

ExactTarget, Inc.  
Form 10-Q  
May 14, 2012  
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As filed with the Securities and Exchange Commission on May 11, 2012

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**Form 10-Q**

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

For the quarterly period ended March 31, 2012

For the quarterly period ended March 31, 2012

OR

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

Commission File Number 001-35461

# ExactTarget, Inc.

(Exact name of registrant as specified in its charter)

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

**20-1367351**  
(I.R.S. Employer

Identification Number)

**20 North Meridian Street, Suite 200**

**Indianapolis, Indiana**  
(Address of principal executive offices)

**46204**  
(Zip Code)

**(317) 423-3928**

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☐ No ☐

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

Large accelerated filer ☐

Accelerated Filer ☐

Non-accelerated filer ☒ (Do not check if smaller reporting company)

Smaller reporting company ☐

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

As of May 7, 2012 there were approximately 65,906,733 shares of the registrant's common stock outstanding.

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**Table of Contents****PART I. FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****EXACTTARGET, INC.****Condensed Consolidated Balance Sheets****(Unaudited; in thousands, except share data)**

	As of March 31, 2012	As of December 31, 2011
<b>Assets</b>		
<i>Current Assets:</i>		
Cash and cash equivalents	\$ 211,535	\$ 60,705
Accounts receivable, net of allowances of \$1,119 and \$775 as of March 31, 2012 and December 31, 2011, respectively	42,479	43,380
Prepaid expenses and other current assets	10,433	11,186
Total current assets	264,447	115,271
Property and equipment, net	54,121	54,616
Goodwill	18,530	18,447
Other non-current assets	4,850	4,950
Total assets	\$ 341,948	\$ 193,284
<b>Liabilities and Stockholders Equity</b>		
<i>Current Liabilities:</i>		
Accounts payable	\$ 6,625	\$ 8,124
Accrued liabilities	9,646	10,725
Accrued compensation and related expenses	9,935	14,167
Current portion of long-term obligations and other	1,476	4,787
Deferred revenue	43,848	39,273
Total current liabilities	71,530	77,076
Long-term portion of debt		13,333
Other non-current liabilities	4,749	5,134
Total liabilities	\$ 76,279	\$ 95,543
<i>Redeemable convertible preferred stock:</i>		
Series E, Series F, and Series G redeemable convertible preferred stock at respective redemption value. Authorized 4,912,646 shares; issued and outstanding no shares and 4,912,646 at March 31, 2012, and December 31, 2011, respectively;	\$	\$ 63,000
<i>Stockholders equity:</i>		
Common stock, \$0.0005 par value. Authorized 300,000,000 shares; Issued and outstanding 65,899,266 and 9,042,346 shares at March 31, 2012 and December 31, 2011, respectively;	33	5
Additional paid in capital	417,250	17,031
Series A, Series B, and Series D preferred stock, at respective issuance date fair value. Authorized 18,554,573 shares; issued and outstanding no shares and 18,554,573 at March 31, 2012 and December 31, 2011, respectively;		164,894
Accumulated other comprehensive loss	(793)	(1,051)
Accumulated deficit	(150,821)	(146,138)

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Total stockholders' equity	265,669	34,741
Total liabilities and stockholders' equity	\$ 341,948	\$ 193,284

See accompanying notes to condensed consolidated financial statements.

**Table of Contents****EXACTTARGET, INC.****Condensed Consolidated Statements of Operations and Comprehensive Loss****(Unaudited; in thousands, except share and per share data)**

	Three Months Ended March 31,	
	2012	2011
Revenue:		
Subscription	\$ 51,147	\$ 37,223
Professional services	12,910	6,803
Total revenue	64,057	44,026
Cost of revenue:		
Subscription	12,710	8,676
Professional services	11,131	5,990
Total cost of revenues	23,841	14,666
Gross profit	40,216	29,360
Operating expenses:		
Sales and marketing	25,215	20,325
Research and development	11,160	8,437
General and administrative	8,270	5,557
Total operating expenses	44,645	34,319
Operating loss	(4,429)	(4,959)
Other expense, net	(254)	(248)
Loss before taxes	(4,683)	(5,207)
Income tax benefit		(1,945)
Net loss	\$ (4,683)	\$ (3,262)
Other comprehensive loss:		
Foreign currency translation adjustment	258	90
Comprehensive loss	\$ (4,425)	\$ (3,172)
Net loss per common share basic and diluted	\$ (0.32)	\$ (0.38)
Weighted average number of common shares outstanding basic and diluted	14,732,963	8,561,066

See accompanying notes to condensed consolidated financial statements.

