SALESFORCE COM INC
Form 10-Q
November 28, 2012
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x **Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the quarterly period ended October 31, 2012

OR

¨ **Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
Commission File Number: 001-32224

salesforce.com, inc.

(Exact name of registrant as specified in its charter)

Delaware	**94-3320693**
(State or other jurisdiction of incorporation or organization)	**(IRS Employer Identification No.)**

The Landmark @ One Market, Suite 300

San Francisco, California 94105

(Address of principal executive offices)

Telephone Number (415) 901-7000

(Registrant s telephone number, including area code)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 (the Exchange Act) 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 (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

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

Large accelerated filer x	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company ¨

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

As of October 31, 2012, there were approximately 142.0 million shares of the Registrant s Common Stock outstanding.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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Condensed Consolidated Balance Sheets

(in thousands)

	October 31, 2012 (unaudited)	January 31, 2012
Assets		
Current assets:		
Cash and cash equivalents	$ 521,720	$ 607,284
Short-term marketable securities	83,844	170,582
Accounts receivable, net	418,590	683,745
Deferred commissions	100,808	98,471
Deferred income taxes, net	14,723	31,821
Prepaid expenses and other current assets	117,600	80,319
Total current assets	1,257,285	1,672,222
Marketable securities, noncurrent	810,486	669,308
Property and equipment, net	583,839	527,946
Deferred commissions, noncurrent	80,304	78,149
Deferred income taxes, noncurrent, net	6,285	87,587
Capitalized software, net	225,137	188,412
Goodwill	1,525,154	785,381
Other assets, net	153,800	155,149
Total assets	$ 4,642,290	$ 4,164,154
Liabilities, temporary equity and stockholders equity		
Current liabilities:		
Accounts payable	$ 57,940	$ 33,258
Accrued expenses and other liabilities	524,267	502,442
Deferred revenue	1,226,118	1,291,622
Convertible senior notes, net	514,891	496,149
Total current liabilities	2,323,216	2,323,471
Income taxes payable, noncurrent	46,246	37,258
Long-term lease liabilities and other	63,629	48,651
Deferred revenue, noncurrent	65,585	88,673
Total liabilities	2,498,676	2,498,053
Temporary equity	59,999	78,741
Stockholders equity:		
Common stock	142	137
Additional paid-in capital	2,149,962	1,415,077
Accumulated other comprehensive income	23,649	12,683

Retained earnings (deficit)	(90,138)	159,463
Total stockholders equity	2,083,615	1,587,360
Total liabilities, temporary equity and stockholders equity	$ 4,642,290	$ 4,164,154

See accompanying Notes.

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Condensed Consolidated Statements of Operations

(in thousands, except per share data)

(unaudited)

	Three Months Ended October 31, 2012	Three Months Ended October 31, 2011	Nine Months Ended October 31, 2012	Nine Months Ended October 31, 2011
Revenues:				
Subscription and support	$ 740,600	$ 549,182	$ 2,083,313	$ 1,531,965
Professional services and other	47,798	35,078	132,201	102,661
Total revenues	788,398	584,260	2,215,514	1,634,626
Cost of revenues (1)(2):				
Subscription and support	134,183	96,306	361,446	260,693
Professional services and other	52,065	32,259	138,771	91,848
Total cost of revenues	186,248	128,565	500,217	352,541
Gross profit	602,150	455,695	1,715,297	1,282,085
Operating expenses (1)(2):				
Research and development	114,074	76,049	308,292	214,734
Marketing and sales	428,507	304,571	1,178,456	842,043
General and administrative	113,757	85,232	318,452	254,016
Total operating expenses	656,338	465,852	1,805,200	1,310,793
Loss from operations	(54,188)	(10,157)	(89,903)	(28,708)
Investment income	3,887	5,136	15,521	18,303
Interest expense	(8,190)	(3,859)	(22,593)	(11,376)
Other income (expense)	(4,360)	30	(4,776)	(4,001)
Loss before benefit from (provision for) income taxes	(62,851)	(8,850)	(101,751)	(25,782)
Benefit from (provision for) income taxes (3)	(157,446)	5,094	(147,850)	18,288
Net loss	$ (220,297)	$ (3,756)	$ (249,601)	$ (7,494)
Basic net loss per share	$ (1.55)	$ (0.03)	$ (1.78)	$ (0.06)
Diluted net loss per share	$ (1.55)	$ (0.03)	$ (1.78)	$ (0.06)
Shares used in computing basic net loss per share	142,203	135,847	139,959	134,824
Shares used in computing diluted net loss per share	142,203	135,847	139,959	134,824

