpretation of the pro forma revenue and earnings disclosure requirements for business combinations. The update specifies that if a public entity presents comparative financial statements, the entity should disclose revenue and earnings of the combined entity as though the business combination(s) that occurred during the current year had occurred as of the beginning of the comparable prior annual reporting period only. It also expands the supplemental pro forma disclosures to include a description of the nature and amount of material, nonrecurring pro forma adjustments directly attributable to the business combination included in the reported pro forma revenue and earnings. This update is effective prospectively for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2010. We have adopted this update and, with the acquisition of Direct EDI in May 2011, the required supplementary pro forma information is presented in Note B.

**NOTE B — Acquisition of Direct EDI**

On May 17, 2011, we entered into an asset purchase agreement with Direct EDI LLC, a privately-held provider of cloud-based integration solutions for electronic data interchange, and we completed the asset purchase on May 18, 2011. Under the asset purchase agreement, we purchased and acquired substantially all of the assets of Direct EDI for \$10.8 million in cash and assumed certain liabilities of Direct EDI. The acquisition of Direct EDI allows us to expand our base of recurring revenue customers.

***Purchase Price Allocation***

We accounted for the acquisition as a business combination. We allocated the purchase price to the tangible and identifiable intangible assets acquired and liabilities assumed based on their estimated fair values as of the acquisition date. We engaged an independent third-party valuation firm to assist us in the determination of the

**SPS COMMERCE, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

value of the purchased intangible assets. The excess of the purchase price over the fair value of net tangible and identifiable intangible assets acquired was recorded as goodwill. Goodwill is attributed to a trained workforce and other buyer-specific value resulting from expected synergies, including long-term cost savings that are not included in the fair values of assets. Goodwill will not be amortized; however it is deductible for tax purposes. During the fourth quarter of 2011, we completed our evaluation of the purchase price allocation and recorded a purchase price adjustment of approximately \$25,000 related to working capital.

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the acquisition date (in thousands):

Current assets	\$ 195
Property and equipment	42
Intangible assets	6,120
Goodwill	4,688
Current liabilities	(204)
Total purchase price	<u>\$10,841</u>

***Purchased Intangible Assets***

The following table summarizes the estimated fair value of the purchased intangible assets and their estimated useful lives:

<u>Purchased Intangible Assets</u>	<u>Estimated Fair Value (in thousands)</u>	<u>Estimated Life (in years)</u>
Subscriber relationships	\$ 5,250	7
Non-competition agreements	870	3
Total	<u>\$ 6,120</u>	

The purchased intangible assets are being amortized on a straight-line basis over their estimated useful lives. Amortization expense related to these intangible assets was \$643,000 for the year ended December 31, 2011.

***Acquisition-Related Costs and Post-Acquisition Operating Results***

Acquisition-related costs were approximately \$232,000 and are included in general and administrative expense in our consolidated statements of operations for the year ended December 31, 2011. The operating results of Direct EDI have been included in our consolidated financial statements from May 18, 2011, the date of the acquisition. For the year ended December 31, 2011, approximately \$2.7 million of our revenues were derived from Direct EDI customers. The amount of operating income or loss from Direct EDI was not separately identifiable due to our integration.

***Unaudited Pro Forma Financial Information***

The unaudited pro forma financial information in the table below presents the combined operating results of SPS Commerce and Direct EDI as if the acquisition had occurred on January 1, 2010. The unaudited pro forma information includes the historical operating results of each company and certain pro forma adjustments,



**SPS COMMERCE, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

including annual amortization expense for purchased intangible assets of approximately \$1.0 million and additional annual compensation expense of approximately \$280,000 related to employment arrangements entered into as part of the acquisition.

	Year Ended December 31,	
	2011	2010
	(in thousands, except per share data)	
Pro forma total revenue	\$59,815	\$48,746
Pro forma net income	13,576	2,299
Pro forma net income per share		
Basic	1.14	0.29
Diluted	1.07	0.20

The unaudited pro forma financial information is presented for informational purposes only and is not necessarily indicative of the results of operations that would have actually been reported had the acquisition occurred on January 1, 2010, nor is it necessarily indicative of our results of operations for any future periods.

**NOTE C — Financial Statement Components**

***Allowance for Doubtful Accounts***

The allowance for doubtful accounts activity was as follows (in thousands):

	2011	2010	2009
Balances, January 1	\$ 209	\$ 226	\$ 308
Provision for doubtful accounts	425	274	439
Write-offs, net of recoveries	(412)	(291)	(521)
Balances, December 31	<u>\$ 222</u>	<u>\$ 209</u>	<u>\$ 226</u>

***Property and Equipment, net***

Property and equipment, net included the following (in thousands):

	December 31,	
	2011	2010
Computer equipment and purchased software	\$ 7,914	\$ 6,678
Office equipment and furniture	1,964	1,840
Leasehold improvements	882	720
	10,760	9,238
Less: accumulated depreciation and amortization	(7,378)	(6,478)
	<u>\$ 3,382</u>	<u>\$ 2,760</u>

At December 31, 2011, our property and equipment, net included approximately \$26,000 of assets held at subsidiary and office locations outside of the United States of America.