**Table of Contents****EXACTTARGET, INC.****Condensed Consolidated Statements of Cash Flows****(Unaudited; in thousands)**

	Three Months Ended March 31,	
	2012	2011
Cash flows from operating activities:		
Net loss	\$ (4,683)	\$ (3,262)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	5,215	3,667
Provision for doubtful accounts	(181)	282
Stock-based compensation	2,178	1,323
Change in deferred taxes		(1,422)
Other	38	6
Changes in operating assets and liabilities:		
Accounts receivable, net	1,388	829
Prepaid expenses and other assets	671	(1,119)
Accounts payable and accrued liabilities	(889)	590
Accrued compensation and related expenses	(4,268)	(1,903)
Deferred revenue	4,143	759
Net cash provided by (used in) operating activities	3,612	(250)
Cash flows from investing activities:		
Business combination	(806)	
Purchases of property and equipment	(4,801)	(5,520)
Net cash used in investing activities	(5,607)	(5,520)
Cash flows from financing activities:		
Repayments on capital leases	(194)	(162)
Net payments on term loan and revolving line of credit	(16,667)	(833)
Proceeds from issuance of common stock from option exercises	467	56
Payments of contingent consideration	(456)	(603)
Proceeds from issuance of preferred stock, net of issuance costs		30,000
Proceeds from issuance of common stock, net of issuance costs	169,709	
Net cash provided by financing activities	152,859	28,458
Effect of exchange rate changes on cash and cash equivalents	(34)	44
Increase in cash and cash equivalents	150,830	22,732
Cash and cash equivalents, beginning of the period	60,705	22,804
Cash and cash equivalents, end of the period	\$ 211,535	\$ 45,536
Supplemental Disclosures:		
Net cash paid for interest	\$ 282	\$ 89
Supplemental disclosure of noncash investing activities:		
Change in payables for purchases of property and equipment	\$ (657)	\$ (861)
Capital lease obligation entered into for property and equipment	\$ 239	\$ 166

See accompanying notes to condensed consolidated financial statements.





**Table of Contents****EXACTTARGET, INC.****Notes to Condensed Consolidated Financial Statements****(Unaudited; in thousands except share data or stated otherwise)****(1) Summary of Significant Accounting Policies*****(a) Description of Business***

ExactTarget, Inc. ( ExactTarget or the Company ), headquartered in Indianapolis, Indiana, is a leading global provider of cross-channel, interactive marketing software-as-a-service ( SaaS ) solutions that provide marketers with a suite of integrated applications to plan, automate, deliver and optimize data-driven, interactive marketing campaigns and real-time communications. The Company's suite of cross-channel, interactive marketing applications, which include email, mobile, social media and sites, is built on a highly-scalable and flexible multi-tenant SaaS platform.

***(b) Principles of Consolidation***

The accompanying unaudited condensed consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission ( SEC ). Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America ( GAAP ) have been condensed or omitted pursuant to such rules and regulations. Interim results are not necessarily indicative of results for a full year. The information included in this Form 10-Q should be read in conjunction with the 2011 consolidated financial statements included in the Company's registration statement on Form S-1 filed with the U.S. Securities and Exchange Commission in March 2012.

***(c) Use of Estimates***

The preparation of financial statements requires the Company's management to make a number of estimates and assumptions related to the reported amount of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of revenues and expenses during the reporting period. Significant items subject to such estimates and assumptions include the allowance for doubtful accounts receivable, allowance for future credits, valuation of deferred tax assets, and the valuation of share-based payments. Actual results could differ from these estimates.

***(d) Segments***

The Company manages its operations as a single segment for purposes of assessing performance and making operating decisions. Revenue is generated predominately in the United States, and all significant assets are held in the United States.

Revenue by geographic region, based on the billing address of the clients, was as follows for the periods presented:

	Three Months Ended March 31,	
	2012	2011
United States	\$ 53,137	\$ 39,526
International	10,920	4,500
<b>Total revenue</b>	<b>\$ 64,057</b>	<b>\$ 44,026</b>

Percentage of revenue generated outside the United States 17% 10%

No single country outside the United States represented more than 10% of revenue during any period reported.

**Table of Contents****(e) Foreign Currency Translation**

The U.S. dollar is the reporting currency for all periods presented. The financial information for entities outside the United States is measured using the local currency as the functional currency. All assets and liabilities denominated in foreign currency are translated to U.S. Dollars at the exchange rate on the balance sheet date. Revenue and expenses are translated at the average exchange rate during the period. Equity transactions are translated using historic exchange rates.

**(f) Net Loss per Common Share**

Basic net loss per common share is computed by dividing net loss by the weighted average number of common shares outstanding for the period in accordance with FASB ASC Topic 260, *Earnings per Share*. Diluted net loss per common share is computed by dividing the sum of net loss available for common stockholders by the sum of the weighted average number of common shares outstanding and any dilutive potential common equivalents for the period.