(1) Amounts include amortization of purchased intangibles from business combinations, as follows:	Three Months Ended October 31, 2012	Three Months Ended October 31, 2011	Nine Months Ended October 31, 2012	Nine Months Ended October 31, 2011
Cost of revenues	$ 23,247	$ 17,469	$ 58,363	$ 42,937
Marketing and sales	2,995	953	8,829	4,499

(2) Amounts include stock-based expenses, as follows:	Three Months Ended October 31, 2012	Three Months Ended October 31, 2011	Nine Months Ended October 31, 2012	Nine Months Ended October 31, 2011
Cost of revenues	$ 9,336	$ 4,138	$ 24,453	$ 12,168
Research and development	21,984	12,197	53,740	31,224
Marketing and sales	55,304	29,123	142,072	80,024
General and administrative	18,488	11,548	51,530	35,742

	Three Months Ended October 31,	Nine Months Ended October 31,

(3) Amount includes one-time tax items, as follows:	2012	2011	2012	2011
Benefit from (provision for) income taxes	$ (149,147)	$ 0	$ (149,147)	$ 0

See accompanying Notes.

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Condensed Consolidated Statements of Comprehensive Loss

(in thousands)

(unaudited)

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2012	2011	2012	2011
Net loss	$ (220,297)	$ (3,756)	$ (249,601)	$ (7,494)
Other comprehensive income (loss), before tax and net of reclassification adjustments:				
Foreign currency translation and other gains	3,134	1,666	10,081	447
Unrealized gains (losses) on investments	1,252	(7,361)	1,411	(4,616)
Other comprehensive income (loss), before tax	4,386	(5,695)	11,492	(4,169)
Tax effect	(467)	2,453	(526)	1,427
Other comprehensive income (loss), net of tax	3,919	(3,242)	10,966	(2,742)
Comprehensive loss	$ (216,378)	$ (6,998)	$ (238,635)	$ (10,236)

See accompanying Notes.

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Condensed Consolidated Statements of Cash Flows

(in thousands)

(unaudited)

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2012	2011	2012	2011
Operating activities:				
Net loss	$ (220,297)	$ (3,756)	$ (249,601)	$ (7,494)
Adjustments to reconcile net loss to net cash provided by operating activities:				
Depreciation and amortization	59,960	41,553	159,400	111,385
Amortization of debt discount and transaction costs	6,471	2,138	17,511	6,470
Amortization of deferred commissions	39,070	26,862	111,099	76,453
Expenses related to employee stock plans	105,112	57,006	271,795	159,158
Excess tax benefits from employee stock plans	(3,160)	(6,892)	(28,905)	(11,012)
Tax valuation allowance	149,147	0	149,147	0
Changes in assets and liabilities:				
Accounts receivable, net	33,664	30,101	270,802	120,152
Deferred commissions	(48,251)	(33,611)	(115,591)	(80,252)
Prepaid expenses and other current assets	39,390	9,035	(16,706)	(9,959)
Other assets	6,775	4,693	7,639	67
Accounts payable	(14,356)	5,944	21,725	8,928
Accrued expenses and other current liabilities	1,152	13,081	(51,118)	(4,936)
Deferred revenue	(48,762)	(17,445)	(91,873)	(17,800)
Net cash provided by operating activities	105,915	128,709	455,324	351,160
Investing activities:				
Business combinations, net of cash acquired	(515,760)	(66,115)	(574,751)	(364,785)
Land activity and building improvements	0	(6,654)	(4,106)	(13,090)
Strategic investments	(1,657)	(21,508)	(5,451)	(34,723)
Purchases of marketable securities	(213,505)	(100,664)	(808,409)	(408,228)
Sales of marketable securities	82,085	126,672	630,317	563,621
Maturities of marketable securities	41,992	13,159	126,879	31,894
Capital expenditures	(51,054)	(34,678)	(125,079)	(107,043)
Net cash used in investing activities	(657,899)	(89,788)	(760,600)	(332,354)
Financing activities:				
Proceeds from equity plans	76,483	15,794	203,874	90,362
Excess tax benefits from employee stock plans	3,160	6,892	28,905	11,012
Contingent consideration payment related to prior business combinations	0	0	0	(16,200)
Principal payments on capital lease obligations	(7,664)	(7,685)	(22,717)	(21,796)
Net cash provided by financing activities	71,979	15,001	210,062	63,378
Effect of exchange rate changes	995	(729)	9,650	(3,489)
Net increase (decrease) in cash and cash equivalents	(479,010)	53,193	(85,564)	78,695
Cash and cash equivalents, beginning of period	1,000,730	449,794	607,284	424,292

Cash and cash equivalents, end of period	$ 521,720	$ 502,987	$ 521,720	$ 502,987
Supplemental cash flow disclosure:				
Cash paid during the period for:				
Interest, net	$ 641	$ 632	$ 4,031	$ 3,718
Income taxes, net of tax refunds	$ 6,514	$ 7,858	$ 51,981	$ 19,864
Non-cash financing and investing activities:				
Fixed assets acquired under capital leases	$ 9,788	$ 18,600	$ 25,585	$ 65,803
Fair value of equity awards assumed (Note 4)	$ 37,428	$ 1,043	$ 37,898	$ 5,772

See accompanying Notes.

