PARTNERRE LTD
Form 10-K
March 01, 2010
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2009

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from to

Commission file number 1-14536

PartnerRe Ltd.

(Exact name of registrant as specified in its charter)

Bermuda	**Not Applicable**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
90 Pitts Bay Road, Pembroke, Bermuda	**HM 08**
(Address of principal executive offices)	**(Zip Code)**

(441) 292-0888

(Registrant s telephone number, including area code)

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

Title of each class	**Name of each exchange on which registered**
Common Shares, $1.00 par value	**New York Stock Exchange, NYSE Euronext Paris, Bermuda Stock Exchange**
6.75% Series C Cumulative Preferred Shares, $1.00 par value	**New York Stock Exchange**
6.50% Series D Cumulative Preferred Shares, $1.00 par value	**New York Stock Exchange**

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 x No ¨

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

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 x 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 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 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. x

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

Large accelerated filer	x	Accelerated filer	¨
Non-accelerated filer	¨	Smaller reporting company	¨

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

The aggregate market value of the voting stock held by non-affiliates of the registrant as of most recently completed second fiscal quarter (June 30, 2009) was $3,670,057,556 based on the closing sales price of the registrant s common shares of $64.95 on that date.

The number of the registrant s common shares (par value $1.00 per share) outstanding, net of treasury shares, as of February 22, 2010 was 81,202,954.

Documents Incorporated by Reference:

Document	Part(s) Into Which Incorporated
Portions of the registrant s definitive proxy statement to be filed with the Securities and Exchange Commission pursuant to Regulation 14A under the Securities Exchange Act of 1934, as amended, relating to the registrant s Annual General Meeting of Shareholders scheduled to be held May 12, 2010 are incorporated by reference into Part II and Part III of this report. With the exception of the portions of the Proxy Statement specifically incorporated herein by reference, the Proxy Statement is not deemed to be filed as part of this report.	

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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

PartnerRe Ltd. has made statements under the captions Business, Risk Factors, Management s Discussion and Analysis of Financial Condition and Results of Operation, and in other sections of this annual report on Form 10-K that are forward-looking statements. In some cases, you can identify these statements by forward-looking words such as may, might, will, should, expects, plans, anticipates, believes, estimat potential, or continue, the negative of these terms and other comparable terminology. These forward-looking statements, which are subject to risks, uncertainties and assumptions about us, may include projections of our future financial performance, our anticipated growth strategies and anticipated trends in our business. These statements are only predictions based on our current expectations and projections about future events. There are important factors that could cause our actual results, level of activity, performance or achievements to differ materially from the results, level of activity, performance or achievements expressed or implied by the forward-looking statements, including those factors described under the caption entitled Risk Factors. You should specifically consider the numerous risks outlined under Risk Factors.

Although we believe the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, level of activity, performance or achievements. Moreover, neither we nor any other person assumes responsibility for the accuracy and completeness of any of these forward-looking statements. We are under no duty to update any of these forward-looking statements after the date of this annual report on Form 10-K to conform our prior statements to actual results or revised expectations.

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PART I

ITEM 1. BUSINESS

General

PartnerRe Ltd. (the Company or PartnerRe), incorporated in Bermuda in August 1993, is an international reinsurance group. The Company provides reinsurance on a worldwide basis through its wholly owned subsidiaries, including Partner Reinsurance Company Ltd. (Partner Reinsurance), Partner Reinsurance Europe Limited (PartnerRe Europe), Partner Reinsurance Company of the U.S. (PartnerRe U.S.), PARIS RE SA (Paris Re France) and PARIS RE Switzerland AG (Paris Re Switzerland). Risks reinsured include, but are not limited to, property, casualty, motor, agriculture, aviation/space, catastrophe, credit/surety, engineering, energy, marine, specialty property, specialty casualty, multiline and other lines and life/annuity and health. The Company also offers alternative risk products that include weather and credit protection to financial, industrial and service companies on a worldwide basis.

The Company was initially formed to capitalize on a void of capacity in the catastrophe reinsurance market following the significant devastation wrought by Hurricane Andrew in 1992 and the concurrent difficulties being faced by Lloyds of London. After raising nearly $1 billion with its initial public offering, the Company became one of the premier catastrophe reinsurers on a global basis, with acknowledged underwriting skills and disciplined risk management principles.

In 1997, recognizing the limits of a continued monoline strategy, the Company shifted its strategic focus to execute a plan to become a leading multiline reinsurer. Through both organic growth and strategic acquisitions, the Company moved to capitalize on the benefits of diversification both in terms of geography and business lines. In July 1997, the Company completed the acquisition of SAFR (subsequently renamed PartnerRe SA), a well-established global professional reinsurer based in Paris. In December 1998, the Company completed the acquisition of the reinsurance operations of Winterthur Re, further enhancing the Company s expansion strategy.

In November 2005, the European Parliament adopted Directive 2005/68/EC, the European Union Reinsurance Directive (Reinsurance Directive). The Reinsurance Directive seeks to harmonize the supervision of reinsurance business within the European Union by creating a single regulated market. To ensure operational efficiency, the Company determined that it was in its best commercial interests to restructure its European operations to create a single operating platform in Europe and that the appropriate entity to operate as such single operating platform was its Irish reinsurance subsidiary, PartnerRe Europe. This reorganization occurred on January 1, 2008.

On July 4, 2009, the Company entered into definitive agreements (Transaction Agreements) to effect a multi-step acquisition of all of the outstanding common shares and warrants of PARIS RE Holdings Limited (Paris Re), a French-listed, Swiss-based reinsurer.

On October 2, 2009, the Company caused a wholly-owned subsidiary (Merger Subsidiary) to complete the purchase (Block Purchase) in which the Company acquired approximately 57% of the outstanding Paris Re common shares and certain outstanding Paris Re warrants. These shares, when added together with the approximately 6% of the outstanding Paris Re common shares that the Company purchased in July 2009 and an additional approximately 20% of the outstanding Paris Re common shares that the Company subsequently committed to acquire simultaneously with the closing of the Block Purchase from certain other Paris Re shareholders, gave the Company an aggregate ownership of approximately 83% of the outstanding Paris Re common shares following the closing of the Block Purchase on October 2, 2009.

Following the closing of the Block Purchase, in late October 2009, the Company entered into a number of separate securities purchase agreements pursuant to which the Company acquired in the aggregate approximately 6% of the outstanding Paris Re common shares. As a result, the Company s ownership of Paris Re increased to approximately 89% of outstanding Paris Re common shares.

In each step of these purchases, the Company exchanged 0.300 Company common shares for each Paris Re common share and 0.167 Company common shares for each Paris Re warrant.

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On December 7, 2009, the Company completed its acquisition of Paris Re, achieving 100% ownership. The final step of the acquisition was effected by a merger under Swiss law, pursuant to which Paris Re was merged with and into the Merger Subsidiary, with the Merger Subsidiary continuing as the surviving entity, in accordance with the terms of the Transaction Agreements (Merger).

By virtue of the Merger, each issued and outstanding Paris Re common share (other than those already owned by the Company) was converted into the right to receive 0.3018 PartnerRe common shares, which is the same per share consideration paid by PartnerRe in connection with its previous purchases of Paris Re common shares, as adjusted upwards to account for the $0.47 per share cash dividend declared on the PartnerRe common shares on October 26, 2009 with a record date of November 20, 2009.

Paris Re s operating subsidiaries are in the process of being fully integrated into the Company s existing operating structure. The Company s Consolidated Statement of Operations for the year ended December 31, 2009, included in this report, reflects the results of Paris Re only from October 2, 2009, the date of acquisition (Acquisition Date), through December 31, 2009.

On December 7, 2009, PartnerRe successfully cross-listed PartnerRe common shares on NYSE Euronext Paris, under the ticker symbol PRE. As such the Company is subject to the rules and regulations of Autorité des Marches Financiers.

PartnerRe common shares will continue to be listed on the New York Stock Exchange (the NYSE) in the United States and the Bermuda Stock Exchange (the BSX) in Bermuda, and PartnerRe will remain subject to the rules and regulations of the NYSE, the U.S. Securities and Exchange Commission and the BSX.

Summary of certain agreements between AXA SA, Colisée Re and Paris Re

On December 21, 2006, Colisée Re (formerly known as AXA RE), a subsidiary of AXA SA (AXA) transferred substantially all of its assets and liabilities, other than specified reinsurance and retrocession agreements and certain other excluded assets and liabilities, to Paris Re France (AXA Transfer). The AXA Transfer was immediately followed by the acquisition, which consisted of the indirect acquisition by Paris Re of all the outstanding capital stock of Paris Re France (AXA Acquisition). In connection with the AXA Acquisition, AXA, Colisée Re and Paris Re entered into various agreements (2006 Acquisition Agreements).

2006 Acquisition Agreements

The following are the principal agreements entered into between Paris Re France, and its affiliates, and Colisée Re, and its affiliates, to give effect to the AXA Acquisition:

Quota Share Retrocession Agreement

In connection with the AXA Acquisition, the transfer of the benefits and risks of Colisée Re s reinsurance agreements to Paris Re France was effected by two 100% quota share retrocession agreements. One quota share retrocession agreement is between Colisée Re and Paris Re France, and the other, which relates exclusively to business written by the Canadian branch of Colisée Re, is between the Canadian branch of Colisée Re and the Canadian branch of Paris Re France. These two agreements, dated as of the closing of the AXA Acquisition, are effective as of January 1, 2006, and are on substantially similar terms (collectively, Quota Share Retrocession Agreement). The Quota Share Retrocession Agreement provides for the payment of premiums to Paris Re France (including its Canadian branch) by Colisée Re as consideration for reinsuring the covered liabilities. The Quota Share Retrocession Agreement provides that these premiums will be on a funds withheld basis. Paris Re France will receive any surplus, and be responsible for any deficits remaining with respect to the Funds Held Directly Managed Account discussed below, after all liabilities have been discharged and payments pursuant to the Reserve Agreement (defined below) have been settled. In addition, every quarter Colisée Re will release to Paris Re France any investment income, or Paris Re France will pay to Colisée Re an amount equal to any investment loss, as the case may be, generated by the funds held.

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Issuance Agreement and Claims Management and Services Agreement

To enable Paris Re France (including its Canadian branch) to write business after the closing of the AXA Acquisition, Colisée Re agreed, pursuant to an issuance agreement entered into between Colisée Re and Paris Re France on the closing of the AXA Acquisition (Issuance Agreement) to write business on behalf of Paris Re France for a specified period which ended on September 30, 2007. The Issuance Agreement provides for indemnification by Paris Re France to Colisée Re for any loss incurred by Colisée Re in connection with the performance of its obligations, except to the extent the loss results from fraud, willful misconduct or gross negligence of, or a material breach of the agreement by, Colisée Re. On the closing of the AXA Acquisition, Paris Re France and Colisée Re also entered into a claims management and services agreement (Claims Management and Services Agreement). The Claims Management and Services Agreement specifies certain services, including claims management, to be provided by Paris Re France in respect of the business that is covered by the Quota Share Retrocession Agreement and that was written by Colisée Re from January 1, 2006 to the closing of the AXA Acquisition as well as contracts Colisée Re has issued for the benefit of Paris Re France under the Issuance Agreement. Pursuant to the Claims Management and Services Agreement, Paris Re France manages the retrocession agreements that relate to this business.

Reserve Agreement and Run Off Services and Management Agreement

On the closing of the AXA Acquisition, AXA, Colisée Re and Paris Re France entered into a reserve agreement (Reserve Agreement). The Reserve Agreement provides that AXA and Colisée Re shall guarantee reserves in respect of Paris Re France and subsidiaries acquired in the AXA Acquisition. The Reserve Agreement covers losses incurred prior to December 31, 2005, including any adverse development in respect thereof, by Paris Re France, and the subsidiaries of Colisée Re transferred to Paris Re France as part of the 2006 Acquisition Agreements, in respect of reinsurance policies issued or renewed, and in respect of which premiums were earned, on or prior to December 31, 2005 (but excluding any amendments thereto effected after the closing of the 2006 Acquisition Agreements).

Pursuant to the Reserve Agreement, AXA has agreed to cause AXA Liabilities Managers, an affiliate of Colisée Re (AXA LM), to provide Paris Re France with periodic reports setting forth the amount of losses incurred in respect of the business guaranteed by AXA. The reserve guarantee provided by AXA and Colisée Re is conditioned upon, among other things, the guaranteed business, including all related ceded reinsurance, being managed by AXA LM. The Reserve Agreement further contemplates that Colisée Re or Paris Re France, as the case may be, shall pay to the other party amounts equal to any deficiency or surplus in the transferred reserves with respect to losses incurred, such losses being net of any recovery by Colisée Re including through retrocessional protection, salvage or subrogation.

The rights and obligations of AXA LM with respect to the management of this business are set forth in a run off services and management agreement among AXA LM, Colisée Re and Paris Re France (Run Off Services and Management Agreement). Under the Run Off Services and Management Agreement, Paris Re has agreed that AXA LM will manage claims arising from all reinsurance and retrocession contracts subject to the Reserve Agreement, either directly or, for contracts that were issued by certain Colisée Re entities identified in the agreement, by delegation to certain other specified entities, including Paris Re France. This includes contract administration, the administration of ceded reinsurance, claims handling, settlements and business commutations. Although Paris Re has certain consultation rights in connection with the management of the run-off of the contracts subject to the Reserve Agreement, AXA LM does not need to obtain Paris Re s prior consent in connection with claims handling and settlements, and no consent is required for business commutations if the amount of case reserves related to commuted contracts does not exceed 100 million in any twelve month period.