**SPS COMMERCE, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

**Intangible Assets, net**

Intangible assets, net included the following (in thousands):

	December 31,					
	2011			2010		
	Carrying Amount	Accumulated Amortization	Net	Carrying Amount	Accumulated Amortization	Net
Subscriber relationships	\$ 7,180	\$ (2,394)	\$4,786	\$ 1,930	\$ (1,930)	\$ —
Non-competition agreements	1,450	(469)	981	580	(290)	290
	<u>\$ 8,630</u>	<u>\$ (2,863)</u>	<u>\$5,767</u>	<u>\$ 2,510</u>	<u>\$ (2,220)</u>	<u>\$290</u>

Amortization expense for intangible assets was \$643,000, \$0 and \$155,000 for the years ended December 31, 2011, 2010 and 2009, respectively. The amortization for 2009 was included in general and administrative expense in the consolidated statement of operations.

At December 31, 2011, future amortization expense for intangible assets was as follows (in thousands):

2012	\$1,040
2013	1,040
2014	861
2015	750
2016	750
Thereafter	1,036
	<u>\$5,477</u>

The table above does not include amounts related to non-competition agreements where the term of the agreement has not yet started. The term of such agreements, and the related amortization, begins with the termination of employment of the respective employee(s).

**NOTE D — Fair Value of Financial Instruments**

Fair value represents the price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. There are three levels of inputs that may be used to measure fair value:

- Level 1 — quoted prices in active markets for identical assets and liabilities.
- Level 2 — observable inputs other than quoted prices in active markets for identical assets and liabilities.
- Level 3 — unobservable inputs in which there is little or no market data available, which require the reporting entity to develop its own assumptions.

We previously had warrants outstanding to purchase 68,201 shares of our Series B redeemable convertible preferred stock. With the completion of our initial public offering in April 2010, these warrants were converted into warrants to purchase common stock and the related liability was transferred to additional paid-in capital in

**SPS COMMERCE, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

our consolidated balance sheets. See Note G for additional information. The table below presents a reconciliation of these preferred stock warrants, which were measured at fair value on a recurring basis using significant unobservable inputs (Level 3 inputs) (in thousands):

Balance at January 1, 2010	\$ 569
Total losses recognized	27
Converted into warrants to purchase common stock and liability transferred to additional paid-in capital	(596)
Balance at December 31, 2010	<u>\$ —</u>

**NOTE E — Debt**

***Revolving Credit Agreement***

On September 30, 2011, we entered into a revolving credit agreement with JPMorgan Chase Bank, N.A. The revolving credit agreement provides for a \$20 million revolving credit facility that we may draw upon from time to time, subject to certain terms and conditions, and will mature on September 30, 2016. Proceeds from the credit facility are anticipated to be used for acquisitions and our capital needs.

Interest on amounts borrowed under the credit facility is based on (i) an Adjusted LIBO Rate (as defined in the revolving credit agreement) plus an applicable margin of 175 to 225 basis points based on our net working capital, or (ii) JPMorgan's prime rate (provided it is not less than the Adjusted One Month LIBO Rate (as defined in the revolving credit agreement)) plus an applicable margin of -25 to 25 basis points based on our net working capital. Interest is payable monthly in arrears. Availability under the credit facility is subject to a borrowing base equal to the sum of 250% of our eligible monthly recurring revenue (as defined in the revolving credit agreement) and all borrowings are due in full no later than the maturity date of the agreement.

The revolving credit agreement contains customary representations, warranties, covenants and events of default, including, but not limited to financial covenants requiring us to maintain a fixed charge coverage ratio of not less than 1.20 to 1.00, cash and cash equivalents of not less than \$10 million and a minimum number of recurring revenue customers. If an event of default occurs, among other things, the applicable interest rate is subject to an increase of 2% and all outstanding obligations may become immediately due and payable.

There were no borrowings under the revolving credit agreement during 2011. As of December 31, 2011, there were no borrowings outstanding and approximately \$11.6 million was available for borrowings. We were in compliance with all covenants under the revolving credit agreement as of that date.

**NOTE F – Commitments and Contingencies**

***Capital Leases***

We previously leased certain computer equipment and purchased software under capital leases with an interest rate of 10.75%. These capital lease obligations were fully repaid in 2011.

***Operating Leases***

We are obligated under non-cancellable operating leases primarily for office space. Rent expense charged to operations was \$963,000, \$684,000 and \$682,000 for the years ended December 31, 2011, 2010 and 2009, respectively.

**SPS COMMERCE, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

At December 31, 2011, future minimum payments under operating leases were as follows (in thousands):

2012	\$1,071
2013	27
2014	—
2015	—
2016	—
Thereafter	—
	<u>\$1,098</u>

The lease for our current headquarters in Minneapolis, Minnesota expires in October 2012. A new lease agreement for this same location was executed subsequent to December 31, 2011, which is not reflected in the table above. See Note N for additional information.

***Management Incentive Agreements***

Our board of directors previously approved management incentive agreements that provide for a bonus to be paid to certain executive officers upon a sale of the company. The aggregate bonus is equal to 0.322% of the amount of the purchase price, as defined, exceeding \$25 million and less than \$65 million. The aggregate bonus under these agreements is limited to \$150,000. These management incentive agreements terminate on June 30, 2012, regardless of employment status. At December 31, 2011 and 2010, no expense or liability had been recorded relating to these agreements.

***Other Contingencies***

We are involved in various claims and legal actions in the normal course of business. Our management believes that the outcome of such claims and legal actions will not have a significant adverse effect on our financial position, results of operations or cash flows.

**NOTE G — Redeemable Convertible Preferred Stock and Stockholders' Equity (Deficit)**

***Reverse Stock Split***

On April 13, 2010, we effected a 0.267 for 1 reverse stock split in the form of a combination of our outstanding stock. All share and per share amounts in the accompanying financial statements and notes have been retroactively adjusted for all periods presented to give effect to the reverse stock split.