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Notes to Condensed Consolidated Financial Statements

1. Summary of Business and Significant Accounting Policies

Description of Business

Salesforce.com, inc. (the Company) is a leading provider of enterprise cloud computing services. The Company is dedicated to helping customers of all sizes and industries worldwide transform themselves into social enterprises. Social enterprises leverage social, mobile and open technologies to place their customers and employees at the center of their business and to engage and collaborate with them in new and powerful ways.

Fiscal Year

The Company s fiscal year ends on January 31. References to fiscal 2013, for example, refer to the fiscal year ending January 31, 2013.

Basis of Presentation

The accompanying condensed consolidated balance sheet as of October 31, 2012 and the condensed consolidated statements of operations, the condensed consolidated statement of comprehensive income (loss) and the condensed consolidated statements of cash flows for the three and nine months ended October 31, 2012 and 2011, respectively, are unaudited. The condensed consolidated balance sheet data as of January 31, 2012 was derived from the audited consolidated financial statements which are included in the Company s Form 10-K for the fiscal year ended January 31, 2012, which was filed with the Securities and Exchange Commission (the SEC) on March 9, 2012. The accompanying statements should be read in conjunction with the audited consolidated financial statements and related notes contained in the Company s fiscal 2012 Form 10-K. During the first quarter of fiscal 2013, the Company adopted the requirements of Accounting Standards Update No. 2011-05, *Comprehensive Income (Topic 220) Presentation of Comprehensive Income* by presenting the total of comprehensive income (loss), the components of net loss, and the components of other comprehensive income in two separate but consecutive statements.

The accompanying condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (U.S. GAAP) for interim financial information. Accordingly, they do not include all of the financial information and footnotes required by U.S. GAAP for complete financial statements. In the opinion of the Company s management, the unaudited condensed consolidated financial statements have been prepared on the same basis as the audited consolidated financial statements in the Form 10-K, and include all adjustments necessary for the fair presentation of the Company s statement of financial position as of October 31, 2012, and its results of operations, including its comprehensive income (loss), and its cash flows for the three and nine months ended October 31, 2012 and 2011. All adjustments are of a normal recurring nature. The results for the three and nine months ended October 31, 2012 are not necessarily indicative of the results to be expected for any subsequent quarter or for the fiscal year ending January 31, 2013.

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions in the Company s condensed consolidated financial statements and notes thereto.

Significant estimates and assumptions made by management include the determination of:

- the best estimate of selling price of the deliverables included in multiple-deliverable revenue arrangements,
- the fair value of assets acquired and liabilities assumed for business combinations,
- recognition, measurement and valuation of current and deferred income taxes,

the fair value of stock awards issued, and

the valuation of strategic investments and the determination of other-than-temporary impairments.

Actual results could differ materially from those estimates.

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Principles of Consolidation

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

Segments

The Company operates as one operating segment. Operating segments are defined as components of an enterprise for which separate financial information is evaluated regularly by the chief operating decision maker, or decision making group, in deciding how to allocate resources and assessing performance. Over the past few years, the Company has completed several acquisitions. These acquisitions have allowed the Company to expand its offerings, presence and reach in various segments of the enterprise cloud computing market. While the Company has offerings in multiple enterprise cloud computing market segments, the Company s business operates in one operating segment because the Company s chief operating decision maker evaluates the Company s financial information and resources and assesses the performance of these resources on a consolidated basis. Since the Company operates in one operating segment, all required financial segment information can be found in the condensed consolidated financial statements.

Concentrations of Credit Risk and Significant Customers

The Company s financial instruments that are exposed to concentrations of credit risk consist primarily of cash and cash equivalents, marketable securities and trade accounts receivable. Although the Company deposits its cash with multiple financial institutions, its deposits, at times, may exceed federally insured limits. Collateral is not required for accounts receivable. The Company maintains an allowance for doubtful accounts receivable balances. The allowance is based upon historical loss patterns, the number of days that billings are past due and an evaluation of the potential risk of loss associated with delinquent accounts.