The numbers of preferred stock, stock options and restricted stock awards that could potentially dilute loss per basic share in the future, but have not been included in the computation of loss per diluted share because to do so would have been antidilutive, were 47,484,578 and 42,919,034 shares for the three month periods ended March 31, 2012 and 2011, respectively.

**(g) Recent Accounting Pronouncements**

On January 1, 2012, the Company adopted the guidance set forth in Accounting Standards Update No. 2011-08, *Testing Goodwill for Impairment (Topic 350)*. The Company conducts a test for the impairment of goodwill at least annually and more frequently upon the occurrence of certain events. The adoption of this update did not impact the consolidated results of operations and financial condition.

On January 1, 2012, the Company adopted Accounting Standards Update No. 2011-05, *Presentation of Comprehensive Income (Topic 220)*. The standard update had no impact on the Company's financial position or results of operations, but resulted in a change in the presentation of the Company's basic financial statements.

**(2) Property and Equipment**

Property and equipment, including assets held under capital leases, are summarized as follows as of March 31, 2012 and December 31, 2011. Construction in progress represents costs associated with new equipment, office leasehold improvements, and software not yet placed in service as of March 31, 2012 and December 31, 2011.

	As of March 31, 2012	As of December 31, 2011	Estimated Useful Life (in Years)
Furniture and equipment	\$ 56,454	\$ 55,581	2-7
Software	26,356	23,217	5
Leasehold improvements	11,364	10,881	*
Construction in progress	459	1,508	
<b>Total property and equipment</b>	<b>94,633</b>	<b>91,187</b>	
Less accumulated depreciation and amortization	(40,512)	(36,571)	
<b>Total property and equipment, net</b>	<b>\$ 54,121</b>	<b>\$ 54,616</b>	

\* Shorter of lease term or estimated useful life.

Depreciation and amortization expense totaled \$4.9 million and \$3.4 million for March 31, 2012 and 2011, respectively.

**(3) Goodwill and Intangible Assets**

Goodwill and intangible assets consisted of the following:

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	As of March 31, 2012	As of December 31, 2011	Economic Useful Life Indefinite
Goodwill	\$ 18,530	\$ 18,447	
Customer lists	2,550	2,501	4-5
Software technology	1,200	1,200	4
Noncompete agreements	1,710	1,673	2-3
Total gross intangible assets	5,460	5,374	
Less accumulated amortization	(2,438)	(2,088)	
Net intangible assets	\$ 3,022	\$ 3,286	

The estimated future amortization expense related to intangible assets as of March 31, 2012, is as follows:

	Amortization Expense
2012	\$ 864
2013	1,007
2014	628
2015	362
2016	161
Thereafter	
Total amortization expense	\$ 3,022

Amortization expense was \$0.3 million and \$0.3 million for the three month periods ended March 31, 2012 and 2011, respectively.

**(4) Acquisitions***mPath Global Pty Ltd.*

In August 2010, the Company acquired certain assets and liabilities of mPath for \$2.0 million. During the three month period ended March 31, 2012, the Company paid the \$0.4 million estimated fair value of contingent consideration due as agreed upon in the original acquisition purchase price.

*Frontier Technologia, Ltda.*

In August 2011, the Company acquired all outstanding shares of Frontier for \$5.4 million in stock and cash consideration, net of cash acquired. During the three month period ended March 31, 2012, the Company paid the \$0.8 million escrow due as agreed upon in the original acquisition purchase price.

**(5) Notes Payable**

In February 2012, the Company entered into a fourth loan modification agreement that modified the Company's existing Loan and Security Agreement. The fourth loan modification set forth the criteria under the financial covenants for 2012.

During the three months ended March 31, 2012, the Company made payments of \$10.0 million and \$6.7 million on its bank term loan and revolving line of credit, respectively.

In April 2012, the Company terminated its Loan and Security Agreement, pursuant to which the Company had received a \$10.0 million bank term loan and a \$20.0 million revolving line of credit.

**(6) Income Taxes    Valuation Allowance**

The Company evaluates whether it will realize the benefits of its net deferred tax assets and establishes a valuation allowance to reduce the carrying value of its deferred tax assets to the amount considered more likely than not. Deferred tax assets arise as a result of tax loss carry-forwards and various differences between the book basis of assets and the tax basis. As of September 30, 2011, the Company determined that it was no longer more likely than not that deferred tax assets will be recognized due to continued planned business investment and, as a result, recorded a valuation allowance for the full value of its deferred tax assets as of September 30, 2011. During the three month period ended March 31, 2012, the valuation allowance increased by \$1.8 million to \$21.0 million due to additional losses incurred since December 31, 2011.

**Table of Contents****(7) Initial Public Offering**

In March 2012, the Company completed the sale of 9,775,000 shares of common stock, including the underwriters' exercise of an over-allotment option, at a price of \$19.00 per share. A total of \$185.7 million in gross proceeds was raised in the initial public offering. After deducting the underwriting discount of \$13.0 million and offering expenses \$3.0 million, net proceeds were \$169.7 million.