Funds Held Directly Managed Account

Following the AXA Acquisition, Paris Re and its subsidiaries entered into the Issuance Agreement and Quota Share Retrocession Agreement to assume business written by Colisée Re from January 1, 2006 to September 30, 2007 as well as the in-force business as of December 31, 2005. The agreements provided that the

premium related to the transferred business was retained by Colisée Re and credited to a funds held account. The assets underlying the funds held directly managed account are maintained by Colisée Re in a segregated investment portfolio and managed by Paris Re. The segregated investment portfolio underlying the funds held directly managed account is carried at fair value. Realized and unrealized investment gains and losses and net investment income related to the underlying investment portfolio in the funds held directly managed account inure to the benefit of Paris Re. The composition of this portfolio at December 31, 2009 and realized and unrealized investment gains and losses and net investment income recognized from the Acquisition Date are discussed below.

Business Strategy

The Company assumes and manages global insurance and capital markets risks. Its strategy is founded on a capital-based risk appetite and the selected risks that Management believes will allow the Company to meet its goals for appropriate profitability and risk management within that appetite. Management believes that this construct allows the Company to balance cedants need for absolute certainty of claims payment with its shareholders need for an appropriate return on their capital. Operating Return on Equity (ROE) and growth in diluted book value per share are two of the principal metrics used by Management to measure the Company s results. Consequently, the Company has set a goal of an average 13% operating ROE and a compound annual growth rate of 10% in diluted book value per share after the payment of dividends over a reinsurance cycle. Operating ROE is obtained by dividing operating earnings by common shareholders equity at the beginning of the year. Operating earnings is defined as net income or loss available to common shareholders less after-tax net realized and unrealized investment gains or losses on investments, after-tax net realized gain on purchase of capital efficient notes (CENts), after-tax net interest in earnings or losses of equity investments, where the Company does not control the investee companies activities, and preferred share dividends. Diluted book value per share is calculated using common shareholders equity, defined as total shareholders equity less the aggregate liquidation value of the preferred shares, divided by the number of fully diluted common shares outstanding (assuming exercise of all stock-based awards and other dilutive securities).

The Company has adopted the following five-point strategy:

Diversify risk across products, assets and geographies: PartnerRe writes most lines of business in approximately 150 countries worldwide. The Company s geographic spread of premiums mirrors that of the global insurance industry. Management believes diversification is a competitive advantage, which increases return per unit of risk, provides access to reinsurance business opportunities worldwide, and reduces the overall volatility of results. It is also the cornerstone of the Company s risk management approach. The reinsurance business is cyclical, but cycles by line of business and by geography are rarely synchronized. This diversification strategy allows the Company to rapidly deploy capital to risk classes and geographies that offer the greatest return over time.

Maintain a risk appetite moderately above the market: PartnerRe is in the business of assuming risk for an appropriate return. The Company s products address accumulation risks, complex coverage issues and large exposures faced by clients. The Company s willingness and ability to assume these risks make PartnerRe an important reinsurer to many of the world s insurance companies. The Company seeks to focus its book of business on those lines of business and market segments where it perceives greatest potential for profit over time. This means a high proportion of the business written by the Company is in severity lines of business such as casualty, catastrophe, specialized property and aviation, although the Company also writes frequency lines of business such as property, motor and life, which have historically provided modestly lower levels of returns with less volatility.

Actively manage capital across the portfolio and over the cycle: PartnerRe seeks to manage its capital to optimize shareholder returns over the cycle. In order to manage capital across a portfolio and over a cycle, the Company believes two things are critical: an appropriate and common measure of risk-adjusted performance and the ability and willingness to redeploy capital for its most efficient and effective use, either within the business or

by return to the shareholders. To achieve effective and efficient capital allocation, the Company has an intense focus on operating ROE. This discipline and focus, supported by strong actuarial and financial analysis, allows the Company to make well-informed decisions at the underwriting and pricing level, as well as in the allocation of capital within its portfolio of reinsurance businesses and within pre-established risk limits.

Add value through underwriting and transactional excellence: Underwriting and transactional excellence is achieved in three principal ways: through the quality of the Company s people, the structure they operate in, and the effectiveness of various processes and tools. Maintaining continuity and depth in the Company s management, underwriting, actuarial and financial areas is critical to maintaining an independent view of risk, a core part of the strategy. Equally important, the Company believes, is organizing its operations around geography, lines of business, distribution or client characteristics, and providing and building the right infrastructure to continually improve its capabilities in all transactional areas: underwriting, financial reporting and controls, reserving, pricing and claims.

Achieve superior returns on invested assets in the context of a disciplined risk framework: Strong underwriting must be complemented with prudent financial management, careful reserving and superior asset management in order to achieve the Company s targeted returns. The Company is committed to maintaining a strong and transparent balance sheet and achieving superior investment returns by gradually expanding its investment portfolio into new risk classes, many of which have more connection with capital markets than with traditional reinsurance markets. The Company assumes investment risk according to the same principles used for reinsurance underwriting, including diversification.

The Paris Re transaction does not change the Company s strategy and goals, fundamental values, or the way it thinks about, evaluates and values risk. Rather, the Company believes that the acquisition will help it be better positioned to achieve its strategy and goals in the future.

Reinsurance Operations

General

The Company provides reinsurance for its clients in approximately 150 countries around the world. Through its branches and subsidiaries, the Company provides reinsurance of non-life and life risks of ceding companies (primary insurers, cedants or reinsureds) on either a proportional or non-proportional basis through treaties or facultative reinsurance. The Company s offices are located in Beijing, Bermuda, Dublin, Greenwich (Connecticut), Hong Kong, Labuan, Mexico City, Miami, Montreal, New York, Paris, Santiago, Sao Paulo, Seoul, Singapore, Tokyo, Toronto, Washington, D.C., Zug and Zurich.

In a proportional reinsurance arrangement (also known as pro-rata reinsurance, quota-share reinsurance or participating reinsurance), the reinsurer shares a proportional part of the original premiums of the reinsured. In return, the reinsurer assumes a proportional share of the losses incurred by the cedant. The reinsurer pays the ceding company a commission, which is generally based on the ceding company s cost of acquiring the business being reinsured (including commissions, premium taxes, assessments and miscellaneous administrative expenses) and may also include a profit.

Non-proportional (or excess of loss) reinsurance indemnifies the reinsured against all or a specified portion of losses on underlying insurance policies in excess of a specified amount, which is called a level, retention or attachment point. Non-proportional business is written in layers and a reinsurer or group of reinsurers accepts a band of coverage up to a specified amount. The total coverage purchased by the cedant is referred to as a program and is typically placed with predetermined reinsurers in pre-negotiated layers. Any liability exceeding the upper limit of the program reverts to the ceding company.

Facultative reinsurance (proportional or non-proportional) is the reinsurance of individual risks. The reinsurer separately rates and underwrites each risk rather than assuming all or a portion of a class of risks as in the case of treaty reinsurance.

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The Company monitors the performance of its operations in three segments, Non-life, Life and Corporate & Other. The Non-life segment is further divided into five sub-segments, U.S., Global (Non-U.S.) Property and Casualty (Global (Non-U.S.) P&C), Global (Non-U.S.) Specialty, Catastrophe and Paris Re. Segments and sub-segments represent markets that are reasonably homogeneous in terms of geography, client types, buying patterns, underlying risk patterns and approach to risk management. The Company expects that over time the operations of Paris Re will be integrated with the operations of PartnerRe and that the sub-segment reporting will be adjusted accordingly.

The U.S. sub-segment includes property, casualty, motor, multiline, agriculture, surety and other risks generally originating in the United States. The Global (Non-U.S.) P&C sub-segment includes property, casualty and motor business generally originating outside of the United States. The Global (Non-U.S.) Specialty sub-segment is comprised of business that is generally considered to be specialized due to the sophisticated technical underwriting required to analyze risks, and is global in nature. This sub-segment consists of several lines of business for which the Company believes it has developed specialized knowledge and underwriting capabilities. These lines of business include agriculture, aviation/space, credit/surety, engineering, energy, marine, specialty property, specialty casualty and other lines. The Catastrophe sub-segment is comprised of the Company s catastrophe line of business. The Paris Re sub-segment includes agriculture, aviation/space, catastrophe, credit/surety, energy, engineering, marine, motor, property, specialty casualty, specialty property and other lines underwritten by Paris Re. The Life segment includes life, health and annuity lines of business. Corporate and Other is comprised of the capital markets and investment related activities of the Company (including Paris Re), including principal finance transactions, insurance-linked securities and strategic investments, and its corporate activities, including other operating expenses.

Property Property business provides reinsurance coverage to insurers for property damage or business interruption losses resulting from fires, catastrophes and other perils covered in industrial and commercial property and homeowners policies and is written on both a proportional and non-proportional basis, including structured reinsurance of property risks. The Company s most significant exposure is typically to losses from windstorm and earthquake, although the Company is exposed to losses from sources as diverse as freezes, riots, floods, industrial explosions, fires, hail and a number of other loss events. The Company s predominant exposure under these property coverages is to property damage. However, other risks, including business interruption and other non-property losses may also be covered under a property reinsurance contract when arising from a covered peril. In accordance with market practice, the Company s property reinsurance treaties generally exclude certain risks such as war, nuclear, biological and chemical contamination, radiation and environmental pollution.

Casualty The Company s casualty business includes third party liability, employers liability, workers compensation and personal accident coverages written on both a proportional and non-proportional basis, including structured reinsurance of casualty risks.

Multiline The Company s multiline business provides both property and casualty reinsurance coverages written on both a proportional and non-proportional basis.

Motor The Company s motor business includes reinsurance coverages for third party liability and property damage risks arising from both passenger and commercial fleet automobile coverages written by cedants. This business is written predominantly on a proportional basis.

Agriculture The Company reinsures, primarily on a proportional basis, agricultural yield and price/revenue risks related to flood, drought, hail and disease related to crops, livestock and aquaculture.

Aviation/Space The Company provides specialized reinsurance protection for airline, general aviation and space insurance business primarily on a proportional basis and through facultative arrangements. Its space business relates to coverages for satellite assembly, launch and operation for commercial space programs.

Catastrophe The Company provides property catastrophe reinsurance protection, written primarily on a non-proportional basis, against the accumulation of losses caused by windstorm, earthquake, flood or by any

other natural hazard that is covered under a comprehensive property policy. Through the use of underwriting tools based on proprietary computer models developed by its research team, the Company combines natural science with highly professional underwriting skills in order to offer capacity at a price commensurate with the risk.

Credit/Surety Credit reinsurance, written primarily on a proportional basis, provides coverage to commercial credit insurers, and the surety line relates primarily to bonds and other forms of security written by specialized surety insurers.

Engineering The Company provides reinsurance for engineering projects throughout the world, predominantly on a proportional treaty basis and through facultative arrangements.

Energy (Energy Onshore) The Company provides reinsurance coverage for the onshore oil and gas industry, mining, power generation and pharmaceutical operations primarily on a proportional basis and through facultative arrangements.

Marine (Marine/Energy Offshore) The Company provides reinsurance protection and technical services relating to marine hull, cargo, transit and offshore oil and gas operations on a proportional or non-proportional basis.

Specialty Property The Company provides specialized reinsurance protection for non-U.S. property business that requires specialized underwriting expertise due to the nature of the underlying risk or the complexity of the reinsurance treaty. This reinsurance protection is offered on a proportional, non-proportional or facultative basis.

Specialty Casualty The Company provides specialized reinsurance protection for non-U.S. casualty business that requires specialized underwriting expertise due to the nature of the underlying risk or the complexity of the reinsurance treaty. This reinsurance protection is offered on a proportional, non-proportional or facultative basis.

Life/Annuity and Health Life treaties provide reinsurance coverage to primary life insurers and pension funds with respect to individual and group life and health risks. Annuity treaties provide reinsurance coverage to insurers who issue annuity contracts offering long-term retirement benefits to consumers who seek protection against outliving their financial resources. Life business is written primarily on a proportional basis through treaty arrangements.

The Company s business is produced both through brokers and through direct relationships with insurance companies. In North America, business is primarily written through brokers, while in the rest of the world, the business is written on both a direct and broker basis.

For the year ended December 31, 2009, the Company had two brokers that individually accounted for 10% or more of its gross premiums written. The Aon Group (including the Benfield Group) accounted for approximately $997 million, or 25% of total gross premiums written, while Marsh (including Guy Carpenter) accounted for approximately $779 million, or 19% of total gross premiums written. The following table summarizes the percentage of gross premiums written through these two brokers by segment and sub-segment for the year ended December 31, 2009:

Non-life	
U.S.	78%
Global (Non-U.S.) P&C	29
Global (Non-U.S.) Specialty	26
Catastrophe	71
Paris Re	44
Life	18

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The Company s business is geographically diversified with premiums being written in approximately 150 countries. See Note 22 to Consolidated Financial Statements in Item 8 of Part II of this report for additional disclosure of the geographic distribution of gross premiums written and financial information about segments and sub-segments.

Risk Management, Underwriting, Underwriting Risk and Exposure Controls, Retrocessions and Claims

Risk Management

In the reinsurance industry, the core of the business model is the assumption of risk. Hence, risk management entails both the determination of an optimum risk-adjusted appetite for assumed business risks, and the reduction or mitigation of risks for which the organization is either not sufficiently compensated, or those risks that could threaten the ability of the Company to achieve its objectives.

All business decisions entail a risk/return trade-off. In the context of assumed business risks, this requires an accurate evaluation of risks to be assumed, and a determination of the appropriate economic returns required as fair compensation for such risks. For other than voluntarily assumed business risks, the decision relates to comparing the probability and potential severity of a risk event against the costs of risk mitigation strategies. In many cases, the potential impact of a risk event is so severe as to warrant significant, and potentially expensive, risk mitigation strategies. In other cases, the probability and potential severity of a risk does not warrant extensive risk mitigation.