No customer accounted for more than five percent of accounts receivable at October 31, 2012 and one customer accounted for six percent of accounts receivable at January 31, 2012. No single customer accounted for five percent or more of total revenue in the three and nine months ended October 31, 2012 and 2011.

As of both October 31, 2012 and January 31, 2012, assets located outside the Americas were 13 percent of total assets, respectively.

Revenues by geographical region are as follows (in thousands):

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2012	2011	2012	2011
Americas	$ 547,399	$ 397,118	$ 1,540,326	$ 1,104,052
Europe	133,791	103,864	376,694	300,315
Asia Pacific	107,208	83,278	298,494	230,259
	$ 788,398	$ 584,260	$ 2,215,514	$ 1,634,626

Revenue Recognition

The Company derives its revenues from two sources: (1) subscription revenues, which are comprised of subscription fees from customers accessing the Company s enterprise cloud computing services and from customers purchasing additional support beyond the standard support that is included in the basic subscription fees; and (2) related professional services such as process mapping, project management, implementation services and other revenue. Other revenue consists primarily of training fees.

The Company commences revenue recognition when all of the following conditions are satisfied:

There is persuasive evidence of an arrangement;

The service has been or is being provided to the customer;

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The collection of the fees is reasonably assured; and

The amount of fees to be paid by the customer is fixed or determinable.

The Company s subscription service arrangements are non-cancelable and do not contain refund-type provisions.

Subscription and Support Revenues

Subscription and support revenues are recognized ratably over the contract terms beginning on the commencement date of each contract, which is the date the Company s service is made available to customers. Amounts that have been invoiced are recorded in accounts receivable and in deferred revenue or revenue, depending on whether the revenue recognition criteria have been met.

Professional Services and Other Revenues

The majority of the Company s professional services contracts are on a time and material basis. When these services are not combined with subscription revenues as a single unit of accounting, as discussed below, these revenues are recognized as the services are rendered for time and material contracts, and when the milestones are achieved and accepted by the customer for fixed price contracts. Training revenues are recognized as the services are performed.

Multiple-Deliverable Arrangements

The Company enters into arrangements with multiple-deliverables that generally include subscription, premium support and professional services.

Prior to February 1, 2011, the deliverables in multiple-deliverable arrangements were accounted for separately if the delivered items had standalone value and there was objective and reliable evidence of fair value for the undelivered items. If the deliverables in a multiple-deliverable arrangement could not be accounted for separately, the total arrangement fee was recognized ratably as a single unit of accounting over the contracted term of the subscription agreement. A significant portion of the Company s multiple-deliverable arrangements were accounted for as a single unit of accounting because the Company did not have objective and reliable evidence of fair value for certain of its deliverables. Additionally, in these situations, the Company deferred the direct costs of a related professional services arrangement and amortized those costs over the same period as the professional services revenue was recognized.

In October 2009, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2009-13, *Revenue Recognition (Topic 605), Multiple-Deliverable Revenue Arrangements a consensus of the FASB Emerging Issues Task Force* (ASU 2009-13) which amended the previous multiple-deliverable arrangements accounting guidance. Pursuant to the updated guidance, objective and reliable evidence of fair value of the deliverables to be delivered is no longer required in order to account for deliverables in a multiple-deliverable arrangement separately. Instead, arrangement consideration is allocated to deliverables based on their relative selling price.

In the first quarter of fiscal 2012, the Company adopted this updated accounting guidance on a prospective basis. The Company applied the updated accounting guidance to those multiple-deliverable arrangements entered into or materially modified on or after February 1, 2011, which was the beginning of the Company s fiscal 2012.

The adoption of this updated accounting guidance did not have a material impact on the Company s financial condition, results of operations or cash flows for the fiscal year ended January 31, 2012. As of October 31, 2012, the deferred professional services revenue and deferred costs under the previous accounting guidance are $13.1 million and approximately $6.0 million, respectively, which will continue to be recognized over the related remaining subscription period.

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Under the updated accounting guidance, in order to treat deliverables in a multiple-deliverable arrangement as separate units of accounting, the deliverables must have standalone value upon delivery. If the deliverables have standalone value upon delivery, the Company accounts for each deliverable separately. Subscription services have standalone value as such services are often sold separately. In determining whether professional services have standalone value, the Company considers the following factors for each professional services agreement: availability of the services from other vendors, the nature of the professional services, the timing of when the professional services contract was signed in comparison to the subscription service start date and the contractual dependence of the subscription service on the customer s satisfaction with the professional services work. To date, the Company has concluded that all of the professional services included in multiple-deliverable arrangements executed have standalone value.