***Initial Public Offering***

On April 27, 2010, we completed our initial public offering of 4,711,198 shares of common stock at an offering price of \$12.00 per share. We issued and sold 3,114,504 shares, including 614,504 shares sold pursuant to the exercise in full of the underwriters' over-allotment option, and the selling stockholders sold 1,596,694 shares. We received proceeds of approximately \$33.0 million, after payment of underwriting discounts and commissions and legal, accounting and other fees incurred in connection with the offering. On April 30, 2010, approximately \$555,000 of the net proceeds was used to repay principal and interest on certain outstanding equipment loans.

At the close of the initial public offering, our previously outstanding shares of redeemable convertible preferred stock were automatically converted into 8,093,826 shares of common stock and warrants to purchase

**SPS COMMERCE, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

68,201 shares of redeemable convertible preferred stock were converted into warrants to purchase 68,201 shares of common stock. Accordingly, the related warrant liability of approximately \$596,000 was transferred to additional paid-in capital in our consolidated balance sheet. These common stock warrants have an exercise price of \$3.67 per share and expiration dates ranging from May 2011 to February 2016.

***Secondary Stock Offering***

On December 3, 2010, we completed a secondary stock offering of 3,301,926 shares of common stock at an offering price of \$12.25 per share. We issued and sold 115,000 shares, including 15,000 shares sold pursuant to the exercise in full of the underwriters' over-allotment option, and the selling stockholders sold 3,186,926 shares. We received proceeds of approximately \$1.0 million after payment of underwriting discounts and commissions and legal, accounting and other fees incurred in connection with the offering.

***Preferred Stock Warrants***

As discussed above, we previously had warrants outstanding to purchase 68,201 shares of our Series B redeemable convertible preferred stock. These warrants had an exercise price of \$3.67 per share and expiration dates ranging from May 2011 to February 2016. We classified these outstanding warrants as a liability in our consolidated balance sheets. These warrants were subject to revaluation at each balance sheet date and any change in fair market value was recognized as a component of other income (expense) in our consolidated statements of operations.

Prior to the conversion of the preferred stock warrants into common stock warrants, we recorded other expense of \$27,000 and \$381,000 for the years ended December 31, 2010 and 2009, respectively, for changes in the fair market value of these warrants.

***Redeemable Convertible Preferred Stock***

As discussed above, we previously had issued various classes of redeemable convertible preferred stock. The holders of our Series A, B, and C redeemable convertible preferred stock had the option to put their shares back to the company at the liquidation preference value, as defined in the Certificate of Incorporation, in the event of any liquidation, dissolution or winding up of the company, as defined.

None of the Series A, B and C redeemable convertible preferred stock had a mandatory redemption feature. In the event of a liquidation, as defined, the holders of Series C redeemable convertible preferred stock were entitled to receive, prior to and in preference to any distribution of any assets or surplus funds of the company to the holders of Series A and B redeemable convertible preferred stock or common stock, an amount in cash equal to \$5.99 per share plus accrued unpaid dividends. After the liquidation payment to Series C redeemable convertible preferred stockholders, the holders of Series B redeemable convertible preferred stock were entitled to receive, prior to and in preference to any distribution of any assets or surplus funds of the company to the holders of Series A redeemable convertible preferred stock or common stock, an amount in cash equal to \$3.67 per share plus accrued unpaid dividends. After the liquidation payment of Series B redeemable convertible preferred stockholders, the holders of Series A redeemable convertible preferred stock were entitled to receive, prior to and in preference to any distribution of any assets or surplus funds of the company to the holders of common stock, an amount in cash equal to \$8.65 per share plus accrued unpaid dividends. After the liquidation payment to Series A, B and C redeemable convertible preferred stockholders, holders of common stock and Series A, B and C redeemable convertible preferred stock would share pro rata in the remaining assets of the company.

**SPS COMMERCE, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

Each share of Series A, B, and C redeemable convertible preferred stock, at the option of the holder, was convertible into common shares at a conversion ratio equal to the conversion value divided by the conversion price. The conversion ratio was 1 to 1 at December 31, 2009. The conversion value and conversion price were initially set in our Fifth Amended and Restated Certificate of Incorporation at \$8.65, \$3.67 and \$5.99 for the Series A, B and C redeemable convertible preferred stock, respectively. The conversion price was subject to adjustment for certain dilutive issuances. We had not issued any dilutive instruments which would adjust the conversion price and, therefore, the conversion value and the conversion price had not changed since they were initially set.

Each share of Series A, B and C redeemable convertible preferred stock were to be automatically and immediately converted into shares of common stock upon the closing of a public offering pursuant to an effective registration statement at the then effective conversion ratio, if the offering price per share was not less than \$13.45 and the gross proceeds to the company were at least \$20,000,000. Each share of redeemable convertible preferred stock was subject to weighted-average anti-dilution price protection. The holders of the redeemable convertible preferred stock were entitled to dividends only when declared. No dividends had been declared since the issuance of the redeemable convertible preferred stock. The holders of Series A, B and C redeemable convertible preferred stock were generally entitled to vote on all matters submitted to a vote of stockholders, except those required by law to be submitted to a class vote.

**NOTE H — Stock-Based Compensation**

Our equity compensation plans provide for the grant of incentive and nonqualified stock options, as well as other stock-based awards, to employees, non-employee directors and other consultants who provide services to us. Stock options generally vest over three to four years and have a contractual term of ten years from the date of grant. During 2011, approximately 711,000 additional shares were authorized under our 2010 Equity Incentive Plan as available for grant and, at December 31, 2011, there were approximately 660,000 shares available for grant under approved equity compensation plans. Each award exercised results in the issuance of new shares.