The Company sets its appetite for assumed business risks in order to provide value to its clients and adequate risk-adjusted returns to its shareholders, without overexposing the Company to any one or series of related risks. Assumed business risks are mitigated to the extent the risk mitigation strategies provide a positive return on the Company s investment.

The Company utilizes a multi-level risk management structure, whereby critical exposure limits, return requirement guidelines, capital at risk and key policies are established by the Executive Management and Board of Directors (Board), but day-to-day execution of risk assumption activities and related risk mitigation strategies are delegated to the business units. Reporting on risk management activities is integrated within the Company s annual planning process, quarterly operations reports, periodic reports on exposures and large losses, and presentations to the Executive Management and Board. Individual business units employ, and are responsible for reporting on, operating risk management procedures and controls, while the Corporate Audit Group periodically tests these controls to ensure ongoing compliance. See Other Key Issues of Management Risk Management in Item 7 of Part II of this report for a detailed discussion of the Company s risk management.

Underwriting

The Company s underwriting is conducted through specialized underwriting teams with the support of technical staff in disciplines such as actuarial, claims, legal, risk management and finance.

The Company s underwriters generally speak the local language and/or are native to their country or area of specialization. They develop close working relationships with their ceding company counterparts and brokers through regular visits, gathering detailed information about the cedant s business and local market conditions and practices. As part of the underwriting process, the underwriters also focus on the reputation and quality of the proposed cedant, the likelihood of establishing a long-term relationship with the cedant, the geographic area in which the cedant does business and the cedant s market share, historical loss data for the cedant and, where available, historical loss data for the industry as a whole in the relevant regions, in order to compare the cedant s historical loss experience to industry averages, and to gauge the perceived insurance and reinsurance expertise and financial strength of the cedant. The Company trains its underwriters extensively and strives to maintain continuity of underwriters within specific geographic markets and areas of specialty.

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Underwriting Risk and Exposure Controls

Because the Company underwrites volatile lines of business, such as catastrophe reinsurance, the operating results and financial condition of the Company can be adversely affected by catastrophes and other large losses that may give rise to claims under reinsurance coverages provided by the Company. The Company manages its exposure to catastrophic and other large losses by (i) attempting to limit its aggregate exposure on catastrophe reinsurance in any particular geographic zone, (ii) selective underwriting practices, (iii) diversification of risks by geographic area and by lines and classes of business, and (iv) to a limited extent by purchasing retrocessional reinsurance.

The Company generally underwrites risks with specified limits per treaty program. Like other reinsurance companies, the Company is exposed to multiple insured losses arising out of a single occurrence, whether a natural event such as hurricane, windstorm, flood or earthquake, or other man-made events. Any such catastrophic event could generate insured losses in one or many of the Company s reinsurance treaties and facultative contracts in one or more lines of business. The Company considers such event scenarios as part of its evaluation and monitoring of its aggregate exposures to catastrophic events.

Retrocessions

The Company uses retrocessional agreements to a limited extent to reduce its exposure on certain specialty reinsurance risks assumed and to mitigate the effect of any single major event or the frequency of medium-sized events. These agreements provide for recovery of a portion of losses and loss expenses from retrocessionaires. The bulk of the retrocessional agreements currently in place cover the Paris Re sub-segment for property exposures, predominantly catastrophe risks. The Company also utilizes retrocessions in the Life segment to manage the amount of per-event and per-life risks to which it is exposed. Retrocessionaires are selected based on their financial condition and business practices, with stability, solvency and credit ratings being important criteria.

The Company remains liable to its cedants to the extent that the retrocessionaires do not meet their obligations under retrocessional agreements, and therefore retrocessions are subject to credit risk in all cases and to aggregate loss limits in certain cases. The Company holds collateral, including escrow funds, securities and letters of credit under certain retrocessional agreements. Provisions are made for amounts considered potentially uncollectible and reinsurance losses recoverable from retrocessionaires are reported after allowances for uncollectible amounts. At December 31, 2009, the Company had $357 million of reinsurance recoverables under such arrangements, the majority of which relate to the Paris Re agreements described above.

In addition to the retrocessional agreements, Paris Re has a Reserve Agreement in place with Colisée Re. See Summary of certain agreements between AXA SA, Colisée Re and Paris Re above.

Claims

In addition to managing and settling reported claims and consulting with ceding companies on claims matters, the Company conducts periodic audits of specific claims and the overall claims procedures at the offices of ceding companies. The Company attempts to evaluate the ceding company s claim adjusting techniques and reserve adequacy and whether it follows proper claims processing procedures. The Company also provides recommendations regarding procedures and processes to the ceding company.

Reserves

General

Loss reserves represent estimates of amounts an insurer or reinsurer ultimately expects to pay in the future on claims incurred at a given time, based on facts and circumstances known at the time that the loss reserves are established. It is possible that the total future payments may exceed, or be less than, such estimates. The

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estimates are not precise in that, among other things, they are based on predictions of future developments and estimates of future trends in claim severity, frequency and other variable factors such as inflation. During the loss settlement period, it often becomes necessary to refine and adjust the estimates of liability on a claim either upward or downward. Despite such adjustments, the ultimate future liability may exceed or be less than the revised estimates.

As part of the reserving process, insurers and reinsurers review historical data and anticipate the impact of various factors such as legislative enactments and judicial decisions that may affect potential losses from casualty claims, changes in social and political attitudes that may increase exposure to losses, mortality and morbidity trends and trends in general economic conditions. This process assumes that past experience, adjusted for the effects of current developments, is an appropriate basis for anticipating future events.

See Critical Accounting Policies and Estimates in Item 7 of Part II of this report for a discussion of the Company s reserving process.

Reserve Agreement

See Summary of certain agreements between AXA SA, Colisée Re and Paris Re above.

Changes in Reserves

The following table shows the development of net reserves for unpaid losses and loss expenses for the Company s Non-life business. The table begins by showing the initial reported year-end gross and net reserves, including incurred but not reported (IBNR) reserves, recorded at the balance sheet date for each of the ten years presented, except for Paris Re s liability for unpaid losses and loss expenses, which is included as of December 31, 2009 for the first time. For years prior to 2009, this table excludes the reserves of the Paris Re companies acquired.

The next section of the table shows the re-estimated amount of the initial reported net reserves for up to ten subsequent years, based on experience at the end of each subsequent year. The re-estimated net liabilities reflect additional information, received from cedants or obtained through reviews of industry trends, regarding claims incurred prior to the end of the preceding financial year. A redundancy (or deficiency) arises when the re-estimation of reserves is less (or greater) than its estimation at the preceding year-end. The cumulative redundancies (or deficiencies) reflect cumulative differences between the initial reported net reserves and the currently re-estimated net reserves. Annual changes in the estimates are reflected in the income statement for each year as the liabilities are re-estimated. Reserves denominated in foreign currencies are revalued at each year-end s foreign exchange rates.

The lower section of the table shows the portion of the initial year-end net reserves that was paid (claims paid) as of the end of subsequent years. This section of the table provides an indication of the portion of the re-estimated net liability that is settled and is unlikely to develop in the future. Claims paid are converted to U.S. dollars at the average foreign exchange rates during the year of payment and are not revalued at the current year foreign exchange rates. Because claims paid in prior years are not revalued at the current year s foreign exchange rates, the difference between the cumulative claims paid at the end of any given year and the immediately previous year represents the claims paid during the year.

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Development of Loss and Loss Expense Reserves

(in thousands of U.S. dollars)

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
for unpaid expenses	$ 2,616,556	$ 2,386,032	$ 3,005,628	$ 3,658,416	$ 4,755,059	$ 5,766,629	$ 6,737,661	$ 6,870,785	$ 7,231,436	$ 7,510,666
bility for nd loss	205,982	203,180	214,891	217,777	175,685	153,018	185,280	138,585	132,479	125,215
r unpaid expenses	**$ 2,410,574**	**$ 2,182,852**	**$ 2,790,737**	**$ 3,440,639**	**$ 4,579,374**	**$ 5,613,611**	**$ 6,552,381**	**$ 6,732,200**	**$ 7,098,957**	**$ 7,385,451**
e-estimated										
	2,376,763	2,111,483	3,035,309	3,806,231	4,688,964	5,006,767	6,602,832	6,715,107	6,343,714	7,076,796
r	2,205,861	2,302,284	3,310,898	3,975,926	4,301,161	5,044,922	6,618,112	6,165,297	6,009,194	
er	2,316,164	2,489,601	3,456,250	3,781,574	4,373,992	5,092,289	6,168,445	5,897,044		
r	2,448,562	2,611,045	3,326,527	3,894,500	4,494,182	4,845,644	6,002,031			
r	2,540,927	2,513,123	3,433,887	4,019,813	4,315,702	4,731,856				
	2,461,178	2,617,775	3,528,665	3,918,380	4,264,865					
er	2,553,570	4,937	4,061							

of	14,171	10,786	28,180	21,339
t	30,197	24,741	57,101	47,814
rketing, d tive	24,267	15,935	46,722	30,223
nd nt	11,092	8,026	22,651	16,121
n-related	579	—	1,969	—
t charge	2,130	—	2,130	—
ome tions	(7,871)	780	(16,371)	1,470
nse, net	(571)	(129)	(1,543)	(234)
ome ome tax	(8,442)	651	(17,914)	1,236
rovision	(1,240)	71	(1,800)	(1,078)
ncome	(7,202)	580	(16,114)	2,314
e to lling	(206)	—	(663)	—
ncome e to dings,	(6,996)	580	(15,451)	2,314

earnings				
e to dings,				
	$(0.24)	$0.02	$(0.54)	$0.08
	$(0.24)	$0.02	$(0.54)	$0.08
average shares:				
	28,958,233	28,006,517	28,813,008	27,881,957
	28,958,233	29,958,580	28,813,008	29,710,202
sive me, net				
rrency	203	—	177	—
sive	203	—	177	2,314
t of tax				
nsive me	(6,999)	580	(15,937)	2,314
nsive table to lling	(186)	—	(643)	—
nsive me e to dings,	$(6,813)	$580	$(15,294)	$2,314

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

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PROS Holdings, Inc.
Condensed Consolidated Statements of Cash Flows
(In thousands)
(Unaudited)

	For the Six Months Ended June 30,	
	2014	2013
Operating activities:		
Net (loss) income	$(16,114)	$2,314
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	5,416	1,999
Share-based compensation	10,396	7,559
Tax shortfall from share-based compensation	—	(10)
Provision for doubtful accounts	(244)	(70)
Impairment charge	2,130	—
Changes in operating assets and liabilities:		
Accounts and unbilled receivables	(4,771)	1,317
Prepaid expenses and other assets	(3,780)	(821)
Accounts payable and other liabilities	122	715
Accrued liabilities	371	391
Accrued payroll and other employee benefits	(1,753)	(2,841)
Deferred revenue	(859)	(2,619)
Net cash (used in) provided by operating activities	(9,086)	7,934
Investing activities:		
Purchases of property and equipment	(4,520)	(2,172)
Acquisition of Cameleon Software, net of cash acquired	(22,048)	—
Capitalized internal-use software development costs	(1,623)	(1,534)
Decrease in restricted cash	37,218	—
Net cash provided by (used) in investing activities	9,027	(3,706)
Financing activities:		
Exercise of stock options	1,091	2,771
Tax withholding related to net share settlement of restricted stock units	(12,319)	(2,330)
Increase in Parent's ownership in Cameleon Software	(3,410)	—
Net cash (used in) provided by financing activities	(14,638)	441
Effect of foreign currency rates on cash	43	—
Net change in cash and cash equivalents	(14,654)	4,669
Cash and cash equivalents:		
Beginning of period	44,688	83,558
End of period	$30,034	$88,227

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

PROS Holdings, Inc.
Notes to Condensed Consolidated Financial Statements
(Unaudited)

1. Organization and Nature of Operations

PROS Holdings, Inc., a Delaware corporation, through its operating subsidiaries ("PROS" or the “Company”), provides big data software applications designed to help companies outperform in their markets by using big data to sell more effectively. The Company applies data science to unlock buying patterns and preferences within transaction data to reveal which opportunities are most likely to close, which offers are most likely to sell and which prices are most likely to win. The Company offers big data software applications to analyze, execute, and optimize sales, pricing, quoting, rebates and revenue management. The Company also provides professional services to implement its software applications as well as business consulting. In addition, the Company provides product maintenance and support to its customers, including unspecified upgrades, maintenance releases and bug fixes during the term of the support period on a when-and-if-available basis. The Company provides its big data software applications to enterprises across a range of industries, including manufacturing, distribution, services and travel.

In December 2013, the Company acquired SignalDemand, Inc. ("SignalDemand"), an optimization software company headquartered in San Francisco, California, with approximately 40 professionals, for total cash consideration of $13.5 million. This acquisition broadened the Company's offerings to companies in resource-based and commodity-driven industries, with products designed to help our clients better serve their customers in volatile markets with greater confidence and agility. Through SignalDemand's SaaS-based solutions and PROS big data software applications, PROS processes thousands of variables to deliver real-time recommendations, helping companies make price and mix decisions across products, customers and channels.

On January 8, 2014, the Company acquired approximately 81.7% of the common stock of Cameleon Software SA ("Cameleon"), a publicly traded French société anonyme headquartered in Toulouse, France, in an all-cash tender offer for approximately $29.1 million. The Company has continued to purchase shares of Cameleon in the open market. Since the initial tender offer the Company has acquired an additional 9.8% of Cameleon's common stock in the market for approximately $3.4 million. As of June 30, 2014, the Company owned 91.5% of the common stock of Cameleon.

2. Summary of Significant Accounting Policies

The accompanying unaudited condensed consolidated financial statements reflect the application of significant accounting policies as described below and elsewhere in these notes to the condensed consolidated financial statements.