Under the updated accounting guidance, when multiple-deliverables included in an arrangement are separated into different units of accounting, the arrangement consideration is allocated to the identified separate units based on a relative selling price hierarchy. The Company determines the relative selling price for a deliverable based on its vendor-specific objective evidence of selling price (VSOE), if available, or its best estimate of selling price (BESP), if VSOE is not available. The Company has determined that third-party evidence of selling price (TPE) is not a practical alternative due to differences in its service offerings compared to other parties and the availability of relevant third-party pricing information. The amount of revenue allocated to delivered items is limited by contingent revenue, if any.

For certain professional services, the Company has established VSOE as a consistent number of standalone sales of this deliverable have been priced within a reasonably narrow range. The Company has not established VSOE for its subscription services due to lack of pricing consistency, the introduction of new services and other factors. Accordingly, the Company uses its BESP to determine the relative selling price.

The Company determined BESP by considering its overall pricing objectives and market conditions. Significant pricing practices taken into consideration include the Company s discounting practices, the size and volume of the Company s transactions, the customer demographic, the geographic area where services are sold, price lists, its go-to-market strategy, historical standalone sales and contract prices. The determination of BESP is made through consultation with and approval by the Company s management, taking into consideration the go-to-market strategy. As the Company s go-to-market strategies evolve, the Company may modify its pricing practices in the future, which could result in changes in relative selling prices, including both VSOE and BESP.

Deferred Revenue

The deferred revenue balance does not represent the total contract value of annual or multi-year, non-cancelable subscription agreements. Deferred revenue primarily consists of billings or payments received in advance of revenue recognition from subscription services described above and is recognized as the revenue recognition criteria are met. The Company generally invoices customers in annual or quarterly installments. Deferred revenue is influenced by several factors, including seasonality, the compounding effects of renewals, invoice duration, invoice timing and new business linearity within the quarter.

As a result of the updated accounting guidance previously described, billings against professional services arrangements entered into prior to February 1, 2011 were generally added to deferred revenue and recognized over the remaining related subscription contract term.

Deferred revenue that will be recognized during the succeeding twelve month period is recorded as current deferred revenue and the remaining portion is recorded as noncurrent.

Deferred Commissions

Deferred commissions are the incremental costs that are directly associated with non-cancelable subscription contracts with customers and consist of sales commissions paid to the Company s direct sales force.

The commissions are deferred and amortized over the non-cancelable terms of the related customer contracts, which are typically 12 to 24 months. The commission payments are paid in full the month after the customer s service commences. The deferred commission amounts are recoverable through the future revenue streams under the non-cancelable customer contracts. The Company believes this is the preferable method of accounting as the commission charges are so closely related to the revenue from the non-cancelable customer contracts that they should be recorded as an asset and charged to expense over the same period that the subscription revenue is recognized. Amortization of deferred commissions is included in marketing and sales expense in the accompanying condensed consolidated statements of operations.

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Cash and Cash Equivalents

The Company considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents. Cash and cash equivalents are stated at fair value.

Marketable Securities

Management determines the appropriate classification of marketable securities at the time of purchase and reevaluates such determination at each balance sheet date. Securities are classified as available for sale and are carried at fair value, with the unrealized gains and losses, net of tax, reported as a separate component of stockholders equity. Fair value is determined based on quoted market rates when observable or utilizing data points that are observable, such as quoted prices, interest rates and yield curves. Declines in fair value judged to be other-than-temporary on securities available for sale are included as a component of investment income. In order to determine whether a decline in value is other-than-temporary, the Company evaluates, among other factors: the duration and extent to which the fair value has been less than the carrying value and its intent and ability to retain the investment for a period of time sufficient to allow for any anticipated recovery in fair value. The cost of securities sold is based on the specific-identification method. Interest on securities classified as available for sale is also included as a component of investment income.

Fair Value Measurement

The Company measures its cash equivalents, marketable securities and foreign currency derivative contracts at fair value.

The Company reports its financial and non-financial assets and liabilities that are re-measured and reported at fair value at each reporting period.

The additional disclosures regarding the Company s fair value measurements are included in Note 2.

Property and Equipment

Property and equipment are stated at cost. Depreciation is calculated on a straight-line basis over the estimated useful lives of those assets.

Capitalized Software Costs

The Company capitalizes costs related to its enterprise cloud computing services and certain projects for internal use incurred during the application development stage. Costs related to preliminary project activities and post implementation activities are expensed as incurred. Internal-use software is amortized on a straight line basis over its estimated useful life, generally three years. Management evaluates the useful lives of these assets on an annual basis and tests for impairment whenever events or changes in circumstances occur that could impact the recoverability of these assets.