We recorded non-cash stock-based compensation expense of \$1.8 million, \$750,000 and \$228,000 for the years ended December 31, 2011, 2010 and 2009, respectively. This expense was allocated as follows (in thousands):

	Year Ended December 31,		
	2011	2010	2009
Cost of revenues	\$ 255	\$103	\$ 46
Operating expenses			
Sales and marketing	471	211	91
Research and development	56	20	4
General and administrative	986	416	88
Total stock-based compensation expense	<u>\$1,768</u>	<u>\$750</u>	<u>\$229</u>

As of December 31, 2011, there was approximately \$4.3 million of unrecognized stock-based compensation expense under our equity compensation plans, which is expected to be recognized on a straight line basis over a weighted average period of approximately 2 years.

**SPS COMMERCE, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

Our stock option activity was as follows:

	Options (#)	Weighted Average Exercise Price (\$/share)
Outstanding at January 1, 2009	1,187,583	\$ 2.69
Granted	339,187	2.86
Exercised	(15,640)	0.37
Forfeited	(262,925)	7.98
Outstanding at December 31, 2009	1,248,205	1.65
Granted	479,691	11.87
Exercised	(157,056)	0.82
Forfeited	(21,496)	23.92
Outstanding at December 31, 2010	1,549,344	4.59
Granted	431,790	17.04
Exercised	(289,286)	2.15
Forfeited	(22,439)	11.38
Outstanding at December 31, 2011	<u>1,669,409</u>	8.14

Of the total outstanding options at December 31, 2011, 955,342 were exercisable with a weighted average exercise price of \$3.23 per share. The total outstanding options had a weighted average remaining contractual life of 6.2 years.

The fair value of options vested during the years ended December 31, 2011, 2010 and 2009 was \$1.3 million, \$200,000 and \$228,000, respectively.

The intrinsic value of options exercised during the years ended December 31, 2011, 2010 and 2009 was \$4.9 million, \$1.7 million and \$101,000, respectively. The intrinsic value of outstanding options was \$29.7 million, \$17.4 million and \$12.9 million at December 31, 2011, 2010 and 2009 respectively.

The weighted-average fair values per share of options granted during 2011, 2010 and 2009 were \$8.25, \$5.82 and \$1.54, respectively. The fair value of the options granted was estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions:

	2011	2010	2009
Weighted-average volatility	45%	46% - 49%	49% - 53%
Expected dividend yield	—	—	—
Expected life (in years)	6.25	6.25	4.0 - 7.0
Weighted-average risk-free interest rate	1.58% - 3.05%	1.79% - 3.14%	2.71% - 4.01%

Prior to becoming a public entity in 2010, historic volatility was not available for our shares. As a result, we estimated volatility based on a peer group of companies, which collectively provided a reasonable basis for estimating volatility. We intend to continue to consistently use the same group of publicly traded peer companies to determine volatility in the future until sufficient information regarding volatility of our share price becomes available or the selected companies are no longer suitable for this purpose.

We have not issued dividends on our common stock and do not expect to do so in the foreseeable future. The expected term of the options is based on evaluations of historical and expected future employee exercise

**SPS COMMERCE, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

behavior. The estimated pre-vesting forfeiture rate is based on our historical experience. The risk-free interest rate is based on the U.S. Treasury rates at the date of grant with maturity dates approximately equal to the expected life at the grant date.

**NOTE I — Income Taxes**

The provision (benefit) for income taxes was as follows (in thousands):

	Year Ended December 31,		
	2011	2010	2009
Current			
Federal	\$ —	\$41	\$36
State	89	23	27
Deferred			
Federal	(12,282)	26	26
State	(426)	2	2
	<u>\$(12,619)</u>	<u>\$92</u>	<u>\$91</u>

Our provision (benefit) for income taxes includes state income and franchise taxes and the release of a substantial portion of the valuation allowance on our deferred tax assets. The release of the valuation allowance is a non-cash event that indicates we expect the probability is more likely than not that we will generate sufficient future profits to fully utilize our deferred tax assets.

A reconciliation of the provision (benefit) for income taxes to the statutory federal rate was as follows (in thousands):

	Year Ended December 31,		
	2011	2010	2009
Expected federal income tax at statutory rate	\$ 396	\$ 1,013	\$ 420
State income taxes, net of federal tax effect	37	75	52
Tax impact of foreign activity	55	—	—
Permanent book/tax differences	100	106	83
Change in valuation allowance	(1,310)	(6,475)	(751)
Release of valuation allowance	(12,802)	—	—
Section 382 limitation	415	6,427	—
Prior year true up	43	69	100
AMT expense	—	71	36
General business credit	—	(107)	—
State net operating loss adjustment	413	(1,087)	—
Other	34	—	151
Total provision (benefit) for income taxes	<u>\$(12,619)</u>	<u>\$ 92</u>	<u>\$ 91</u>

As of December 31, 2011, we had an income tax receivable of \$90,000, which is included in prepaid expenses and other current assets in the consolidated balance sheets.

As of December 31, 2011, we had net operating loss carryforwards of \$51.1 million for U.S. federal tax purposes and \$22.5 million of various state net operating loss carryforwards. Our net operating loss carryforwards will expire between 2012 and 2031 if not utilized.