Basis of presentation

The accompanying unaudited condensed consolidated financial statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) for interim financial reporting and applicable quarterly reporting regulations of the Securities and Exchange Commission (“SEC”). In management’s opinion, the accompanying interim unaudited condensed consolidated financial statements include all adjustments necessary for a fair statement of the financial position of the Company as of June 30, 2014, the results of operations for the three and six months ended June 30, 2014 and cash flows for the six months ended June 30, 2014.

Certain information and disclosures normally included in the notes to the annual financial statements prepared in accordance with GAAP have been omitted from these interim unaudited condensed consolidated financial statements pursuant to the rules and regulations of the SEC. Accordingly, these unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements in the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2013 (“Annual Report”) filed with the SEC. The condensed consolidated balance sheet as of December 31, 2013 was derived from the Company’s audited consolidated financial statements but does not include all disclosures required by GAAP.

Certain prior year amounts have been reclassified to conform to the current period financial statement presentation. These changes and reclassifications did not impact net or comprehensive income.

Basis of consolidation

The unaudited condensed consolidated financial statements include the accounts of the Company and its subsidiaries. All intercompany transactions and balances have been eliminated in consolidation.

Dollar amounts

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

Use of estimates

The Company's management prepares the unaudited condensed consolidated financial statements in accordance with GAAP. The Company makes estimates and assumptions in the preparation of its unaudited condensed consolidated financial statements, and its estimates and assumptions may affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the unaudited condensed consolidated financial statements, and the reported amounts of revenue and expenses during the reporting periods. Actual results could differ from those estimates. The complexity and judgment required in the Company's estimation process, as well as issues related to the assumptions, risks and uncertainties inherent in the application of the percentage-of-completion method of accounting, affect the amounts of revenue, expenses, unbilled receivables and deferred revenue. Estimates are also used for, but not limited to, receivables, allowance for doubtful accounts, useful lives of assets, depreciation, income taxes and deferred tax asset valuation, valuation of stock options, other current liabilities and accrued liabilities. Numerous internal and external factors can affect estimates. The critical accounting policies related to the estimates and judgments are discussed in the Company's Annual Report under management's discussion and analysis of financial condition and results of operations. There have been no significant changes to the Company's critical accounting policies as described in the Company's Annual Report.

Revenue recognition

The Company derives its revenue from the licensing and implementation of software solutions and associated software maintenance and support. To a lesser extent, the Company's revenue includes nonsoftware related cloud-based services. The Company's arrangements with customers typically include: (a) license fees for the use of our solutions either in perpetuity or over a specified term, (b) professional services fees for configuration, implementation and training services, and (c) maintenance and support fees related to technical support and software updates. If there is significant uncertainty about contract completion or collectability is not reasonably assured, revenue is deferred until the uncertainty is sufficiently resolved or collectability is reasonably assured. In addition, revenue is recognized when persuasive evidence of an arrangement exists, delivery has occurred and fees are fixed or determinable.

License revenue includes perpetual license revenue recognized upon software delivery and an allocation of revenue from solution sales that are recognized using the percentage of completion method. The allocation represents management's estimate of the relative fair value of the perpetual licenses included in the solution sale arrangement.

Subscription revenues include revenue from our SaaS, cloud-based and term license offerings.

Services revenues consist of fees associated with the implementation and configuration of our software and subscription contracts, on-site support, training and other consulting services.

Maintenance and support revenue includes post-implementation customer support and the right to unspecified software updates and enhancements on a when and if available basis. The Company generally invoices for maintenance and support services on a monthly, quarterly or on an annual basis during the maintenance and support period. The Company recognizes revenue from maintenance arrangements ratably over the period in which the services are provided.

In determining whether professional services revenue should be accounted for separately from license revenue, the Company evaluates whether the professional services are considered essential to the functionality of the software using factors such as: the nature of its software products; whether they are ready for use by the customer upon receipt; the nature of professional services; the availability of services from other vendors; whether the timing of payments for license revenue coincides with performance of services; and whether milestones or acceptance criteria exist that affect the realizability of the software license fee.

If the Company determines that professional services revenue should not be accounted for separately from license revenue, the license revenue is recognized together with the professional services revenue using the percentage-of-completion method or completed contract method. The completed contract method is also used for contracts where there is a risk over final acceptance by the customer or for contracts that are short-term in nature.

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The percentage-of-completion computation is measured by the percentage of man-days incurred during the reporting period as compared to the estimated total man-days necessary for each contract for implementation of the software solutions. The Company measures performance under the percentage-of-completion method using the total man-day method based on current estimates of man-days to complete the project. The Company believes that for each such project, man-days expended in proportion to total estimated man-days at completion represents the most reliable and meaningful measure for determining a project's progress toward completion. Under our fixed-fee arrangements, should a loss be anticipated on a contract, the full amount is recorded when the loss is determinable.

The Company also licenses software solutions under term license agreements that typically include maintenance during the license term. When maintenance is included for the entire term of the license, there is no renewal rate and the Company has not established vendor specific objective evidence ("VSOE") of fair value for the maintenance on term licenses. For term license agreements, revenue and the associated costs are deferred until the delivery of the solution and recognized ratably over the remaining license term.

Our cloud-based services are designed to be options for our customers to deploy our solutions without any significant investment in hardware as we integrate our software in a cloud-based IT environments that we deploy, support and manage on the customers' behalf.

For arrangements that include cloud-based services, the Company allocates the arrangement consideration between the service and other elements and recognizes the cloud-based services fee ratably beginning on the date the customer commences use of the Company's services and continuing through the end of the customer term.

The Company's customer arrangements typically contain multiple elements that include software license, implementation services and post-implementation maintenance and support. For multiple element arrangements involving our nonsoftware services, the Company must (1) determine whether and when each element has been delivered; (2) determine the fair value of each element using the selling price hierarchy of VSOE of fair value, third party evidence ("TPE"), or best estimated selling price ("BESP"), as applicable, and (3) allocate the total price among the various elements based on the selling price method.

For multiple-element arrangements that include software and nonsoftware elements such as the Company's cloud-based service offerings, the Company allocates revenue between the software and software-related elements as a group and any nonsoftware elements based on a relative fair value allocation. The Company determines fair value for each deliverable using this hierarchy and utilizes VSOE of fair value if it exists.

In certain instances, the Company may not be able to establish VSOE for all deliverables in an arrangement with multiple elements. This may be due to the Company's limited experience selling each element separately, not pricing solutions or services within a narrow range, or only having a limited sales history. In addition, TPE may not be available. When the Company is unable to establish selling prices using VSOE or TPE, it uses BESP in its allocation of arrangement consideration. The objective of BESP is to determine the price at which we would transact a sale if the product or service were sold on a stand-alone basis. For transactions that only include software and software-related elements, the Company continues to account for such arrangements under the software revenue recognition standards which require it to establish VSOE of fair value to allocate arrangement consideration among multiple deliverables.

Software license and implementation revenue that has been recognized, but for which the Company has not invoiced the customer, is recorded as unbilled receivables. Invoices that have been issued before software license, implementation and maintenance and support revenue has been recognized are recorded as deferred revenue in the accompanying consolidated balance sheets.

Business Combinations

We record tangible and intangible assets acquired and liabilities assumed in business combinations under the acquisition method of accounting. Amounts paid for each acquisition are allocated to the assets acquired and liabilities assumed based on their fair values at the date of acquisition.

Significant management judgments and assumptions are required in determining the fair value of acquired assets and liabilities, particularly acquired intangible assets. The valuation of purchased intangible assets is based upon estimates of the future performance and cash flows from the acquired business. Each asset is measured at fair value from the perspective of a market participant.

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The Company uses its best estimates and assumptions to accurately assign fair value to the tangible and intangible assets acquired and liabilities assumed at the acquisition date. The Company's estimates are inherently uncertain and subject to refinement. During the measurement period, which may be up to one year or more from the acquisition date, the Company may record adjustments to the fair value of these tangible and intangible assets acquired and liabilities assumed, with the corresponding offset to goodwill. In addition, uncertain tax positions and tax-related valuation allowances are initially established in connection with a business combination as of the acquisition date. The Company continues to collect information and reevaluates these estimates and assumptions quarterly and records any adjustments to the Company's preliminary estimates to goodwill, provided that the Company is within the measurement period. Upon the conclusion of the measurement period or final determination of the fair value of assets acquired or liabilities assumed, whichever comes first, any subsequent adjustments are recorded to the Company's condensed consolidated statements of operations.

Internal-use software

Costs incurred to develop internal-use software during the development stage are capitalized, stated at cost, and depreciated using the straight-line method over the estimated useful lives of the assets. Development stage costs generally include salaries and personnel costs and third party contractor expenses associated with internal-use software configuration, coding, installation and testing. Capitalized internal-use software development costs related to the Company's cloud-based offerings were $0.9 million and $0.8 million for the three months ended June 30, 2014 and 2013, respectively, and $1.6 million for each of the six months ended June 30, 2014 and 2013. Capitalized internal-use software development costs related to our cloud-based offerings are amortized using the straight-line method over the useful life of the asset. For the three and six months ended June 30, 2014, the Company amortized $0.2 million and $0.3 million, respectively, of capitalized internal-use software development costs related to its cloud-based offerings as compared to $0.1 million and $0.2 million, respectively, for the three and six months ended June 30, 2013. Capitalized software for internal use is included in property and equipment, net in the unaudited condensed consolidated balance sheets. Amortization of capitalized internal-use software development costs related to the Company's cloud-based offerings is included in cost of license and implementation revenues in the accompanying unaudited condensed consolidated statements of comprehensive income.

Impairment of long-lived assets

Property and equipment are reviewed for impairment whenever an event or change in circumstances indicates that the carrying amount of an asset or group of assets may not be recoverable. The impairment review includes comparison of future cash flows expected to be generated by the asset or group of assets with the associated assets' carrying value. If the carrying value of the asset or group of assets exceeds its expected future cash flows (undiscounted and without interest charges), an impairment loss is recognized to the extent that the carrying amount of the asset exceeds its fair value. During the quarter ended June 30, 2014 the Company recorded $2.1 million impairment charge related to certain capitalized development cost associated with the expected future cash flows.

Noncash share-based compensation

The Company measures all share-based payments to its employees based on the grant date fair value of the awards and recognizes expense in the Company's unaudited consolidated statement of comprehensive income on a straight-line basis over the period during which the recipient is required to perform service (generally over the vesting period of the awards). To date, the Company has granted stock options, Restricted Stock Units ("RSUs"), Stock Appreciation Rights ("SARs"), and Market Stock Units ("MSUs"). RSUs include both time-based awards as well as performance-based awards in which the number of shares that vest are based upon the revenue expected to be earned by the Company from binding customer agreements for the provision of configure, price, and quote ("CPQ") solutions. MSUs are performance-based awards in which the number of shares that vest are based upon the Company's

relative stockholder return.

The following table presents the number of shares or units outstanding for each award type as of June 30, 2014 and December 31, 2013, respectively.

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Award type	June 30, 2014	December 31, 2013
Stock options	979,277	1,160,464
Restricted stock units (time based)	1,842,619	1,542,990
Restricted stock units (performance based)	34,000	—
Stock appreciation rights	705,736	721,028
Market stock units	431,900	469,000

Stock options, time based RSUs and SARs vest ratably between two and four years. The actual number of MSUs that will be eligible to vest is based on the total stockholder return of the Company relative to the total stockholder return of the Russell 2000 Index (“Index”) over their respective performance periods, as defined by each award's plan documents. The Company did not grant any stock options, SARs or MSUs during the three month period ended June 30, 2014.

The fair value of the RSUs is based on the closing price of the Company’s stock on the date of grant.

The Company estimates the fair value of MSUs on the date of grant using a Monte Carlo simulation model. The determination of fair value of the MSUs is affected by the Company’s stock price and a number of assumptions including the expected volatilities of the Company’s stock and the Index, its risk-free interest rate and expected dividends. The Company’s expected volatility at the date of grant was based on the historical volatilities of the Company and the Index over the performance period.

The assumptions used to value the MSUs granted during the three and six months ended June 30, 2014 were as follows:

	Grant Date	
	February 24, 2014	February 11, 2014
Volatility	51.13%	50.74%
Risk-free interest rate	0.66%	0.67%
Expected option life in years	2.85	2.89
Dividend yield	—	—

Earnings per share

The Company computes basic earnings per share by dividing net income by the weighted average number of common shares outstanding. Diluted earnings per share is computed by dividing net income by the weighted average number of common shares and dilutive potential common shares then outstanding. Potential common shares consist of shares issuable upon the exercise of stock options and SARs or the vesting of RSUs and MSUs. Diluted earnings per share reflect the assumed conversion of all dilutive share-based awards using the treasury stock method.

Fair value measurement

The Company’s financial assets that are measured at fair value on a recurring basis consisted of $14.7 million and $21.0 million invested in treasury money market funds at June 30, 2014 and December 31, 2013, respectively. The fair value of these accounts is determined based on quoted market prices, which represents level 1 in the fair value hierarchy as defined by Accounting Standard Codification ("ASC") 820, “Fair Value Measurement and Disclosure.”

Deferred revenue and unbilled receivables

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

Credit Facility

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As of June 30, 2014, the Company had no outstanding borrowings under the Company's $50 million revolving credit facility ("Revolver"), and $0.2 million of unamortized debt issuance costs related to the Revolver is included in other long term assets in the unaudited condensed consolidated balance sheets. For each of the three and six months ended June 30, 2014 and 2013, $12,500 and $25,000, respectively, of debt issuance cost amortization is included in Other Expense (Income), net in the unaudited condensed consolidated statements of comprehensive income.