Goodwill, Intangible Assets, Long-Lived Assets and Impairment Assessments

The Company evaluates and tests the recoverability of its goodwill for impairment at least annually during the fourth quarter or more often if and when circumstances indicate that goodwill may not be recoverable.

Intangible assets are amortized over their useful lives. Each period the Company evaluates the estimated remaining useful life of its intangible assets and whether events or changes in circumstances warrant a revision to the remaining period of amortization. The carrying amounts of these assets are periodically reviewed for impairment whenever events or changes in circumstances indicate that the carrying value of these assets may not be recoverable. Recoverability of these assets is measured by comparison of the carrying amount of each asset to the future undiscounted cash flows the asset is expected to generate.

The Company evaluates the recoverability of its long-lived assets for possible impairment whenever events or circumstances indicate that the carrying amount of such assets may not be recoverable. If such review indicates that the carrying amount of long-lived assets is not recoverable, the carrying amount of such assets is reduced to fair value.

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Business Combinations

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. As a result, during the measurement period, which may be up to one year from the acquisition date, the Company may record adjustments to the fair value of assets acquired and liabilities assumed, with the corresponding offset to goodwill. 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.

In addition, income tax uncertainties and tax related valuation allowances assumed in connection with a business combination are initially estimated as of the acquisition date. The Company continues to collect information and reevaluates these items quarterly and records any adjustments to the Company s preliminary estimates to goodwill provided that the Company is within the measurement period. Subsequent to the measurement period, changes to these income tax uncertainties and tax related valuation allowances will affect the Company s provision for income taxes in the Company s condensed consolidated statements of operations.

Accounting for Stock-Based Compensation

The Company recognizes stock-based expenses related to stock options and restricted stock awards on a straight-line basis over the requisite service period of the awards, which is generally the vesting term of four years. The Company recognizes stock-based expenses related to shares issued pursuant to its Employee Stock Purchase Plan (ESPP) on a straight-line basis over the offering period, which is 12 months. Stock-based expenses are recognized net of estimated forfeiture activity.

The fair value of each stock option grant and stock purchase right granted under the ESPP was estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions and fair value per share:

	Three Months Ended October 31,		Nine Months Ended October 31,	
Stock Options	**2012**	**2011**	**2012**	**2011**
Volatility	47%	47%	47 - 51%	47 - 50%
Estimated life	3.7 years	3.7 years	3.7 years	3.7 years
Risk-free interest rate	0.47 - 0.57%	0.68 - 0.79%	0.43 - 0.77%	0.68 - 1.77%
Dividend yield	0	0	0	0
Weighted-average fair value per share of grants	$ 52.07	$ 49.89	$ 52.53	$ 57.90

	Three Months Ended October 31,		Nine Months Ended October 31,	
ESPP	**2012**	**2011**	**2012**	**2011**
Volatility	n/a	n/a	42 - 46%	n/a
Estimated life	n/a	n/a	0.75 years	n/a
Risk-free interest rate	n/a	n/a	0.12 - 0.13%	n/a
Dividend yield	n/a	n/a	0	n/a
Weighted-average fair value per share of grants	n/a	n/a	$ 40.37	n/a

The Company estimated its future stock price volatility considering both its observed option-implied volatilities and its historical volatility calculations. Management believes this is the best estimate of the expected volatility over the expected life of its stock options and stock purchase rights.

The estimated life for the stock options was based on an actual analysis of expected life. The estimated life for the ESPP was based on the two purchase periods within each offering period. The risk free interest rate is based on the rate for a U.S. government security with the same estimated life at the time of the option grant and the stock purchase rights.

There were no shares granted under the ESPP in the three months ended October 31, 2012 as these stock purchase rights are only granted in June and December. There was no stock-based expense related to the ESPP in the three or nine months ended October 31, 2011 because the Company did not commence the ESPP until December 2011.

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Income Taxes

The Company uses the liability method of accounting for income taxes. Under this method, deferred tax assets and liabilities are determined based on temporary differences between the financial statement and tax basis of assets and liabilities and net operating loss and credit carryforwards using enacted tax rates in effect for the year in which the differences are expected to reverse. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Valuation allowances are established when necessary to reduce deferred tax assets to the amounts more likely than not expected to be realized.

Foreign Currency Translation

The functional currency of the Company s major foreign subsidiaries is generally the local currency. Adjustments resulting from translating foreign functional currency financial statements into U.S. dollars are recorded as part of a separate component of stockholders equity. Foreign currency transaction gains and losses are included in net income (loss) for the period. All assets and liabilities denominated in a foreign currency are translated into U.S. dollars at the exchange rate on the balance sheet date. Revenues and expenses are translated at the average exchange rate during the period. Equity transactions are translated using historical exchange rates. During the quarter ended July 31, 2012, the Company modified its transfer pricing agreements which changed the functional currency of some of its foreign subsidiaries. As a result of this change, the balance of other comprehensive income on the Company s condensed consolidated balance sheet as of the date prior to this change, will no longer revalue with fluctuations in foreign currency. All amounts recorded to other comprehensive income subsequent to the date of this change, will revalue with fluctuations in foreign currency.