Upon the closing of the Company's initial public offering, the 23,467,219 shares of the Company's outstanding convertible preferred stock converted, on a two-for-one basis, into 46,934,438 shares of common stock.

**(8) Stockholders' Equity**

In March 2012, the Company's board of directors approved an amendment to the Company's certificate of incorporation to increase the number of authorized shares of common stock to 74,000,000 shares, decrease the par value per share of common stock to \$0.0005 and reclassify and subdivide each share of issued and outstanding common stock into two shares of common stock. The Company's certificate of incorporation was further amended by the Company's board of directors to increase the number of authorized shares of common stock to 300,000,000. As a result of the stock split, proportionate adjustments were made to the applicable conversion prices for each share of the Company's outstanding preferred stock and applicable exercise prices for outstanding stock options.

At March 31, 2012, the Company was authorized to issue 300,000,000 shares of common stock with par value of \$0.0005 per share and 10,000,000 shares of preferred stock with par value of \$0.001 per share.

**(9) Equity Plan Activity**

The following table sets forth the total stock-based compensation expense resulting from stock awards included in the Company's Statements of Operations in accordance with FASB ASC Topic 718:

	As of March 31, 2012	As of March 31, 2011
Cost of revenue	\$ 321	\$ 230
Sales and marketing	712	452
Research and development	374	301
General and administrative	771	340
<b>Total stock-based compensation</b>	<b>\$ 2,178</b>	<b>\$ 1,323</b>

The fair value of options was estimated at the date of grant using a Black-Scholes option pricing model with the following weighted average assumptions:

	Three Months Ended March 31, 2012	2011
Expected volatility	55.54%	57.64%
Risk free interest rate	0.91%	2.12%
Expected dividend yield		
Expected option term (in years)	6.25	6.25

The Company believes the historical volatility of a peer group of companies is representative of future stock price trends. Therefore, expected volatility is based on historical volatility of the publicly traded stock of a peer group of companies analyzed by the Company over the expected term of the options.

The risk-free interest rate for periods within the contractual life of the Company's stock options is based on the U.S. Treasury yield curve in effect at the time of grant for time periods similar to the expected term of the award. The Company has never declared or paid any cash dividends and does not plan to pay cash dividends in the foreseeable future, and therefore used an expected dividend yield of zero in the

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valuation model. The expected option term of 6.25 years is based on the average of the vesting term and the 10-year contractual lives of all options awarded. Using the assumptions above, the weighted average grant date fair value of options granted during the three month periods ended March 31, 2012 and 2011 was \$7.89 and \$4.31 per share, respectively.

A summary of the Company's stock option activity under the Plan and related information is as follows:

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	Shares	Weighted average exercise price	Weighted average remaining contractual life	Aggregate intrinsic value
<b>Outstanding:</b>				
Balance at December 31, 2011	11,323,492	\$ 5.2309	7.37	\$ 54,003
Granted	1,552,000	15.0000		
Exercised	(86,204)	5.4085		
Forfeited	(171,792)	5.7609		
Balance at March 31, 2012	12,617,496	\$ 6.4241	7.41	\$ 246,999
Exercisable at December 31, 2011	5,965,438	\$ 3.8320	6.20	\$ 36,795
Exercisable at March 31, 2012	6,583,755	\$ 4.0670	6.05	\$ 144,401

The aggregate intrinsic value represents the total pretax intrinsic value, based on a stock price of \$26.00 and \$7.70 per share at March 31, 2012 and 2011, respectively, which would have been received by the option holders had all option holders exercised their options as of that date. The total intrinsic value of options exercised was \$0.5 million and \$0.1 million for the three month periods ended March 31, 2012 and 2011, respectively.

During the period ended March 31, 2012, the Company granted 27,666 shares of restricted stock to nonemployee directors with a weighted average fair value of \$15.00 per share, which will vest in January 2013. There were 69,632 and 172,857 shares of unvested restricted stock outstanding at March 31, 2012 and 2011, respectively.

As of March 31, 2012 and 2011, \$27.0 million and \$17.4 million, respectively, of total unrecognized stock-based compensation expense related to non-vested shares is expected to be recognized over the respective vesting terms of each award through 2016. The weighted average term of the unrecognized stock-based compensation expense is 2.9 years for each of the three month periods ended March 31, 2012 and 2011, respectively.

**(10) Commitments and Contingencies****(a) Lease Commitments**

The Company has non-cancelable operating leases, primarily for office space in Indianapolis, Indiana, San Francisco, California, Bellevue, Washington, New York, New York, Australia, Brazil, Germany and the United Kingdom. Operating and capital lease obligations have not changed significantly from those at December 31, 2011, except for the following agreements acquired and entered into during the current fiscal year.