Income taxes

At the end of each interim reporting period, the Company estimates its annual effective tax rate to calculate its income tax provision. The estimated effective tax rate includes U.S. federal, state and foreign income taxes and is based on the application of an estimated annual income tax rate applied to the current quarter’s year-to-date pre-tax income. This estimated effective tax rate is used in providing for income taxes on a year-to-date basis and may change in subsequent interim reporting periods.

The effective tax rate for the three months ended June 30, 2014 and 2013 was 15% and 11%, respectively. The effective tax rate for the six months ended June 30, 2014 and 2013 was 10% and (87)%, respectively. The difference between the effective tax rate and the federal statutory rate of 34% for the three and six months ended June 30, 2014 was due primarily to the limitation on the deductibility of certain officers’ compensation and valuation allowances related to foreign losses.

The tax (benefit) provision recorded for the three months ended June 30, 2014 and 2013 was $(1.2) million and $0.1 million, respectively. The tax benefit for the six months ended June 30, 2014 and 2013 was $1.8 million and $1.1 million, respectively. The change in the tax benefit was related to the Company's net loss in the quarter ended June 30, 2014 as compared to a net income in the quarter ended June 30, 2013. In addition, the change between the three months ended June 30, 2014 and 2013 is primarily attributed to a projected decrease in federal taxes partially offset by higher foreign taxes. The difference between the tax benefit for the six months ended June 30, 2014 compared to the six months ended June 30, 2013 is primarily due to the expiration of the research and experimentation credit as well as a one-time benefit related to the 2012 R&E credit recorded in the first quarter of 2013. The loss of benefits related to R&E credits for the period ending June 30, 2014 was partially offset by a reduced rate impact for nondeductible officers’ compensation.

The Internal Revenue Service is currently examining the Company’s 2009 R&D credit. The Company is not aware of any other audits at the present time.

Recent Accounting Pronouncements

In May 2014, the FASB issued Accounting Standards Update No. 2014-09 (ASU 2014-09) "Revenue from Contracts with Customers." ASU 2014-09 supersedes the revenue recognition requirements in “Revenue Recognition (Topic 605)”, and requires entities to recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled to in exchange for those goods or services. Early adoption is not permitted. The new accounting standards update becomes effective for the Company on January 1, 2017. The Company is currently evaluating the impact that this guidance will have on its financial statements.

With the exception of the new revenue standard discussed above, there have been no other recent accounting pronouncements or changes in accounting pronouncements during the six months ended June 30, 2014, as compared to the recent accounting pronouncements described in our Annual Report on Form 10-K for the year ended December 31, 2013, that are of significance or potential significance to the Company.

3. Business Combination

Cameleon Software, SA

On October 24, 2013, the Company entered into a tender offer agreement with Cameleon, indicating the Company's intent to acquire Cameleon through the tender offer for all of the outstanding share capital of Cameleon. As part of the tender offer, the Company placed approximately $40 million in escrow to fund the acquisition, which was included in current restricted cash as of December 31, 2013. On January 8, 2014, the Company announced that this tender offer for Cameleon was successful. As of the completion of the tender offer, the Company controlled 81.7% of Cameleon's common stock and 94.0% of Cameleon's outstanding warrants, inclusive of the commitments from Cameleon's management regarding their Cameleon free shares. As a result of shares purchased by the Company in the market following the completion of the tender, as of June 30, 2014, the Company controlled 91.5% of Cameleon. All amounts pertaining to the approximate 8.5% of Cameleon that the Company does not own are reported as non-controlling interest in the Company's condensed consolidated financial statements.

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During the three and six months ended June 30, 2014, the Company incurred acquisition-related costs of $0.3 million and $1.0 million, respectively, consisting primarily of retention of key employees, advisory and legal fees.

All of the assets acquired and the liabilities assumed in the transaction have been recognized at their acquisition date fair values at January 8, 2014.

The preliminary allocation of the purchase price for Cameleon is as follows (in thousands):

Cash and cash equivalents	$ 7,086
Accounts receivables	10,444
Prepaid and other assets	1,329
Intangible assets	18,653
Goodwill	16,227
Accounts payable and accrued liabilities	(13,009)
Deferred revenue	(5,392)
Non-controlling interest	(6,204)
Net assets acquired	$ 29,134

The following are the identifiable intangible assets acquired and their respective useful lives (in thousands):

	Amount	Useful Life (years)
Trade Name	$ 1,020	8
Customer Relationships	1,455	2-5
Maintenance Relationships	3,808	8
Developed Technology	11,147	7
Other	1,223	2
Total	$ 18,653	

In performing the preliminary purchase price allocation, the Company considered, among other factors, its anticipated future use of the acquired assets, analysis of historical financial performance, and estimates of future cash flows from Cameleon's products and services. The allocation resulted in acquired intangible assets of $18.7 million. The acquired intangible assets consisted of developed technology, customer and maintenance relationships, trade name and other and were valued using the income approach in which the after-tax cash flows are discounted to present value. The cash flows are based on estimates used to price the transaction, and the discount rates applied were benchmarked with reference to the implied rate of return from the transaction model as well as the weighted average cost of capital. Additionally, the Company assumed certain liabilities in the acquisition, including deferred revenue to which a fair value of $5.4 million was ascribed using a cost-plus profit approach.

Liabilities assumed include $2.7 million related to the Company's offer to pay an additional €0.15 per share cash premium to the Cameleon stockholders tendering their shares and warrants if the Company succeeds acquiring at least 95% of the share capital and voting rights of Cameleon on a fully diluted basis on or before December 31, 2014. The Company has recorded this liability at fair value based on its determination that it expects to meet this threshold prior to December 31, 2014. In addition, the net assets acquired include contingent consideration of $1.4 million related to the committed purchase of free shares owned by Cameleon management.

Goodwill of $16.2 million represents the excess of the purchase price over the fair value of the underlying net tangible and identifiable intangible assets, and represents the expected synergistic benefits of the transaction, the knowledge and experience of Cameleon's workforce in place, and the expectation that the combined company’s complementary

products will significantly broaden the Company's CPQ solution offering. The Company believes the combined company will benefit from a broader global presence and, with the Company's direct sales force and larger channel coverage, significant cross selling opportunities. None of the goodwill is expected to be currently deductible for tax purposes. In accordance with applicable accounting standards, goodwill will not be amortized but instead will be tested for impairment at least annually, or, more frequently if certain indicators are present. In accordance with applicable accounting standards, goodwill is be amortized but instead will be tested for impairment at least

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annually, or, more frequently if certain indicators are present. In the event that the management of the combined company determines that the value of goodwill has become impaired, the combined company will incur an accounting charge for the amount of the impairment during the fiscal quarter in which the determination is made.

SignalDemand, Inc.

In December 2013, the Company acquired SignalDemand, Inc. for total cash consideration of $13.5 million.

During the three and six months ended June 30, 2014, the Company incurred acquisition-related costs of $0.3 million and $1.0 million, respectively, consisting primarily of retention of key employees, advisory, and legal fees.

All of the assets acquired and the liabilities assumed in the transaction have been recognized at their acquisition date fair values at December 16, 2013.

The preliminary allocation of the total purchase price for SignalDemand is as follows (in thousands):

Current assets	$881
Deferred tax asset - current	2,752
Noncurrent assets	193
Intangibles	8,300
Goodwill	7,076
Deferred tax asset - noncurrent	2,572
Accounts payable and accrued liabilities	(1,586)
Deferred revenue	(6,688)
Net assets acquired	$13,500

The following are the identifiable intangible assets acquired and their respective useful lives (in thousands):

	Amount	Useful Life (years)
Developed technology	$4,600	7
Internally developed technology	160	2
Customer relationships	3,500	8
Trade name	40	2
Total	$8,300	

In performing the preliminary purchase price allocation, the Company considered, among other factors, its anticipated future use of the acquired assets, analyses of historical financial performance, and estimates of future cash flows from SignalDemand's products and services. The allocation resulted in acquired intangible assets of $8.3 million. The acquired intangible assets consisted of developed technology, customer relationships and trade name and were valued using the income approach in which the after-tax cash flows are discounted to present value. The cash flows are based on estimates used to price the transaction, and the discount rates applied were benchmarked with reference to the implied rate of return from the transaction model as well as the weighted average cost of capital. Additionally, the Company assumed certain liabilities in the acquisition, including deferred revenue to which a fair value of $6.7 million was ascribed using a cost-plus profit approach.

The Company has made a preliminary determination that $5.3 million of net deferred tax assets were assumed on the acquisition date. The deferred tax assets primarily relate to net operating losses and other expenses accrued but not expensed for tax purposes.

The excess of the purchase price over the estimated amounts of net assets as of the effective date of the acquisition was allocated to goodwill. The factors contributing to the recognition of the amount of goodwill are based on several strategic and synergistic benefits that are expected to be realized from the SignalDemand acquisition. These benefits include the expectation that the combined company's complementary products will significantly broaden the Company's offerings in sales optimization solutions. The Company believes the combined company will benefit from a broader global presence and, with the Company's

direct sales force and larger channel coverage, significant cross selling opportunities. None of the goodwill is expected to be currently deductible for tax purposes. In accordance with applicable accounting standards, goodwill will not be amortized but instead will be tested for impairment at least annually, or, more frequently if certain indicators are present. In the event that the management of the combined company determines that the value of goodwill has become impaired, the combined company will incur an accounting charge for the amount of the impairment during the fiscal quarter in which the determination is made.

Pro Forma Financial Information

The unaudited financial information in the table below summarizes the combined results of operations of the Company, Cameleon and SignalDemand, on a pro forma basis, as though the Company had acquired Cameleon and SignalDemand on January 1, 2013. The pro forma information for all periods presented also includes the effect of business combination accounting resulting from the acquisition, including amortization charges from acquired intangible assets.

	Three months ended June 30,		Six months ended June 30,	
(in thousands, except earnings per share)	2014	2013	2014	2013
Total revenue	$44,368	$41,655	$85,533	$80,381
Net loss attributable to PROS Holdings, Inc.	(6,996)	(990)	(15,583)	(999)
Earnings per share - basic and diluted	$(0.24)	$(0.04)	$(0.54)	$(0.04)

4. Non-controlling interest

The following table presents a roll forward of the non-controlling interest from the date of acquisition of Cameleon on January 8, 2014 through June 30, 2014 (in thousands):

Beginning balance as of January 8, 2014	$6,204
Change in Parent's ownership in the subsidiary	(3,410)
Net loss allocated to non-controlling interest	(663)
Foreign currency translation adjustment	20
Ending balance as of June 30, 2014	$2,151

5. Earnings per Share

The following table sets forth the computation of basic and diluted earnings per share for the three and six months ended June 30, 2014 and 2013:

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
(in thousands, except share data)	2014	2013	2014	2013
Numerator:				
Net (loss) income attributable to PROS Holdings, Inc.	$(6,996)	$580	$(15,451)	$2,314
Denominator:				
Weighted average shares (basic)	28,958,233	28,006,517	28,813,008	27,881,957
Dilutive effect of potential common shares	—	1,952,063	—	1,828,245
Weighted average shares (diluted)	28,958,233	29,958,580	28,813,008	29,710,202
Basic earnings per share	$(0.24)	$0.02	$(0.54)	$0.08
Diluted earnings per share	$(0.24)	$0.02	$(0.54)	$0.08

Dilutive potential common shares consist of shares issuable upon the exercise of stock options, settlement of SARs, and the vesting of RSUs and MSUs. Potential common shares determined to be antidilutive and excluded from diluted weighted average shares outstanding were approximately 3,400 and 2,300 for the three and six months ended June 30, 2013, respectively. Basic shares were used to calculate loss per share for the three and six months ended June 30, 2014.

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6. Noncash Share-based Compensation

During the three months ended June 30, 2014, the Company granted 108,942 shares of RSUs with a weighted average grant-date fair value of $25.50 per share. The Company did not grant any stock options, SARs or MSUs during the three months ended June 30, 2014.

During the six months ended June 30, 2014, the Company granted 902,012 shares of RSUs with a weighted average grant-date fair value of $31.97 per share. The Company granted 185,600 MSUs with a weighted average grant-date fair value of $49.50 to certain executive officers and non-executive employees during the six months ended June 30, 2014. These MSUs vest on January 1, 2017 and the actual number of MSUs that will be eligible to vest is based on the total stockholder return of the Company relative to the total stockholder return of the Index over the Performance Period, as defined by each award's plan documents or individual award agreements. The Company did not grant any stock options or SARs during the six months ended June 30, 2014.

Share-based compensation expense is allocated to expense categories on the unaudited condensed consolidated statements of comprehensive income. The following table summarizes share-based compensation expense included in the Company’s unaudited condensed consolidated statements of comprehensive income for the three and six months ended June 30, 2014 and 2013:

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2014	2013	2014	2013
Share-based compensation:				
Cost of revenue:				
License and implementation	$959	$534	$1,681	$996
Total included in cost of revenue	959	534	1,681	996
Operating expenses:				
Selling, marketing, general and administrative	3,770	2,838	6,442	5,059
Research and development	1,216	767	2,181	1,504
Total included in operating expenses	4,986	3,605	8,623	6,563
Total share-based compensation expense	$5,945	$4,139	$10,304	$7,559

In February 2014, the number of shares available for issuance increased by 900,000 to 8,168,000 under an evergreen provision in the Company's 2007 Equity Incentive Plan ("2007 Stock Plan"). As of June 30, 2014, 890,446 shares remained available for issuance under the 2007 Stock Plan. Also in February 2014, the Company granted inducement awards in an aggregate amount of up to 308,250 shares in accordance with NYSE Rule 303A.08. These inducement awards were in the form of RSUs and MSUs granted to our recently appointed Chief Operating Officer and RSUs granted to certain new employees in connection with our acquisitions of Cameleon and SignalDemand. At June 30, 2014, the Company had an estimated $56.3 million of total unrecognized compensation costs related to share-based compensation arrangements. These costs will be recognized over a weighted average period of 2.7 years.