Warranties and Indemnification

The Company s enterprise cloud computing services are typically warranted to perform in a manner consistent with general industry standards that are reasonably applicable and materially in accordance with the Company s online help documentation under normal use and circumstances.

The Company s arrangements generally include certain provisions for indemnifying customers against liabilities if its products or services infringe a third-party s intellectual property rights. To date, the Company has not incurred any material costs as a result of such obligations and has not accrued any liabilities related to such obligations in the accompanying condensed consolidated financial statements.

The Company has also agreed to indemnify its directors and executive officers for costs associated with any fees, expenses, judgments, fines and settlement amounts incurred by any of these persons in any action or proceeding to which any of those persons is, or is threatened to be, made a party by reason of the person s service as a director or officer, including any action by the Company, arising out of that person s services as the Company s director or officer or that person s services provided to any other company or enterprise at the Company s request. The Company maintains director and officer insurance coverage that would generally enable the Company to recover a portion of any future amounts paid. The Company may also be subject to indemnification obligations by law with respect to the actions of its employees under certain circumstances and in certain jurisdictions.

New Accounting Pronouncement

In September 2011, the FASB issued Accounting Standards Update No. 2011-08, *Intangibles Goodwill and Other (Topic 350) Testing Goodwill for Impairment* (ASU 2011-08), to allow entities to use a qualitative approach to test goodwill for impairment. ASU 2011-08 permits an entity to first perform a qualitative assessment to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying value. If it is concluded that this is the case, it is necessary to perform the currently prescribed two-step goodwill impairment test. Otherwise, the two-step goodwill impairment test is not required. The Company plans to adopt ASU 2011-08 by the fourth quarter of fiscal 2013 and does not believe that the adoption will have a material effect on the condensed consolidated financial statements.

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2. Investments

Marketable Securities

At October 31, 2012, marketable securities consisted of the following (in thousands):

Investments classified as Marketable Securities	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Corporate notes and obligations	$ 601,653	$ 6,130	$ (435)	$ 607,348
U.S. treasury securities	27,811	9	(12)	27,808
Mortgage backed securities	14,286	348	(25)	14,609
Government obligations	3,087	100	0	3,187
Municipal securities	2,697	1	(29)	2,669
Collateralized mortgage obligations	140,336	2,310	(406)	142,240
U.S. agency obligations	96,334	141	(6)	96,469
Total marketable securities	$ 886,204	$ 9,039	$ (913)	$ 894,330

At January 31, 2012, marketable securities consisted of the following (in thousands):

Investments classified as Marketable Securities	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Corporate notes and obligations	$ 502,894	$ 3,485	$ (1,607)	$ 504,772
U.S. treasury securities	79,290	70	(2)	79,358
Mortgage backed securities	15,206	375	(155)	15,426
Government obligations	3,132	78	0	3,210
Municipal securities	8,753	47	(11)	8,789
Collateralized mortgage obligations	118,729	2,192	(426)	120,495
U.S. agency obligations	107,515	331	(6)	107,840
Total marketable securities	$ 835,519	$ 6,578	$ (2,207)	$ 839,890

The duration of the investments classified as marketable securities is as follows (in thousands):

	October 31, 2012	January 31, 2012
Recorded as follows:		
Short-term (due in one year or less)	$ 83,844	$ 170,582
Long-term (due between one and 3 years)	810,486	669,308
	$ 894,330	$ 839,890

As of October 31, 2012, the following marketable securities were in an unrealized loss position (in thousands):

	Less than 12 Months		12 Months or Greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses

Corporate notes and obligations	$ 81,679	$ (203)	$ 12,067	$ (232)	$ 93,746	$ (435)
U.S. treasury securities	12,472	(12)	0	0	12,472	(12)
Mortage backed securities	0	0	657	(25)	657	(25)
Municipal securities	0	0	1,668	(29)	1,668	(29)
Collateralized mortgage obligations	47,943	(266)	9,525	(140)	57,468	(406)
U.S. agency obligations	19,486	(6)	0	0	19,486	(6)
	$ 161,580	$ (487)	$ 23,917	$ (426)	$ 185,497	$ (913)

The unrealized loss for each of these fixed rate marketable securities ranged from less than $1,000 to $99,000. The Company does not believe any of the unrealized losses represent an other-than-temporary impairment based on its evaluation of available evidence as of October 31, 2012. The Company expects to receive the full principal and interest on all of these marketable securities.