**SPS COMMERCE, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

Section 382 of the U.S. Internal Revenue Code generally imposes an annual limitation on the amount of net operating loss carryforwards that might be used to offset taxable income when a corporation has undergone significant changes in stock ownership. We have performed a Section 382 analysis for the time period from our inception through December 8, 2010. During this time period it was determined that we had six separate ownership changes under Section 382. We have not updated the Section 382 analysis subsequent to December 8, 2010; however, we believe there have not been any events subsequent to that date that would impact the analysis. We believe that approximately \$17.6 million of federal losses and \$13.0 million of state losses will expire unused due to Section 382 limitations. The maximum annual limitation of federal net operating losses under Section 382 is approximately \$990,000. The limitation could be further restricted if ownership changes occur in future years.

Our federal and state net operating losses at December 31, 2011 include \$5.9 million and \$0.9 million, respectively, of income tax deductions in excess of previously recorded tax benefits. Although these additional tax deductions are included in the net operating losses referenced above, the related tax benefit will not be recognized until the deductions reduce our income taxes payable. The tax benefit of these excess deductions will be reflected as a credit to additional paid in capital when recognized. Accordingly, our deferred tax assets are reported net of the excess tax deductions for stock compensation and Section 382 limitations.

Realization of our net operating loss carryforwards and other deferred tax temporary differences are contingent upon future taxable earnings. We assess our ability to realize our deferred tax assets on a regular and periodic basis. Based on our assessments prior to the fourth quarter of 2011, we had provided full valuation allowances against all of our deferred tax assets. The valuation allowances had been provided because our management determined that it was more-likely-than-not that we would not realize these deferred tax assets, largely due to our history of taxable losses since inception.

Based on our assessment during the fourth quarter of 2011, we determined that it was more-likely-than-not that we would be able to realize \$12.8 million of our deferred tax assets, which enabled us to release a substantial portion of the valuation allowance previously recorded. This determination was based on weighing both the positive and negative evidence available including, but not limited to, our earnings history, our projected future taxable income, our business strategy and the nature of each of our deferred tax assets. The remaining valuation allowance of \$369,000 relates to various state net operating loss carryforwards, state credit carryforwards and foreign net operating loss carryforwards that we do not expect to utilize.

The assessment of our valuation allowance against our deferred tax assets requires significant judgment. If our estimates of future taxable income vary from actual results, our assessment regarding the realization of our deferred tax assets could change. Future changes in the estimated amount of deferred taxes that are expected to be realized will be reflected in our consolidated financial statements in the period the estimate is changed, with a corresponding adjustment to our operating results.

**SPS COMMERCE, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

The significant components of our deferred tax assets (liabilities) were as follows (in thousands):

	December 31,	
	2011	2010
<b>Current</b>		
Current net operating loss and credit carryforwards	\$ 856	\$ —
Accounts receivable allowance	126	115
Accrued expenses	390	346
Total current deferred tax asset	<u>1,372</u>	<u>461</u>
Deferred operations	(589)	(315)
Total current deferred tax liability	<u>(589)</u>	<u>(315)</u>
Valuation allowance	—	(146)
Net current deferred tax asset	<u>\$ 783</u>	<u>\$ —</u>
<b>Non-current</b>		
Net operating loss and credit carryforwards	\$ 9,342	\$ 12,636
Deferred operations	1,413	1,116
Stock option expense	718	—
Depreciation and amortization	672	444
Other	11	—
Total non-current deferred tax asset	12,156	14,196
Valuation allowance	(369)	(14,334)
Net non-current deferred tax asset	<u>\$11,787</u>	<u>\$ (138)</u>

We are subject to income taxes in the U.S. federal and various state and international jurisdictions. We are generally subject to U.S. federal and state tax examinations for all tax years since 1995 due to our net operating loss carryforwards and the utilization of the carryforwards in years still open under statute. As of December 31, 2011 we are not under any income tax audits by tax authorities.

As of December 31, 2011, we do not have any unrecognized tax benefits. It is our practice to recognize interest and penalties accrued on any unrecognized tax benefits as a component of income tax expense. We do not expect any material changes in our unrecognized tax positions over the next 12 months.

**SPS COMMERCE, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

**NOTE J — Net Income per Share**

The following table presents the components of the computation of basic and diluted net income per share for the periods indicated (in thousands, except per share amounts):

	Year Ended December 31,		
	2011	2010	2009
<b>Numerator</b>			
Net income	<u>\$13,703</u>	<u>\$ 2,884</u>	<u>\$1,162</u>
<b>Denominator</b>			
Weighted average common shares outstanding, basic	11,960	8,036	329
Options and warrants to purchase common and preferred stock	784	973	791
Redeemable convertible preferred stock	—	2,587	8,148
Weighted average common shares outstanding, diluted	<u>12,744</u>	<u>11,596</u>	<u>9,268</u>
<b>Net income per share</b>			
Basic	<u>\$ 1.15</u>	<u>\$ 0.36</u>	<u>\$ 3.53</u>
Diluted	<u>\$ 1.08</u>	<u>\$ 0.25</u>	<u>\$ 0.13</u>

Approximately 19,000 outstanding options and warrants were excluded from the computation of diluted net income per share for the year ended December 31, 2009 because they were anti-dilutive.

**NOTE K — Employee Benefit Plan**

We sponsor a 401(k) retirement savings plan whereby employees are allowed to contribute up to 100% of their salaries and the company will match 25% up to the first 6%. Our matching contributions to the plan, which vest immediately, were \$287,000, \$241,000 and \$219,000 for the years ended December 31, 2011, 2010 and 2009, respectively.