In June 2013, the Board of Directors authorized an Employee Stock Purchase Plan (“ESPP”) which provides for eligible employees to purchase shares on an after-tax basis in an amount between 1% and 10% of their annual pay: (i) on June 30 of each year at a 5% discount of the fair market value of our common stock on January 1 or June 30, whichever is lower, and (ii) on December 31 of each year at a 5% discount of the fair market value of our common stock on July 1 or December 31, whichever is lower. An employee may not purchase more than $5,000 in either of the six-month measurement periods described above or more than $10,000 annually. As of June 30, 2014, there were 500,000 shares authorized for issuance under the ESPP plan, and approximately $0.3 million was held on behalf of employees for future purchases under the ESPP and was recorded in accrued expenses and other current liabilities in the Company's

balance sheet.

7. Commitments and Contingencies

Litigation

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In the ordinary course of business, the Company regularly becomes involved in contract and other negotiations and, in more limited circumstances, becomes involved in legal proceedings, claims and litigation. The outcomes of these matters are inherently unpredictable. The Company is not currently involved in any outstanding litigation that it believes, individually or in the aggregate, will have a material adverse effect on its business, financial condition, results of operations or cash flows.

Lease commitments

As a result of the Cameleon acquisition in January 2014, the Company assumed several operating leases for office space and office equipment that expire at various dates. As of June 30, 2014, the future minimum lease commitments related to these agreements were as follows:

Fiscal year	Amount
Second half of 2014	$559
2015	682
2016	624
2017	571
2018 and thereafter	86
Total minimum lease payments	$2,522

ITEM 2. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

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

This management’s discussion and analysis of financial condition and results of operations should be read along with the unaudited condensed consolidated financial statements and unaudited notes to condensed consolidated financial statements included in Item 1 of this Quarterly Report on Form 10-Q, as well as the audited consolidated financial statements and notes to consolidated financial statements and management’s discussion and analysis of financial condition and results of operations set forth in our Annual Report.

Overview

PROS provides big data software applications designed to help companies outperform in their markets by using big data to sell more effectively. We apply over two decades of data science experience to unlock buying patterns and preferences within transaction data to reveal which opportunities are most likely to close, which offers are most likely to sell and which prices are most likely to win. PROS offers big data software applications to analyze, execute and optimize sales, pricing, quoting, rebates and revenue management. We also provide professional services to implement our software applications, as well as business consulting. Since inception, PROS has completed over 700 implementations of our solutions across more than 40 industries in more than 55 countries.

In December 2013, we acquired SignalDemand, Inc. ("SignalDemand"), an optimization software company headquartered in San Francisco, California. This acquisition broadened our offering to companies in resource-based and commodity-driven industries, with products designed to help our clients better serve their customers in volatile markets with greater confidence and agility. Through its SaaS-based solutions, SignalDemand processes thousands of variables to deliver real-time recommendations to help companies make price and mix decisions across products, customers and channels.

In January 2014, we acquired approximately 81.7% of the common stock of Cameleon Software SA ("Cameleon"), a publicly traded French société anonyme, and a configure, price, and quote ("CPQ") software company headquartered in Toulouse, France. CPQ software helps companies drive sales growth by streamlining and simplifying the configuration, pricing and quote-generation activities that accompany negotiated selling. As of June 30, 2014, the Company owned 91.5% of the common stock of Cameleon following the Company's tender offer and purchase of additional shares of Cameleon in the open market.

We anticipate that the integration of PROS and Cameleon will provide a single platform that combines the transformational benefits of sales execution and big data science to optimize the lead-to-order process. Customers have been forced to use different technologies to optimize prices, and configure product offers and quotes. The combined solution would bring together two key

decisions in the sales process, providing best-in-class automation, data science, analytics and execution that gives sales representatives a competitive selling advantage.

Opportunities, Trends and Uncertainties

The opportunities, trends and uncertainties that we believe are particularly significant to understand our financial results and condition are:

- Variability in revenue. Our historical revenue recognition policy provides visibility into a significant portion of our revenue in the near-term quarters, although the actual timing of revenue recognition varies based on the nature and requirements of our contracts. For the majority of our arrangements, we have not historically recognized license revenue upon customer contract signature and software delivery, however, an increasing number of arrangements require recognition of license revenue upon contract signature and software delivery, and we anticipate that this trend will continue in the future. We evaluate our contract terms and conditions as well as our implementation performance obligations in making our revenue recognition determination for each customer contract. Our contractual performance obligations in the future may differ from historical periods which could impact the timing of recognition of revenue. For example, growth in our term license and cloud-based service offerings may result in the deferral of revenue over the contractual term, whereas growth in perpetual license arrangements that meet the criteria for separation may result in the recognition of license revenue on delivery, provided other revenue recognition criteria are met. Our revenue could also vary based on our customer mix and customer geographic location. We sell our software solutions to customers in the manufacturing, distribution, services and travel industries. From a geographical standpoint, approximately 52% of our consolidated revenues were derived from customers outside the United States for each of the three months ended June 30, 2014 and 2013, and approximately 54% and 52% for the six months ended June 30, 2014 and 2013, respectively. Our contracts with customers outside the United States are predominately denominated in U.S. dollars. The economic and political environments around the world could change our concentration of revenue within industries and across geographies.

- Growth opportunities. We believe the market for our big data software application is underpenetrated. Market interest for our software has increased over the past several years providing us with growth opportunities. We have and will continue to invest in our business to more effectively address these opportunities through significant investment in professional services, research and development, sales, marketing and back office. In addition to organic growth, we may acquire additional companies or technologies that can contribute to the strategic, operational and financial growth of our business. We expect to continue to explore both organic and other strategic growth opportunities.

- Managing our continued growth. Since 2010, we have experienced strong growth in both our revenue and operations, including significant growth in our sales and marketing personnel. Our continued success depends on, among other things, our ability to successfully recruit, train and retain personnel to execute our sales and marketing strategies, successfully integrate the operations and personnel of companies we have acquired or may acquire, appropriately manage our expenses as we grow, enter into and maintain beneficial channel relationships, and enhance and develop existing and new solutions. If we are not able to execute on these actions, our business may not grow as we anticipated.

- Uncertain global economic conditions. Global economic conditions have been uncertain in recent years. The uncertain economic conditions have had and may have a negative impact on the adoption of big data software and may increase the volatility in our business. Due to the uncertain economic conditions, we continue to experience long sales cycles, increased scrutiny on purchasing decisions and overall cautiousness taken by customers. In addition, certain foreign countries are still facing significant economic and political crises, and it is possible that these crises could result in economic deterioration in the markets in which we operate. We believe our solutions provide value to our customers during periods of economic growth as well as in recessions, but the extent to which the current

economic conditions will further affect our business is uncertain.

- Income taxes. For the three and six months ended June 30, 2014, our effective tax rate was 15% and 10% as compared to the federal rate of 34%. Historically, our provision for income taxes has differed from the tax computed at the U.S. federal statutory income tax rate of 34% primarily due to research and development tax credits. The R&E tax credit has not been extended for 2014. Our effective income tax rate may fluctuate quarterly as a result of factors, including transactions entered into, changes in the geographic distribution of our earnings or losses, our assessment of certain tax contingencies, valuation allowances, and changes in tax law in jurisdictions where we conduct business.

- Valuation allowance. We periodically evaluate the realizability of our net deferred tax assets based on all available evidence, both positive and negative. The realization of net deferred tax assets is dependent on our ability to generate sufficient future taxable income during periods prior to the expiration of tax attributes to fully utilize these assets. We

weighed both positive and negative evidence and determined that there is a continued need for a valuation allowance at certain of our subsidiaries due to a cumulative loss position over the previous three years, which is considered significant negative evidence. We have not changed our judgment regarding the need for a full valuation allowance on certain of our deferred tax assets as of June 30, 2014. However, continued improvement in our operating results in certain subsidiaries could lead to reversal of a portion of the related valuation allowance. Should we determine that it would be able to realize its remaining deferred tax assets in the foreseeable future, an adjustment to our remaining deferred tax assets would cause a material increase to income in the period such determination is made.

Results of Operations

Comparison of three months ended June 30, 2014 with three months ended June 30, 2013

Revenue:

	For the Three Months Ended June 30,								
	2014			2013			Variance		
(Dollars in thousands)	Amount	Percentage of Total Revenue		Amount	Percentage of Total Revenue		$	%	
License	$12,332	28	%	$9,725	27	%	$2,607	27	%
Services	13,079	29	%	12,509	35	%	570	5	%
Subscription	5,813	13	%	1,936	5	%	3,877	200	%
Total license, services and subscription	31,224	70	%	24,170	68	%	7,054	29	%
Maintenance and support	13,144	30	%	11,357	32	%	1,787	16	%
Total revenue	$44,368	100	%	$35,527	100	%	$8,841	25	%

License, services and subscription. License, services and subscription revenue increased $7.1 million to $31.2 million for the three months ended June 30, 2014, from $24.2 million for the three months ended June 30, 2013, representing a 29% increase. The increase in total license, services and subscription revenue was the result of a $3.9 million increase in subscription revenue, a $2.6 million increase in license revenue and a $0.6 million increase in services revenue.

License revenue increased $2.6 million to $12.3 million for the three months ended June 30, 2014, from $9.7 million for the three months ended June 30, 2013, representing a 27% increase. Our perpetual license revenue in a particular period is dependent upon the number of customers generating license revenue, the size of license contracts and the timing of contract execution. In addition, the timing of recognition of license revenue is also impacted by whether license revenue is recognized upon software delivery or recognized over the implementation period using the percentage of completion method. The increase in license revenue was attributable to an increase in the average license revenue recognized per customer. The average license revenue per customer, for customers with greater than $0.1 million of license revenue recognized, increased to $0.5 million for the three months ended June 30, 2014 from $0.35 million per customer for the three months ended June 30, 2013. The increase in average license revenue recognized per customer was primarily attributable to an increase in license revenue recognized upon software delivery. We recognized $5.7 million of license revenue upon software delivery for the three months ended June 30, 2014. No amount was recognized for the three months ended June 30, 2013.

Services revenue increased $0.6 million to $13.1 million for the three months ended June 30, 2014, from $12.5 million for the three months ended June 30, 2013, representing a 5% increase. The $0.6 million increase in services revenue was primarily attributed to $2.0 million of services revenue from our acquisitions partially offset by a decrease of $1.4 million in our services revenue from implementations of our software. The decrease of $1.4 million was primarily a

result of an increase in the number of third party's implementing our software, recent software implementations requiring less implementation services and several customers delaying some services into 2015. Total service revenue increased due to an overall increase in the number of customers generating services revenue. The total number of customers generating services revenue, including revenue from our acquisitions, was 127 as of June 30, 2014, as compared to 78 in the corresponding period in 2013, an increase of 63%.

Subscription revenue increased $3.9 million to $5.8 million for the three months ended June 30, 2014, from $1.9 million for the three months ended June 30, 2013, representing a 200% increase. The $3.9 million increase in subscription revenue was primarily attributed to $3.2 million of subscription revenue from our acquisitions and an increase in the total number of customers generating subscription revenue. The total number of customers generating subscription revenue was 77 as of June 30, 2014, as compared to 20 in the corresponding period in 2013, an increase of 285%.

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Maintenance and support. Maintenance and support revenue increased $1.8 million to $13.1 million for the three months ended June 30, 2014, from $11.4 million for the three months ended June 30, 2013, representing a 16% increase. The increase in maintenance and support revenue was principally a result of an increase in the number of customers purchasing maintenance and support services and $0.9 million of maintenance and support revenue from our acquisitions.

Cost of revenue and gross profit:

	For the Three Months Ended June 30,					
	2014		2013		Variance	
(Dollars in thousands)	Amount	Percentage of Related Revenue	Amount	Percentage of Related Revenue	$	%
Cost of license	$51	— %	$192	2 %	$(141)	(73)%
Cost of services	10,167	78 %	8,227	66 %	1,940	24 %
Cost of subscription	1,592	27 %	389	20 %	1,203	309 %
Total cost of license, services and subscription	11,810	38 %	8,808	36 %	3,002	34 %
Cost of maintenance and support	2,361	18 %	1,978	17 %	383	19 %
Total cost of revenue	$14,171	32 %	$10,786	30 %	$3,385	31 %
Gross profit	$30,197	68 %	$24,741	70 %	$5,456	22 %

Cost of license. Cost of license consists of third-party fees for licensed software. Cost of license decreased $0.1 million to $0.1 million for the three months ended June 30, 2014, from $0.2 million for the three months ended June 30, 2013. License gross profit percentages for the three months ended June 30, 2014 and 2013, were 100% and 98% respectively, as a result of limited third-party fees for licensed software incurred over both periods.

Cost of services. Cost of services increased $1.9 million to $10.2 million for the three months ended June 30, 2014, from $8.2 million for the three months ended June 30, 2013, representing a 24% increase. The increase was primarily attributable to an increase of $1.9 million related to our acquisitions. Services gross profit percentages for the three months ended June 30, 2014 and 2013, were 22% and 34% respectively. The twelve point decrease in services gross profit percentage was primarily driven by lower services utilization, in addition to lower service margins from our acquisitions. Service margins can vary from period to period depending on different factors, including the utilization of our professional services personnel and any additional headcount needed to support anticipated future implementations.

Cost of subscription. Cost of subscription increased $1.2 million to $1.6 million for the three months ended June 30, 2014, from $0.4 million for the three months ended June 30, 2013, representing a 309% increase. The increase was primarily attributable to a $1.1 million increase related to our acquisitions. Subscription gross profit percentages for the three months ended June 30, 2014 and 2013, were 73% and 80%, respectively. The seven point decrease in subscription gross profit percentage was attributable to our acquisitions.