In January 2012, the Company entered into an operating lease for additional office space near Sao Paulo, Brazil with total annual lease payments of approximately \$0.2 million, \$0.2 million and \$0.2 million, respectively, over the 2.8 year term of the lease.

**(b) Legal Proceedings**

We are not currently, nor have we been in the past, subject to any material legal proceedings. From time to time, however, we may become involved in various legal proceedings in the ordinary course of our business, and may be subject to third-party infringement claims. These claims, even those that lack merit, could result in the expenditure of significant financial and managerial resources.

In the Company's subscription agreements with its clients, it agrees to indemnify its clients against any losses or costs incurred in connection with claims by a third party alleging that a client's use of its services infringes the intellectual property rights of the third party. Based on historical information and other available information as of March 31, 2012, the Company does not expect it will incur any significant liabilities under these indemnification agreements.

**(11) Subsequent Events****(a) Loan and Security Agreement**



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In April 2012, the Company terminated its Loan and Security Agreement, pursuant to which the Company had received a \$10.0 million bank term loan and a \$20.0 million revolving line of credit. All collateral that was pledged has been released and no early termination penalties were incurred.

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### **ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

*The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the unaudited condensed consolidated financial statements and the related notes thereto included elsewhere in this Quarterly Report on Form 10-Q and the audited consolidated financial statements and notes thereto and management's discussion and analysis of financial condition and results of operations for the fiscal year ended December 31, 2011 included in the Company's registration statement on Form S-1. This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended. These statements are often identified by the use of words such as may, will, expect, believe, anticipate, intend, could, estimate, or continue, and similar expressions or variations. Such forward-looking statements are subject to risks, uncertainties and other factors that could cause actual results and the timing of certain events to differ materially from future results expressed or implied by such forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those identified herein, and those discussed in the section titled Risk Factors, set forth in Part II, Item 1A of this Quarterly Report on Form 10-Q and those discussed in the section titled Risk Factors included in our Prospectus filed pursuant to Rule 424(b) under the Securities Act with the Securities and Exchange Commission on March 21, 2012. We disclaim any obligation to update any forward-looking statements to reflect events or circumstances after the date of such statements.*

#### **Overview**

We are a leading global provider of cross-channel, interactive marketing SaaS solutions that empower organizations of all sizes to communicate with their customers through the interactive channels they use most – email, mobile, social media and websites. Our solutions provide marketers with a broad and powerful suite of integrated applications to plan, automate, deliver and optimize data driven interactive marketing campaigns and real-time communications to drive customer engagement, increase sales and improve their return on marketing investment. Our direct client base consists of organizations ranging from enterprises to small businesses, in numerous industries, including retail and e-commerce, media and entertainment, travel and hospitality, financial services and insurance, technology, daily-deal and flash-sale and marketing service providers. Our diverse direct client base includes marketing service providers that extend our global sales distribution by reselling our solutions to several thousand additional organizations.

We provide our solutions primarily through annual and multi-year subscriptions based on the volume of contracted utilization, level of functionality, number of interactive marketing channels, number of users and level of customer support. Clients are charged additional usage-based fees for utilization above the contracted level. Our subscription-based model and track record of long-term client relationships have allowed us to achieve annual dollar-based subscription revenue renewal rates of over 100% for the three months ended March 31, 2012 and for the twelve months ended December 31, 2011, which provides us significant revenue visibility.

We believe that the demand for cross-channel, interactive marketing SaaS solutions is significant and growing, driven by organizations' desire to develop a unified, cross-channel view of their customers to drive real-time, relevant engagement through email, mobile, social media and websites. We anticipate that organizations will continue to increase their use of cross-channel marketing SaaS solutions to plan, automate, deliver and optimize data-driven interactive marketing campaigns and real-time communications to better connect with their customers across interactive channels. We believe the market for our suite of cross-channel, interactive marketing SaaS solutions will become larger as organizations continue to adopt cross-channel, interactive marketing. We also believe significant opportunity exists in new markets worldwide that are unserved or underserved by existing providers. We intend to increase our direct global presence in international markets to serve our multinational clients and win new clients in these markets. We also believe opportunities to acquire companies and technologies to expand the functionality of our solutions will emerge, providing access to new clients or markets, or both, although we have no agreements or understandings regarding future acquisitions at this time.

We face a number of risks in the execution of our strategy, including our potential failure to manage our domestic and international growth effectively, inability to attract new clients and retain existing clients, inability to achieve and sustain profitability and the overall impact of uncertain economic conditions. Due to the size and expected growth of the market opportunity, we recognize that we may face increased competition from established vendors and potential new entrants in our markets. We believe the expansion of our suite of cross-channel, interactive marketing SaaS solutions have been important in winning new clients and expanding relationships with our existing client base. While email continues to be the primary interactive marketing channel for our clients and represents a substantial majority of our total revenue, revenue from our mobile, social media and sites solutions is growing rapidly.