**NOTE L — Guarantees**

We provide limited guarantees to certain customers through service level agreements. These service level agreements are defined in the master agreements with the customer and performance is measured on a monthly basis for the life of the contract. Service level agreements require us to perform at specified levels which would include, but are not limited to, document processing times, data center availability, customer support and issue resolution.

**NOTE M — Selected Quarterly Financial Data (Unaudited)**

The following table presents our selected unaudited quarterly statements of operations data (in thousands, except per share amounts):

2011	For the Three Months Ended			
	Mar 31	Jun 30	Sep 30	Dec 31
Revenue	\$12,649	\$13,937	\$15,529	\$15,854
Gross profit	9,328	10,187	11,453	11,635
Operating income (loss)	507	(41)	270	399
Net income (loss)	492	(109)	177	13,143
Diluted earnings (loss) per share	0.04	(0.01)	0.01	1.02

**SPS COMMERCE, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

2010	For the Three Months Ended			
	Mar 31	Jun 30	Sep 30	Dec 31
Revenue	\$10,243	\$10,944	\$11,491	\$11,919
Gross profit	7,262	7,843	8,280	8,586
Operating income	1,047	679	868	442
Net income	919	638	886	441
Diluted earnings per share	0.10	0.05	0.07	0.04

**NOTE N — Subsequent Event (Unaudited)**

On February 14, 2012, we executed a new lease agreement for our current headquarters location which commences on November 1, 2012 and expires on April 30, 2020. The lease includes additional square footage upon commencement, an automatic expansion of space on or about September 1, 2013, a right of first offer to lease certain additional space, and two options to extend the term of the lease for three years at a market rate determined in accordance with the lease. In connection with this new lease, we will deliver to the landlord cash or an irrevocable letter of credit for approximately \$172,000, subject to increase based on square footage expansion, as security for performance of our obligations under the lease.

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**Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure**

None.

**Item 9A. Controls and Procedures**

**Evaluation of Disclosure Controls and Procedures**

We evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of December 31, 2011, the end of the period covered by this Annual Report on Form 10-K. This evaluation was done under the supervision and with the participation of management, including our Chief Executive Officer (“CEO”) and Chief Financial Officer (“CFO”). Disclosure controls and procedures means controls and other procedures that are designed to provide reasonable assurance that information required to be disclosed in the reports that we file or submit under the Securities and Exchange Act of 1934, as amended (the “Exchange Act”), such as this Annual Report on Form 10-K, is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission (“SEC”). Disclosure controls and procedures include, without limitation, controls and procedures designed such that information is accumulated and communicated to our management, including our CEO and CFO, as appropriate to allow timely decisions regarding required disclosure. Based on this evaluation, our CEO and CFO have concluded that as of December 31, 2011, our disclosure controls and procedures were effective.

**Management’s Annual Report on Internal Control Over Financial Reporting**

Our management is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act as a process designed by, or under the supervision of, our principal executive and principal financial officer and effected by our board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that:

- pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of our assets;
- provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that our receipts and expenditures are being made only in accordance with authorizations of our management and directors; and
- provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on our financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Under the supervision and with the participation of management, including our principal executive and financial officers, we assessed our internal control over financial reporting as of December 31, 2011, based on criteria for effective internal control over financial reporting established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this assessment, management concluded that we maintained effective internal control over financial reporting as of December 31, 2011 based on the specified criteria.

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The effectiveness of our internal control over financial reporting as of December 31, 2011 has been audited by Grant Thornton LLP, our independent registered public accounting firm, as stated in their report, which is included under Item 8 of this Annual Report on Form 10-K.

**Changes in Internal Control over Financial Reporting**

There were no changes in our internal control over financial reporting during the most recent fiscal quarter ended December 31, 2011 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**Item 9B. Other Information**

None.

**PART III**

**Item 10. Directors, Executive Officers and Corporate Governance**

The information required by this item with respect to executive officers is contained in Item 1 of this Annual Report on Form 10-K under the heading “Executive Officers” and with respect to other information relating to our directors and executive officers will be set forth in our 2012 Proxy Statement under the caption “Item 1 — Election of Directors,” which will be filed no later than 120 days after the end of the fiscal year covered by this Annual Report on Form 10-K, and is incorporated herein by reference.

The information required by this item under Item 405 of Regulation S-K is incorporated herein by reference to the section titled “Section 16(a) Beneficial Ownership Reporting Compliance” of our 2012 Proxy Statement, which will be filed no later than 120 days after the end of the fiscal year covered by this Annual Report on Form 10-K. The information required by this item under Item 407(d)(4) and (d)(5) of Regulation S-K is incorporated herein by reference to the section titled “Information Regarding the Board of Directors and Corporate Governance — Board Committees — Audit Committee” of our 2012 Proxy Statement, which will be filed no later than 120 days after the end of the fiscal year covered by this Annual Report on Form 10-K.

We have adopted a code of business conduct applicable to our directors, officers (including our principal executive officer and principal financial officer) and employees. The Code of Business Conduct is available on our website at [www.spscommerce.com](http://www.spscommerce.com) under the Investor Relations section. We plan to post on our website at the address described above any future amendments or waivers of our Code of Conduct.

**Item 11. Executive Compensation**

Information related to security ownership required by this item is incorporated herein by reference to the sections titled “Executive Compensation,” and “Certain Relationships and Related Transactions — Compensation Committee Interlocks and Insider Participation” of our 2012 Proxy Statement, which will be filed no later than 120 days after the end of the fiscal year covered by this Annual Report on Form 10-K.

**Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters**

Information related to security ownership required by this item is incorporated herein by reference to the section titled “Security Ownership” of our 2012 Proxy Statement, which will be filed no later than 120 days after the end of the fiscal year covered by this Annual Report on Form 10-K. Information related to our equity compensation plans required by this item is incorporated herein by reference to the section titled “Executive Compensation — Outstanding Equity Awards” of our 2012 Proxy Statement, which will be filed no later than 120 days after the end of the fiscal year covered by this Annual Report on Form 10-K.

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**Item 13. *Certain Relationships and Related Transactions, and Director Independence***

Information required by this item is incorporated herein by reference to the sections titled “Certain Relationships and Related Transactions,” and “Information Regarding the Board of Directors and Corporate Governance — Director Independence” of our 2012 Proxy Statement, which will be filed no later than 120 days after the end of the fiscal year covered by this Annual Report on Form 10-K.

**Item 14. *Principal Accounting Fees and Services***

Information required by this item is incorporated herein by reference to the section titled “Audit Committee Report and Payment of Fees to Our Independent Auditor” of our 2012 Proxy Statement, which will be filed no later than 120 days after the end of the fiscal year covered by this Annual Report on Form 10-K.

**PART IV**

**Item 15. *Exhibits, Financial Statement Schedules***

The following documents are filed as a part of this Annual Report on Form 10-K:

- (a) Financial Statements: The financial statements filed as a part of this report are listed in Part II, Item 8.
- (b) Financial Statement Schedules: The schedules are either not applicable or the required information is presented in the consolidated financial statements or notes thereto.
- (c) Exhibits: The exhibits incorporated by reference or filed as a part of this Annual Report on Form 10-K are listed in the Exhibit Index immediately following the signatures to this report.

**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) 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.

Dated: March 9, 2012

**SPS COMMERCE, INC.**

By: /s/ ARCHIE C. BLACK

Archie C. Black  
*President and Chief Executive Officer*

Each of the undersigned hereby appoints Archie C. Black and Kimberly K. Nelson, and each of them (with full power to act alone), as attorneys and agents for the undersigned, with full power of substitution, for and in the name, place and stead of the undersigned, to sign and file with the Securities and Exchange Commission under the Securities Act of 1934, any and all amendments and exhibits to this annual report on Form 10-K and any and all applications, instruments, and other documents to be filed with the Securities and Exchange Commission pertaining to this annual report on Form 10-K or any amendments thereto, with full power and authority to do and perform any and all acts and things whatsoever requisite and necessary or desirable. Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities indicated on March 9, 2012.

<u>Name and Signature</u>	<u>Title</u>
<u>/s/ ARCHIE C. BLACK</u> Archie C. Black	<i>Chief Executive Officer, President and Director (principal executive officer)</i>
<u>/s/ KIMBERLY K. NELSON</u> Kimberly K. Nelson	<i>Executive Vice President and Chief Financial Officer (principal financial and accounting officer)</i>
<u>/s/ DANIEL R. FISHBACK</u> Daniel R. Fishback	<i>Director</i>
<u>/s/ MICHAEL B. GORMAN</u> Michael B. Gorman	<i>Director</i>
<u>/s/ MARTIN J. LEESTMA</u> Martin J. Leestma	<i>Director</i>
<u>/s/ PHILIP E. SORAN</u> Philip E. Soran	<i>Director</i>
<u>/s/ GEORGE H. SPENCER, III</u> George H. Spencer, III	<i>Director</i>
<u>/s/ SVEN A. WEHRWEIN</u> Sven A. Wehrwein	<i>Director</i>



**EXHIBIT INDEX**

<u>Exhibit Number</u>	<u>Exhibit Description</u>	<u>Incorporated By Reference</u>			<u>Exhibit Number</u>	<u>Filed Herewith</u>
		<u>Form</u>	<u>File Number</u>	<u>Date of First Filing</u>		
2.1	Asset Purchase Agreement, dated as of May 17, 2011, by and between Direct EDI LLC and the registrant	8-K	001-34702	05/23/2011	2.1	
3.1	Amended and Restated Certificate of Incorporation	S-1/A	333-163476	04/13/2010	3.1	
3.2	Amended and Restated Bylaws	S-1/A	333-163476	03/05/2010	3.2	
4.1	Registration Rights Agreement, as amended	8-K	001-34702	05/06/2011	10.2	
10.1	1999 Equity Incentive Plan**	S-1/A	333-163476	01/11/2010	10.1	
10.2	Form of Option Agreement under 1999 Equity Incentive Plan**	S-1/A	333-163476	01/11/2010	10.2	
10.3	2001 Stock Option Plan**	S-1/A	333-163476	01/11/2010	10.3	
10.4	Form of Incentive Stock Option Agreement under 2001 Stock Option Plan**	S-1/A	333-163476	01/11/2010	10.4	
10.5	Form of Non-Statutory Stock Option Agreement (Director) under 2001 Stock Option Plan**	S-1/A	333-163476	01/11/2010	10.5	
10.6	2010 Equity Incentive Plan**	S-1/A	333-163476	03/05/2010	10.6	
10.7	Form of Incentive Stock Option Agreement under 2010 Equity Incentive Plan**	8-K	001-34702	02/17/2012	10.2	
10.8	Form of Non-Statutory Stock Option Agreement (Employee) under 2010 Equity Incentive Plan**	8-K	001-34702	02/17/2012	10.3	
10.9	Form of Non-Statutory Stock Option Agreement (Director) under 2010 Equity Incentive Plan**	8-K	001-34702	02/17/2012	10.4	
10.10	Form of Restricted Stock Unit Award Agreement under 2010 Equity Incentive Plan**	8-K	001-34702	02/17/2012	10.5	
10.11	2002 Management Incentive Agreement between the Company and Archie C. Black**	S-1/A	333-163476	01/11/2010	10.14	
10.12	2002 Management Incentive Agreement between the Company and James J. Frome**	S-1/A	333-163476	01/11/2010	10.15	
10.13	Non-Employee Director Compensation Policy**	S-1/A	333-163476	02/12/2010	10.16	
10.14	Form of Indemnification Agreement for Steve A. Cobb, Michael B. Gorman, and George H. Spencer, III	S-1/A	333-163476	01/11/2010	10.17	