Cost of maintenance and support. Cost of maintenance and support increased $0.4 million to $2.4 million for the three months ended June 30, 2014, from $2.0 million for the three months ended June 30, 2013. The increase in cost of maintenance and support was attributable to an increase in personnel costs associated with the continued growth in our customer maintenance and support function commensurate with our maintenance and support growth, $0.1 million of which were related to our acquisitions. Maintenance and support gross margins were 82% and 83% for the three months ended June 30, 2014 and 2013, respectively.

Gross profit. Gross profit increased $5.5 million to $30.2 million for the three months ended June 30, 2014, from $24.7 million for the three months ended June 30, 2013, representing a 22% increase. The increase in overall gross profit was attributable to a 25% increase in total revenue for the same period, which included revenue from our acquisitions. Our acquisitions contributed $3.1 million of gross profit for the three months ended June 30, 2014.

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Operating expenses:

	For the Three Months Ended June 30,					
	2014		2013		Variance	
(Dollars in thousands)	Amount	Percentage of Total Revenue	Amount	Percentage of Total Revenue	$	%
Selling, marketing, general and administrative	$24,267	55 %	$15,935	45 %	$8,332	52 %
Research and development	11,092	25 %	8,026	23 %	3,066	38 %
Acquisition-related	579	1 %	—	— %	579	— %
Impairment charge	2,130	5 %	—	— %	2,130	— %
Total operating expenses	$38,068	86 %	$23,961	67 %	$14,107	59 %

Selling, marketing, general and administrative expenses. Selling, marketing, general and administrative expenses increased $8.3 million, or 52%, to $24.3 million for the three months ended June 30, 2014, from $15.9 million for the three months ended June 30, 2013. The increase was attributable to an increase of $5.3 million of personnel costs, which included $1.8 million related to our our acquisitions. Personnel costs increased primarily as a result of an increase in headcount from our acquisitions and headcount in sales, marketing, general and administrative to support our current and future growth objectives. The majority of the increase in headcount was due to our acquisitions. Also included in the increase in personnel costs was an increase of $0.9 million of noncash share-based compensation and $0.7 million in commissions. In addition, the increase included $1.8 million of non-personnel related expenses related to our acquisitions, and the remaining increase primarily related to $0.5 million in recruiting expense, $0.5 million in travel, and $0.5 million in facility, depreciation and other overhead expenses.

Research and development expenses. Research and development expenses increased $3.1 million to $11.1 million for the three months ended June 30, 2014, from $8.0 million for the three months ended June 30, 2013, representing a 38% increase. The increase was attributable to an increase of $2.3 million of personnel costs, which included $1.0 million related to our acquisitions. Personnel costs, which include our employees and third party contractors, increased as a result of an increase in headcount from our acquisitions and additional headcount to support ongoing development activities. The majority of the increase in headcount was due to our acquisitions. Included in the increase in personnel costs was an increase of $0.4 million of noncash share based compensation expense. Additionally, there was an increase of $0.7 million of non-personnel related expenses related to our acquisitions.

Acquisition-related expenses. Acquisition-related expenses were $0.6 million for the three months ended June 30, 2014 consisting primarily of retention bonuses, advisory and legal fees, accounting and other professional fees related to our acquisition and integration of Cameleon and SignalDemand.

Impairment charge. During the quarter ended June 30, 2014 we recorded a $2.1 million impairment charge related to internally developed software. The impairment resulted from a reduction of projected cash flows for a product group based on revisions to our projections during the quarter and was recorded to reduce the carrying value to fair value. This reflected changes to our plans for this product group in connection with the integration of our acquisitions.

Other expense, net:

	For the Three Months Ended June 30,					
	2014		2013		Variance	
(Dollars in thousands)	Amount	Percentage of Total Revenue	Amount	Percentage of Total Revenue	$	%
Other expense, net	$(571)	— %	$(129)	— %	$(442)	nm

Other expense, net. Other expense, net consisted of interest income on our cash and cash equivalents, interest expense which included debt issuance cost amortization on the revolving credit facility ("Revolver") and foreign currency exchange gains and losses on transactions denominated in currencies other than the functional currency. Other expense, net increased by $0.4 million during the three months ended June 30, 2014, primarily due to net increases in foreign currency losses during the period.

Income tax (benefit) provision:

(Dollars in thousands)	For the Three Months Ended June 30, 2014		2013		Variance $		%	
Effective tax rate	15	%	11	%	n/a		4	%
Income tax (benefit) provision	$(1,240	)	$71		$(1,311	)	nm	

Income tax (benefit) provision. Our income tax benefit changed $1.3 million to $1.2 million for the three months ended June 30, 2014 from $0.1 million provision for the three months ended June 30, 2013. The change in the tax benefit was related to the Company's net loss in the quarter ended June 30, 2014 as compared to a net income in the quarter ended June 30, 2013. In addition, the change is primarily attributed to a projected decrease in federal taxes partially offset by higher foreign taxes.

Our effective tax rate was 15% and 11% for the three months ended June 30, 2014 and 2013, respectively. The difference between the effective tax rate and the federal statutory rate of 34% for the three months ended June 30, 2014 was due primarily to the limitation on the deductibility of certain officers’ compensation.

Comparison of six months ended June 30, 2014 with six months ended June 30, 2013

Revenue:

	For the Six Months Ended June 30, 2014			2013			Variance		
(Dollars in thousands)	Amount	Percentage of Total Revenue		Amount	Percentage of Total Revenue		$	%	
License	$24,195	28	%	$19,114	28	%	$5,081	27	%
Services	25,195	30	%	23,744	34	%	1,451	6	%
Subscription	10,126	12	%	3,904	6	%	6,222	159	%
Total license, services and subscription	59,516	70	%	46,762	68	%	12,754	27	%
Maintenance and support	25,765	30	%	22,391	32	%	3,374	15	%
Total revenue	$85,281	100	%	$69,153	100	%	$16,128	23	%

License, services and subscription. License, services and subscription revenue increased $12.8 million to $59.5 million for the six months ended June 30, 2014 from $46.8 million for the six months ended June 30, 2013, representing a 27% increase. The increase in total license, services and subscription revenue was was the result of a $6.2 million increase in subscription revenue, a $5.1 million increase in license revenue and a $1.5 million increase in services revenue.

License revenue increased $5.1 million to $24.2 million for the six months ended June 30, 2014 from $19.1 million for the six months ended June 30, 2013, representing a 27% increase. Our perpetual license revenue in a particular period is dependent upon the number of customers generating license revenue, the size of license contracts and the timing of contract execution. In addition, the timing of recognition of license revenue is also impacted by whether license revenue is recognized upon software delivery or recognized over the implementation period of solution sales using the percentage of completion method. The increase in license revenue was attributable to an increase in the average license revenue recognized per customer. The average license revenue per customer, for customers with greater than $0.1 million of license revenue recognized, increased to $0.7 million for the six months ended June 30, 2014 from $0.5 million per customer for the six months ended June 30, 2013. The increase in average license revenue

recognized per customer was primarily attributable to an increase in license revenue recognized upon software delivery. We recognized $9.7 million and $0.7 million of license revenue upon software delivery for the six months ended June 30, 2014 and 2013, respectively.

Services revenue increased $1.5 million to $25.2 million for the six months ended June 30, 2014 from $23.7 million for the six months ended June 30, 2013, representing a 6% increase. The $1.5 million increase in services revenue was primarily attributed to $3.4 million of services revenue from our acquisitions partially offset by a decrease of $1.9 million in our services revenue from implementations of our software. The decrease of $1.9 million was primarily a result of an increase in the number of third party's implementing our software, recent implementations requiring less implementation services and several customers delaying some services into 2015. Total service revenue increased due to an increase in the overall number of customers generating

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services revenue. The total number of customers generating services revenue was 148 as of June 30, 2014, as compared to 93 in the corresponding period in 2013, an increase of 59%.

Subscription revenue increased $6.2 million to $10.1 million for the six months ended June 30, 2014 from $3.9 million for the six months ended June 30, 2013, representing a 159% increase. The $6.2 million increase in subscription revenue was primarily attributed to $5.1 million of incremental subscription revenue from our acquisitions and an increase in the total number of customers generating subscription revenue. The total number of customers generating subscription revenue was 80 as of June 30, 2014, as compared to 20 in the corresponding period in 2013, an increase of 300%.

Maintenance and support. Maintenance and support revenue increased $3.4 million to $25.8 million for the six months ended June 30, 2014 from $22.4 million for the six months ended June 30, 2013, representing a 15% increase. The increase in maintenance and support revenue was principally a result of an increase in the number of customers purchasing maintenance and support services and $1.6 million of incremental maintenance and support revenue from our acquisitions.

Cost of revenue and gross profit:

	For the Six Months Ended June 30,									
	2014			2013			Variance			
(Dollars in thousands)	Amount	Percentage of Related Revenue		Amount	Percentage of Related Revenue		$		%	
Cost of license	$106	—	%	$233	1	%	$(127	)	(55	)%
Cost of services	20,620	82	%	16,160	68	%	4,460		28	%
Cost of subscription	2,517	25	%	885	23	%	1,632		184	%
Total cost of license, services and subscription	23,243	39	%	17,278	37	%	5,965		35	%
Cost of maintenance and support	4,937	19	%	4,061	18	%	876		22	%
Total cost of revenue	28,180	33	%	21,339	31	%	6,841		32	%
Gross profit	$57,101	67	%	$47,814	69	%	$9,287		19	%

Cost of license. Cost of license consists of third-party fees for licensed software. Cost of license decreased $0.1 million to $0.1 million for the six months ended June 30, 2014 from $0.2 million for the six months ended June 30, 2013. License gross profit percentages for the three months ended June 30, 2014 and 2013, were 100% and 98% respectively, as a result of limited third-party fees for licensed software incurred over both periods.

Cost of services. Cost of services increased $4.5 million to $20.6 million for the six months ended June 30, 2014 from $16.2 million for the six months ended June 30, 2013, representing a 28% increase. The increase was attributed to an increase of $4.9 million of personnel costs, which included $4.0 million related to our acquisitions. Personnel costs, which includes our employees and third-party contractors, increased primarily as a result of headcount from our acquisitions and additional headcount needed to support our implementations. The majority of our increase in headcount was due to our acquisitions. Included in the increase in personnel costs was an increase of $0.6 million of noncash share based compensation expense. In addition, there was a decrease of $0.5 million related to travel expenses. Services gross profit percentages for the six months ended June 30, 2014 and 2013, were 18% and 32% respectively. The fourteen point decrease in services gross profit percentage was primarily driven by lower services utilization, in addition to lower service margins from our acquisitions. Service margins can vary from period to period depending on different factors, including the utilization of our professional services personnel and any additional headcount needed to support anticipated future implementations.

Cost of subscription. Cost of subscription increased $1.6 million to $2.5 million for the six months ended June 30, 2014 from $0.9 million for the six months ended June 30, 2013, representing a 184% increase. The increase was attributable to a $1.6 million increase related to our acquisitions. Subscription gross profit percentages for the six months ended June 30, 2014 and 2013, were 75% and 77%, respectively. The two point decrease in subscription gross profit percentage was attributable to our acquisitions.

Cost of maintenance and support. Cost of maintenance and support increased $0.9 million to $4.9 million for the six months ended June 30, 2014 from $4.1 million for the six months ended June 30, 2013, representing a 22% increase. The increase in cost of maintenance and support was primarily attributable to an increase of $0.8 million of personnel costs associated with the continued growth in our customer maintenance and support function commensurate with our maintenance and support growth,

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$0.1 million of which were in relation to our acquisitions, in addition to a $0.1 million increase in other expenses. Maintenance and support gross margins were 81% and 82% for the six months ended June 30, 2014 and June 30, 2013, respectively.

Gross profit. Gross profit increased $9.3 million to $57.1 million for the six months ended June 30, 2014 from $47.8 million for the six months ended June 30, 2013, representing a 19% increase. The increase in overall gross profit was attributable to a 23% increase in total revenue, which included revenue from our acquisitions. Our acquisitions contributed $4.9 million of gross profit for the six months ended June 30, 2014.

Operating expenses:

	For the Six Months Ended June 30,								
	2014			2013			Variance		
(Dollars in thousands)	Amount	Percentage of Total Revenue		Amount	Percentage of Total Revenue		$	%	
Selling, marketing, general and administrative	$46,722	55	%	$30,223	44	%	$16,499	55	%
Research and development	22,651	27	%	16,121	23	%	6,530	41	%
Acquisition-related	1,969	2	%	—	—	%	1,969	—	%
Impairment charge	2,130	2	%	—	—	%	2,130	—	%
Total operating expenses	$73,472	86	%	$46,344	67	%	$27,128	59	%

Selling, marketing, general and administrative expenses. Selling, marketing, general and administrative expenses increased $16.5 million to $46.7 million for the six months ended June 30, 2014 from $30.2 million for the six months ended June 30, 2013, representing a 55% increase. The increase was attributable to an increase of $10.8 million of personnel costs, which included $3.7 million related to our acquisitions. Personnel costs increased primarily as a result of an increase in headcount from our acquisitions and headcount in sales, marketing, general and administrative to support our current and future growth objectives. The majority of the increase in headcount was due to our acquisitions. Also included in the increase in personnel costs was an increase of $1.3 million in commissions and $1.4 million of noncash share-based compensation. In addition, the increase included $3.5 million of non-personnel related expenses related to our acquisitions, and the remaining increase primarily related to $0.5 million in recruiting expense, $0.8 million in travel, and $0.8 million in facility and other overhead expenses.