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We were founded in December 2000, and initially focused on providing email marketing solutions to small and medium-sized clients. Since that time, we have expanded our solutions to serve the enterprise market. We broadened our product strategy to expand beyond email into emerging cross-channel, interactive marketing technologies such as mobile, landing pages and microsites. We further expanded our suite of products with the acquisition of the enterprise social media management platform, CoTweet. Additionally, we continued to develop and improve our proprietary, cloud-based platform, expanding our integration framework to enable third-party marketing technology providers to embed our technology into their solutions and build applications on our platform. In 2011, we made our Interactive Marketing Hub generally available to clients, providing a broad and powerful suite of cross-channel, interactive marketing SaaS solutions to plan, automate, deliver and optimize data-driven interactive marketing campaigns and real-time communications.

We have established a direct presence in international markets through acquisitions of resellers in the United Kingdom, Australia and Brazil, and have made subsequent investments in each of these operations. In August 2009, we acquired a reseller in the United Kingdom, allowing us to directly support clients in Europe including many of our U.S.-headquartered clients doing business in the region. In August 2010, we acquired an Australian reseller to extend our ability to support multinational clients in the Asia-Pacific region. In August 2011, we acquired a reseller in Sao Paulo, Brazil, to support clients in Latin America and to expand our sales in the region. And most recently, in the first quarter, we established a direct presence in Germany by opening a sales and professional services office in Munich. We intend to continue to expand our direct and indirect sales channels, expand our global reach, extend our suite of cross-channel, interactive marketing SaaS solutions and increase revenue from new and existing clients.

## **Key Metrics**

We use the following key metrics to evaluate and manage our business.

***Recurring Subscription Revenue.*** As a SaaS provider, we monitor recurring subscription revenue to measure our success in executing our strategy to increase the adoption of our SaaS solutions and expand our recurring revenue streams attributable to these solutions. We expect our recurring subscription revenue to remain the most significant portion of our total revenue although its percentage of total revenue may vary from period to period due to a number of factors, including the amount of revenue recognized from utilization above the contracted level and the timing of recognition of professional services revenue. We define recurring subscription revenue as the total amount of contractually-committed subscription revenue under each of our client agreements, which excludes revenue related to utilization above the contracted level. Recurring subscription revenue for the three month periods ended March 31, 2012 and 2011 was \$50.2 million and \$34.2 million, respectively.

***Subscription Revenue Renewal Rate.*** Our ability to retain our clients and expand their use of our suite of cross-channel, interactive marketing SaaS solutions over time is an indicator of the stability of our revenue base and the long-term value of our client relationships. We assess our performance in this area using a metric we refer to as subscription revenue renewal rate. This metric is calculated by dividing (a) total subscription revenue (including revenue related to messaging utilization above clients' contracted levels) in the current period from those clients who were clients during the prior year period, including additional sales to those clients, by (b) total subscription revenue (including revenue related to messaging utilization above our clients' contracted levels) from all clients in the prior year period. This metric is calculated on a quarterly basis and, for periods longer than one quarter, we use an average of the quarterly metrics. For each of the three month periods ended March 31, 2012 and 2011 our subscription revenue renewal rate was greater than 100%.

***Adjusted EBITDA.*** We monitor Adjusted EBITDA because we believe this measure provides important supplemental information regarding our operating performance and is often used by investors and analysts in their evaluation of companies such as ours. In addition, we use Adjusted EBITDA as a measurement of our operating performance because it assists us in comparing our operating performance on a consistent basis by removing the impact of certain non-cash and non-operating items. We calculate Adjusted EBITDA as net income (loss) before (1) other (income) expense, which includes interest income, interest expense and other income and expense, (2) income tax expense (benefit), (3) depreciation and amortization of property and equipment, (4) amortization of intangible assets and (5) stock-based compensation. This non-GAAP financial measure is used in addition to and in conjunction with results presented in accordance with GAAP and should not be relied upon to the exclusion of GAAP financial measures. Adjusted EBITDA reflects an additional way of viewing aspects of our operations that we believe, when viewed with our GAAP results and the accompanying reconciliations to corresponding GAAP financial measures, provides a more complete understanding of factors and trends affecting our business. Adjusted EBITDA was \$3.0 million and \$0.03 million for the three month periods ended March 31, 2012 and 2011, respectively. For reconciliation of net income (loss) to Adjusted EBITDA, see Results of Operations.