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<u>Exhibit Number</u>	<u>Exhibit Description</u>	<u>Incorporated By Reference</u>			<u>Filed Herewith</u>
		<u>Form</u>	<u>File Number</u>	<u>Date of First Filing</u>	
10.15	Form of Indemnification Agreement for Martin J. Leestma, Philip E. Soran and Sven A. Wehrwein	S-1/A	333-163476	01/11/2010	10.18
10.16	Form of Indemnification Agreement for Archie C. Black**	S-1/A	333-163476	01/11/2010	10.19
10.17	Employment Agreement between the Company and Archie C. Black**	S-1/A	333-163476	03/05/2010	10.20
10.18	Form of At-will Confidentiality Agreement Regarding Certain Terms and Conditions of Employment for Kimberly K. Nelson, James J. Frome, Michael J. Gray and David J. Novak, Jr.**	S-1/A	333-163476	03/05/2010	10.21
10.19	Revolving Credit Agreement, dated as of September 30, 2011, by and between the registrant and JPMorgan Chase Bank, N.A.	8-K	001-34702	10/03/2011	10.1
10.20	Standard Form Office Lease, dated as of February 14, 2012, by and between the registrant and CSDV-MN Limited Partnership	8-K	001-34702	02/17/2012	10.1
21.1	Subsidiaries of the registrant				X
23.1	Consent of Grant Thornton LLP				X
24.1	Power of Attorney (included on signature page)				X
31.1	Certification of Principal Executive Officer pursuant to Rules 13a-14(a) under the Securities Exchange Act of 1934, as amended				X
31.2	Certification of Principal Financial Officer pursuant to Rules 13a-14(a) under the Securities Exchange Act of 1934, as amended				X
32.1	Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Sec. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002				X
101	Interactive Data Files Pursuant to Rule 405 of Regulation S-T				X

\*\* Indicates management contract or compensatory plan or arrangement.

**List of SPS Commerce, Inc. Subsidiaries**

SPS Commerce International, Inc. (Delaware)  
SPS Commerce Hong Kong Limited (Hong Kong)

**Consent of Independent Registered Public Accounting Firm**

We have issued our reports dated March 9, 2012, with respect to the consolidated financial statements included in the Annual Report of SPS Commerce, Inc. on Form 10-K for the year ended December 31, 2011. We hereby consent to the incorporation by reference of said reports in the Registration Statements of SPS Commerce, Inc. on Form S-3 (File No. 333-174026, effective June 7, 2011) and on Forms S-8 (File No. 333-179236, effective January 27, 2012, File No. 333-172073, effective February 4, 2011 and File Nos. 333-167315 and 333-167314, effective June 4, 2010).

/S/ GRANT THORNTON LLP  
Minneapolis, Minnesota  
March 9, 2012

## CERTIFICATION PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT

I, Archie C. Black, certify that:

1. I have reviewed this Annual Report on Form 10-K of SPS Commerce, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this report;
4. The Registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Registrant and have:
  - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c. Evaluated the effectiveness of the Registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d. Disclosed in this report any change in the Registrant's internal control over financial reporting that occurred during the Registrant's most recent fiscal quarter (the Registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Registrant's internal control over financial reporting; and
5. The Registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant's auditors and the audit committee of the Registrant's board of directors (or persons performing the equivalent functions):
  - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant's ability to record, process, summarize and report financial information; and
  - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal control over financial reporting.

/s/ ARCHIE C. BLACK

Archie C. Black

*President and Chief Executive Officer*

*(principal executive officer)*

March 9, 2012

## CERTIFICATION PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT

I, Kimberly K. Nelson, certify that:

1. I have reviewed this Annual Report on Form 10-K of SPS Commerce, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this report;
4. The Registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Registrant and have:
  - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c. Evaluated the effectiveness of the Registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d. Disclosed in this report any change in the Registrant's internal control over financial reporting that occurred during the Registrant's most recent fiscal quarter (the Registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Registrant's internal control over financial reporting; and
5. The Registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant's auditors and the audit committee of the Registrant's board of directors (or persons performing the equivalent functions):
  - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant's ability to record, process, summarize and report financial information; and
  - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal control over financial reporting.

/s/ KIMBERLY K. NELSON

Kimberly K. Nelson

*Executive Vice President and Chief Financial Officer*

*(principal financial and accounting officer)*

March 9, 2012

**CERTIFICATION PURSUANT TO  
18 U.S.C. §1350  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Annual Report on Form 10-K of SPS Commerce, Inc. (the "Company") for the period ended December 31, 2011, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned, the Chief Executive Officer and the Chief Financial Officer of the Company, hereby certify, pursuant to and for purposes of 18 U.S.C. §1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ ARCHIE C. BLACK

Archie C. Black

*President and Chief Executive Officer*

/s/ KIMBERLY K. NELSON

Kimberly K. Nelson

*Executive Vice President and Chief Financial Officer*

March 9, 2012