Research and development expenses. Research and development expenses increased $6.5 million to $22.7 million for the six months ended June 30, 2014 from $16.1 million for the six months ended June 30, 2013, representing a 41% increase. The increase was attributable to an increase of $5.2 million of personnel costs, which included $2.8 million related to our acquisitions. Personnel costs, which include our employees and third party contractors, increased as a result of an increase in headcount from our acquisitions and headcount to support ongoing development activities. Included in the increase in personnel costs was an increase of $0.7 million of noncash share based compensation expense. Additionally, there was an increase of $1.3 million of non-personnel related expenses related to our acquisitions.

Acquisition-related expenses. Acquisition-related expenses were $2.0 million for the six months ended June 30, 2014 consisting primarily of retention bonuses, advisory and legal fees, accounting and other professional fees related to our acquisition and integration of Cameleon and SignalDemand.

Impairment charge. During the six months ended June 30, 2014 we recorded a $2.1 million impairment charge related to internally developed software. The impairment resulted from a reduction of projected cash flows for a product group based on revisions to our projections during the quarter and was recorded to reduce the carrying value to fair

value. This reflected changes to our plans for this product group in connection with the integration of our acquisitions.

Other expense, net:

	For the Six Months Ended June 30,					
	2014		2013		Variance	
(Dollars in thousands)	Amount	Percentage of Total Revenue	Amount	Percentage of Total Revenue	$	%
Other expense, net	$(1,543)	—	$(234)	—	$(1,309)	nm

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Other expense, net. Other expense, net consists of interest income on our cash and cash equivalents, interest expense which includes debt issuance cost amortization on the Revolver and foreign currency exchange gains and losses on transactions denominated in currencies other than the functional currency. Other expense, net increased by $1.3 million during the six months ended June 30, 2014, primarily due to net increases in foreign currency losses during the period and foreign currency losses on the restricted cash used for the acquisition of Cameleon.

Income tax benefit:

	For the Six Months Ended June 30,		Variance	
(Dollars in thousands)	2014	2013	$	%
Effective tax rate	10 %	(87)%	n/a	97 %
Income tax (benefit) provision	$(1,800)	$(1,078)	$(722)	67 %

Income tax benefit. Our income tax benefit was $1.8 million for the six months ended June 30, 2014 as compared to $1.1 million for the six months ended June 30, 2013. The increase in the income tax benefit is primarily due to a net loss for the six months ended June 30, 2014 as compared to net income for the six months ended June 30 , 2013, the 2013 R&E credit, recording additional valuation allowance due to losses during the first quarter of 2014, and an increase in nondeductible officer’s compensation between the two periods. In addition, the income tax benefit for the six months ended June 30, 2013 included a $1.4 million discrete benefit attributed to the 2012 Research and Experimentations ("R&E") tax credit that was retroactively reinstated in 2013 and the 2013 R&E credit.

Our effective tax rate was 10% and (87)% for the six months ended June 30, 2014 and 2013, respectively. The difference between the effective tax rate and the federal statutory rate of 34% for the six months ended June 30, 2014 was due primarily to the limitation on the deductibility of certain officers’ compensation and valuation allowances related to foreign losses.

Liquidity and Capital Resources

Liquidity

At June 30, 2014, we had $30.0 million of cash and cash equivalents and $27.8 million of working capital as compared to $44.7 million of cash and cash equivalents and $72.1 million of working capital at December 31, 2013. Year-to-date, working capital decreased primarily due to restricted cash paid as part of the Company's acquisition of Cameleon. The majority of our cash and cash equivalents are denominated in the U.S. dollar and are held in financial institutions located in the U.S. Our principal sources of liquidity are our cash and cash equivalents, cash flows generated from operations and potential borrowings under our Revolver. Our material drivers or variants of operating cash flow are net income, noncash expenses (principally share-based compensation) and the timing of periodic billings and collections related to the sale of our solutions, and related services, maintenance and cloud-based services. The primary source of operating cash flows is the collection of accounts receivable balances from our customers. Our operating cash flows are also impacted by the timing of payments to our vendors for accounts payable and other liabilities. We generally pay our vendors and service providers in accordance with the invoice terms and conditions.

We believe our existing cash and cash equivalent balances, funds available under our Revolver and our current estimates of future operating cash flows will provide adequate liquidity and capital resources to meet our operational requirements and anticipated capital expenditures for the next twelve months. Our future working capital requirements will depend on many factors, including the operations of our existing business, our potential strategic expansion, future acquisitions we might undertake, and the expansion into complementary businesses. If such need arises, we may raise additional funds through equity or debt financings. At June 30, 2014, we had $2.5 million of current restricted cash related to the Cameleon acquisitions and $0.1 million of noncurrent restricted cash related to a letter of credit.

The following table presents key components of our unaudited condensed consolidated statements of cash flows for the six months ended June 30, 2014 and 2013:

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(Dollars in thousands)	For the Six Months Ended June 30, 2014	2013
Net cash (used in) provided by operating activities	$(9,086)	$7,934
Net cash provided by (used in) investing activities	9,027	(3,706)
Net cash (used in) provided by financing activities	(14,638)	441
Cash and cash equivalents (beginning of period)	44,688	83,558
Cash and cash equivalents (end of period)	$30,034	$88,227

Net cash (used in) provided by operating activities. Net cash used in operating activities for the six months ended June 30, 2014 was $9.1 million compared to net cash provided by operating activities of $7.9 million for the six months ended June 30, 2013. The $17.0 million change was primarily due to a $18.4 million decrease in net income and the net impact of working capital changes.

Net cash provided by (used in) investing activities. Net cash provided by investing activities was $9.0 million for the six months ended June 30, 2014 compared to net cash used in investing activities of $3.7 million for the six months ended June 30, 2013. The increase in net cash provided in investing activities for the six months ended June 30, 2014 as compared to the corresponding period in 2013 was primarily to acquire a majority stake in Cameleon and a $2.3 million increase in purchases of property and equipment, offset by $37.2 million decrease of restricted cash related to the Cameleon acquisition.

Net cash (used in) provided by financing activities. Net cash used in financing activities was $14.6 million for the six months ended June 30, 2014 compared to net cash provided by financing activities of $0.4 million for the six months ended June 30, 2014. The increase for the six months ended June 30, 2014 as compared to the corresponding period in 2013 was primarily the result of a decrease in net cash provided by the exercise of stock options of $1.7 million, offset by a $10.0 million increase in tax withholding related to net share settlements of restricted stock units and market stock units, and $3.4 million of cash used in the acquisition of additional common shares of Cameleon which reduced the non-controlling interest during the period.

Off-Balance Sheet Arrangements

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

Contractual Obligations and Commitments

Except as described below, there have been no material changes to our contractual obligations and commitments disclosed in our Annual Report.

Operating Leases

The following table sets forth the contractual obligations as of June 30, 2014, and relates to operating leases for office space and office equipment assumed as part of the Cameleon acquisition (in thousands):

Payment due by period	
Fiscal year	Amount
Second half of 2014	$559

2015	682
2016	624
2017	571
2018 and thereafter	86
Total minimum lease payments	$2,522

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Credit facility

As of June 30, 2014, we had $0.2 million of unamortized debt issuance costs related to the Revolver included in other long-term assets in the unaudited condensed consolidated balance sheets. For the three and six months ended June 30, 2014 and 2013, $12,500 and $25,000 respectively, of debt issue cost amortization are included in other expense, net in the unaudited condensed consolidated statements of comprehensive income.

In July 2012, we entered into a $50 million secured Credit Agreement (the "Revolver"). There were no outstanding borrowings under the Revolver as of June 30, 2014.

Recent Accounting Pronouncements

See Note 2, “Recent Accounting Pronouncements,” of Notes to Unaudited Condensed Consolidated Financial Statements of this Form 10-Q for discussion of recent accounting pronouncements including the respective expected dates of adoption.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Foreign Currency Exchange Risk

Our contracts are predominately denominated in U.S. dollars. We are exposed to foreign currency exchange risk because we also have contracts denominated in foreign currencies. The effect of a hypothetical 10% adverse change in exchange rates on our foreign denominated receivables as of June 30, 2014 would result in a loss of approximately $0.4 million. We are also exposed to foreign currency risk due to our French subsidiary, Cameleon Software SA. A hypothetical 10% adverse change in the value of the U.S. dollar in relation to the Euro, which is the Company’s single most significant foreign currency exposure, would have changed revenue for the three and six months ended June 30, 2014 by approximately $0.3 million and $0.5 million, respectively. In addition, we have operating subsidiaries in the United Kingdom, Canada and Germany. However, due to the relatively low volume of payments made and received by the Company through its foreign subsidiaries, we do not believe that we have significant exposure to foreign currency exchange risks. Fluctuations in foreign currency exchange rates could harm our financial results in the future.

We currently do not use derivative financial instruments to mitigate foreign currency exchange risks. We continue to review this matter and may consider hedging certain foreign exchange risks through the use of currency futures or options in future years.

Exposure to Interest Rates

The Company is exposed to market risk for changes in interest rates related to the variable interest rate on borrowings under the Company’s Revolver. As of June 30, 2014, the Company had no borrowings under the Revolver.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our chief executive officer and chief financial officer, evaluated the effectiveness of our disclosure controls and procedures as defined in Rules 13a-15(e) or 15d-15(e) under the Exchange Act of 1934, as amended (the "Exchange Act") as of June 30, 2014. Based on our evaluation of our disclosure controls and procedures as of June 30, 2014, our chief executive officer and chief financial officer concluded that our disclosure controls and procedures were effective to ensure that information we are required to disclose in reports that

we file or submit under the Exchange Act (i) is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms, and (ii) is accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Control over Financial Reporting

In December 2013, we acquired SignalDemand, Inc. in an all cash transaction. See Note 3, "Business Combinations" - SignalDemand, Inc. to the unaudited interim consolidated financial statements included in this Quarterly Report on SEC form 10-Q for a discussion of this acquisition and related financial data. On January 8, 2014, we acquired control of Cameleon Software, SA through a cash tender offer. See Note 3, "Business Combinations" - Cameleon Software, SA to the unaudited interim consolidated financial statements included in this Quarterly Report on SEC Form 10-Q for a discussion of this acquisition and related financial data. Management has considered these acquisitions material to the results of operations, cash flows and financial position from

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the date of the acquisitions through June 30, 2014. In accordance with SEC guidance, management has elected to exclude SignalDemand, Inc. and Cameleon Software, SA from management's assessment of, and report on, internal controls over financial reporting from the date of each acquisition through June 30, 2014. We are in the process of reviewing the operations of SignalDemand, Inc. and Cameleon Software, SA and evaluating the impact of each of these acquisitions on our internal controls over financial reporting. Excluding these acquisitions, there have been no changes in our internal control over financial reporting during the three months ended June 30, 2014 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

From time to time, we are a party to legal proceedings and claims arising in the ordinary course of business. We are not currently aware of any such proceedings or claims that we believe will have, individually or in the aggregate, a material adverse effect on our business, financial condition, results of operations or cash flows.

ITEM 1A. RISK FACTORS

There have been no material changes to the risk factors as presented in our Annual Report on Form 10-K for the year ended December 31, 2013 as updated in our Quarterly Report on Form 10-Q for the quarter ended March 31, 2014.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS.

We have an ongoing authorization from our Board of Directors to repurchase up to $15.0 million in shares of our common stock in the open market or through privately negotiated transactions. As of June 30, 2014, $10.0 million remained available for repurchase under the existing repurchase authorization.

We did not make any purchases of our common stock under this program for the three months ended June 30, 2014.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

None.

ITEM 4. MINE SAFETY DISCLOSURE

None.

ITEM 5. OTHER INFORMATION.

None.

ITEM 6. EXHIBITS.

Index to Exhibits

Exhibit No.	Description	Provided Herewith	Incorporated by Reference		
			Form	SEC File No.	Filing Date
10.1+	Employment Agreement by and between PROS, Inc., PROS Holdings, Inc. and D. Blair Crump, dated as of February 10, 2014.		8-K		2/10/2014
10.2+	Market Stock Units Grant Notice and Market Stock Units Award Agreement by and between PROS Holdings, Inc. and D. Blair Crump, dates as of February 24, 2014.		S-8		2/24/2014
10.3+	Form of Restricted Stock Units Grant Notice and Restricted Stock Units Agreement (non-plan award).		S-8		2/24/2014
10.4+	Second Amended and Restated Employment Agreement by and between PROS, Inc., PROS Holdings, Inc., and Charles H. Murphy, dated as of April 8, 2014.		8-K		4/9/2014
31.1	Certification of Chief Executive Officer Pursuant to Exchange Act Rule 13a-14(a)/15d-14(a).	X			
31.2	Certification of Chief Financial Officer Pursuant to Exchange Act Rule 13a-14(a)/ 15d-14(a).	X			
32.1*	Certifications of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350.	X			

Exhibit No.	Description
101.INS	XBRL Instance Document.
101.SCH	XBRL Taxonomy Extension Schema Document.
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document.
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document.
101.LAB	XBRL Taxonomy Extension Label Linkbase Document.
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document.

* This certification shall not be deemed “filed” for purposes of Section 18 of the Securities Act of 1934, or otherwise subject to the liability of that Section, nor shall it be deemed to be incorporated by reference into any

filing under the Securities Act of 1933 or the Securities Exchange Act of 1934

+ Indicates a management contract or compensatory plan or arrangement.

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SIGNATURES

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

		PROS HOLDINGS, INC.
August 8, 2014	By:	/s/ Andres Reiner Andres Reiner President and Chief Executive Officer (Principal Executive Officer)
August 8, 2014	By:	/s/ Charles H. Murphy Charles H. Murphy Executive Vice President and Chief Financial Officer (Principal Financial and Accounting Officer)

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