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### **Components of Results of Operations**

#### ***Revenue***

We generate revenue through the sale of subscriptions to our suite of cross-channel, interactive marketing SaaS solutions and the delivery of professional services. More than 80% of our revenue for the three months ended March 31, 2012 and for the twelve months ended December 31, 2011 was derived from our enterprise, medium-sized and small business clients, with the balance attributable to marketing service providers that resell our solutions to thousands of their customers. We serve a wide range of clients across many industries and sizes, and our revenue is not concentrated within any single client or small group of clients. For the three months ended March 31, 2012 and for the twelve months ended December 31, 2011, no single client represented more than 5% of our revenue, and our largest ten clients accounted for less than 20% of our revenue in the aggregate.

Clients are typically invoiced in advance on an annual, quarterly or monthly basis, with payment due upon receipt of the invoice. Invoiced amounts are reflected on the balance sheet as accounts receivable or as cash when collected and as deferred revenue until earned and recognized as revenue ratably over the performance period. Accordingly, deferred revenue represents the amount billed to clients that has not yet been earned or recognized as revenue, pursuant to agreements entered into in current and prior periods, and does not reflect that portion of a contract to be invoiced to clients on a periodic basis for which payment is not yet due. In recent periods, more of our clients have requested quarterly or monthly instead of annual billing terms. As a result, we believe that the proportion of aggregate contract value reflected on the balance sheet as deferred revenue may continue to decrease if this trend continues.

*Subscription Revenue.* Our subscriptions are based on volume of contracted utilization, level of functionality, number of interactive marketing channels, number of users and level of customer support. Utilization levels are based on the volume of email messages, short message service ( SMS ) messages, website impressions and other activities. If clients exceed the specified volume of utilization, additional fees are billed for the excess volume, generally at rates equal to or greater than the contracted minimum per-utilization fee, and are included in subscription revenue. If clients use less than the minimum contracted utilization, no rollover credit or refunds are given. Subscription agreements with our clients typically are not cancellable for a minimum period, generally one year but ranging up to three years. Our subscription revenue accounted for 80% and 85% of our total revenue for the three month periods ended March 31, 2012 and 2011, respectively.

We recognize the aggregate minimum subscription fee ratably on a straight-line basis over the subscription term, provided that an enforceable contract has been signed by both parties, access to our SaaS solutions has been granted to the client, the fee for the subscription is fixed or determinable and collection is reasonably assured. Revenue from utilization above the contracted level is recognized in the period in which the utilization occurs. As a result of new client additions and expansion of our overall client base, we believe revenue attributable to utilization above the contracted level may grow in absolute dollars.

*Professional Services Revenue.* Professional services revenue consists primarily of fees associated with training, implementation, integration, deliverability, campaign services and strategic consulting. Our professional services are not required for clients to utilize our suite of cross-channel, interactive marketing SaaS solutions. Depending upon the nature of the engagement, we may provide professional services over the term of the SaaS subscription or in connection with discrete projects. Revenue for our professional services engagements is recognized proportionally over the period of performance and is typically contracted on a fixed-fee basis. Our professional service revenue accounted for 20% and 15% of our total revenue for the three month periods ended March 31, 2012 and 2011, respectively.

#### ***Cost of Revenue***

We allocate certain overhead expenses, such as rent, utilities, office supplies and depreciation of general office assets to cost of revenue categories based on related headcount. As a result, an overhead expense allocation is reflected in each cost of revenue category.

*Cost of Subscription Revenue.* Cost of subscription revenue consists primarily of wages and benefits for software operations personnel, as well as depreciation, licensing, maintenance and support for hardware and software used in production, and co-location facilities, bandwidth and infrastructure expenses. The expenses related to co-location, bandwidth and infrastructure are affected by the number of clients using our suite of cross-channel, interactive marketing SaaS solutions, the complexity and frequency of their use, the level of utilization and the amount of stored data. In addition, these expenses are affected by our requirement to maintain high application availability. Our system hardware is co-located in two third-party operated hosting facilities in Indianapolis, Indiana and one in Las Vegas, Nevada. We expect to make further significant capital investments in the expansion and operation of our data centers and to continue to expand our business, which will increase our cost of subscription revenue in absolute dollars.



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*Cost of Professional Services Revenue.* Cost of professional services revenue primarily consists of wages and benefits for services personnel, third party contractors and related costs. Our cost of professional services revenue is significantly higher as a percentage of associated revenue than our cost of subscription revenue due to the labor costs associated with providing professional services. As it takes several months to ramp up a professional services consultant to full productivity, we generally increase our professional services capacity ahead of the recognition of associated professional services revenue, which can result in lower margins in a period of significant hiring. We expect the number of professional services personnel and third party contractors to increase in the future as we continue to serve more enterprise clients, resulting in higher cost of professional services revenue in absolute dollars.

### ***Operating Expenses***

We allocate certain overhead expenses, such as rent, utilities, office supplies and depreciation of general office assets to operating expense categories based on related headcount. As a result, an overhead expense allocation is reflected in each operating expense category.

*Sales and Marketing.* Sales and marketing expenses consist primarily of wages and benefits for sales and marketing personnel, sales commissions, travel and meeting expenses and lead-generation marketing programs. All sales and marketing costs are expensed as incurred. In particular, sales bonuses are expensed in the period of contract signing and commissions are expensed upon contract billing. Our sales and marketing expenditures have historically been highest in the last two quarters of each year, which are periods of increased sales and marketing activity. In order to continue to grow our business and increase our brand awareness, we expect to continue investing substantial resources in our sales and marketing efforts. As a result, we expect sales and marketing expenses to increase as we invest to acquire new clients and retain and grow revenue from existing clients.

*Research and Development.* Research and development expenses consist primarily of wages and benefits for product strategy, product architecture, product design, development and quality assurance personnel, and the costs of third-party development contractors. We focus our research and development efforts on usability, application performance, new features and functionality and development of emerging cross-channel marketing technologies. We expense research and development costs as incurred due to our relatively short development cycle. We expect research and development expenses to increase as we continue to enhance our product offerings.

*General and Administrative.* General and administrative expenses consist primarily of wages and benefits for executive, finance and accounting, legal, human resources, internal information technology support and administrative personnel. In addition, general and administrative expenses include professional services fees, bad debt expenses and other corporate expenses. We expect that general and administrative expenses will increase as we continue to add personnel to support our growth. We also anticipate that we will incur additional costs for personnel and for professional services including accounting and legal services, insurance and other corporate governance-related costs related to operating as a public company.

### ***Critical Accounting Policies***

Our condensed consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States. The preparation of our financial statements and related disclosures requires us to make estimates, assumptions and judgments that affect the reported amount of assets, liabilities, revenue, costs and expenses, and related disclosures. The following accounting policies involve the most judgment and complexity: revenue recognition, income taxes, goodwill and acquired intangible assets, and stock-based compensation. Accordingly, we believe these policies are critical to fully understanding and evaluating our financial condition and results of operations. If actual results or events differ materially from the estimates, judgments and assumptions used by us in applying these policies, our reported financial condition and results of operations could be materially affected.

There have been no material changes in our critical accounting policies since December 31, 2011. For further information please see the discussion of critical accounting policies included in our consolidated financial statements included in the Company's registration statement on Form S-1 for the year ended December 31, 2011, as filed with the SEC.

ExactTarget is an emerging growth company under the Jumpstart Our Business Startups Act of 2012 and, except as set forth below, may take advantage of certain exemptions from various reporting requirements that are applicable to other public companies that are not emerging growth companies. Section 107 of the JOBS Act provides that an emerging growth company can take advantage of the extended transition period provided in Section 7(a)(2)(B) of the Securities Act of 1933 for complying with new or revised accounting standards. In other words, an emerging growth company can delay the adoption of certain accounting standards until those standards would otherwise apply to private companies. However, we are choosing to opt out of such extended transition period, and as a result, we will comply with new or revised accounting standards on the relevant dates on which adoption of such standards is required for non-emerging growth companies. Section 107 of the JOBS Act provides that our decision to opt out of the extended transition period for complying with new or revised accounting standards is

irrevocable.

***Off-Balance Sheet Arrangements***

We do not engage in any off-balance sheet financing activities. We do not have any interest in entities referred to as variable interest entities, which include special purpose entities and other structured finance entities.

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The following tables set forth selected consolidated statements of operations data for each of the periods indicated:

	Three Months Ended March 31,	
	2012	2011
	(unaudited; in thousands)	
Revenue:		
Subscription	\$ 51,147	\$ 37,223
Professional services	12,910	6,803
Total revenue	64,057	44,026
Cost of revenue:		
Subscription	12,710	8,676
Professional services	11,131	5,990
Total cost of revenues	23,841	14,666
Gross profit	40,216	29,360
Operating expenses:		
Sales and marketing	25,215	20,325
Research and development	11,160	8,437
General and administrative	8,270	5,557
Total operating expenses	44,645	34,319
Operating loss	(4,429)	(4,959)
Other expense, net	(254)	(248)
Loss before taxes	(4,683)	(5,207)
Income tax benefit		(1,945)
Net loss	\$ (4,683)	\$ (3,262)
Other comprehensive loss:		
Foreign currency translation adjustment	258	90
Comprehensive loss	\$ (4,425)	\$ (3,172)

Subscription revenue includes fees for utilization above the contracted level as follows:

	Three Months Ended March 31,	
	2012	2011
	(unaudited; in thousands)	
Revenue from utilization above the contracted level	\$ 952	\$ 3,056
Percentage of subscription revenue	2%	8%

Total cost of revenue and operating expenses include the following amounts related to stock-based compensation:



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	Three Months Ended March 31,	
	2012	2011
	(unaudited; in thousands)	
Cost of revenue	\$ 321	\$ 230
Sales and marketing	712	452