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Fair Value Measurement

All of the Company s cash equivalents, marketable securities and foreign currency derivative contracts are classified within Level 1 or Level 2 because the Company s cash equivalents, marketable securities and foreign currency derivative contracts are valued using quoted market prices or alternative pricing sources and models utilizing market observable inputs.

During the three months ended October 31, 2012 the Company changed how it categorizes amounts within the fair value hierarchy. The $26.5 million of time deposits at January 31, 2012 are now reported as Level 2 fair value instruments as these were previously shown as Level 1 and have been reclassified.

The Company uses a three-tier fair value hierarchy, which prioritizes the inputs used in the valuation methodologies in measuring fair value:

Level 1. Quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2. Other inputs that are directly or indirectly observable in the marketplace.

Level 3. Unobservable inputs which are supported by little or no market activity.

The following table presents information about the Company s assets and liabilities that are measured at fair value as of October 31, 2012 and indicates the fair value hierarchy of the valuation (in thousands):

Description	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balances as of October 31, 2012
Cash equivalents (1):				
Time deposits	$ 0	$ 28,186	$ 0	$ 28,186
Money market mutual funds	299,567	0	0	299,567
Marketable securities:				
Corporate notes and obligations	0	607,348	0	607,348
U.S. treasury securities	27,808	0	0	27,808
Mortgage backed securities	0	14,609	0	14,609
Government obligations	3,187	0	0	3,187
Municipal securities	0	2,669	0	2,669
Collateralized mortgage obligations	0	142,240	0	142,240
U.S. agency obligations	0	96,469	0	96,469
Foreign currency derivative contracts (2)	0	1,220	0	1,220
Total Assets	$ 330,562	$ 892,741	$ 0	$ 1,223,303
Liabilities				
Foreign currency derivative contracts (3)	$ 0	$ 1,009	$ 0	$ 1,009
Total Liabilities	$ 0	$ 1,009	$ 0	$ 1,009

(1) Included in cash and cash equivalents in the accompanying Condensed Consolidated Balance Sheet as of October 31, 2012, in addition to $194.0 million of cash.
(2) Included in prepaid expenses and other current assets in the accompanying Condensed Consolidated Balance Sheet as of October 31, 2012.
(3) Included in accrued expenses and other liabilities in the accompanying Condensed Consolidated Balance Sheet as of October 31, 2012.

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The following table presents information about the Company s assets and liabilities that are measured at fair value as of January 31, 2012 and indicates the fair value hierarchy of the valuation (in thousands):

Description	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balances as of January 31, 2012
Cash equivalents (1):				
Time deposits	$ 0	$ 26,513	$ 0	$ 26,513
Money market mutual funds	358,369	0	0	358,369
Marketable securities:				
Corporate notes and obligations	0	504,772	0	504,772
U.S. treasury securities	79,358	0	0	79,358
Mortgage backed securities	0	15,426	0	15,426
Government obligations	3,210	0	0	3,210
Municipal securities	0	8,789	0	8,789
Collateralized mortgage obligations	0	120,495	0	120,495
U.S. agency obligations	0	107,840	0	107,840
Foreign currency derivative contracts (2)	0	621	0	621
Total Assets	$ 440,937	$ 784,456	$ 0	$ 1,225,393
Liabilities				
Foreign currency derivative contracts (3)	$ 0	$ 2,551	$ 0	$ 2,551
Total Liabilities	$ 0	$ 2,551	$ 0	$ 2,551

(1) Included in cash and cash equivalents in the accompanying Condensed Consolidated Balance Sheet as of January 31, 2012, in addition to $222.4 million of cash.
(2) Included in prepaid expenses and other current assets in the accompanying Condensed Consolidated Balance Sheet as of January 31, 2012.
(3) Included in accrued expenses and other liabilities in the accompanying Condensed Consolidated Balance Sheet as of January 31, 2012.

Derivative Financial Instruments

The Company enters into foreign currency derivative contracts with financial institutions to reduce the risk that its cash flows and earnings will be adversely affected by foreign currency exchange rate fluctuations. The Company uses forward currency derivative contracts to minimize the Company s exposure of balances primarily denominated in Euros, Japanese yen and British pounds. The Company s foreign currency derivative contracts which are not designated as hedging instruments are used to reduce the exchange rate risk associated primarily with intercompany receivables and payables. The Company s program is not designated for trading or speculative purposes. As of October 31, 2012 and January 31, 2012, the foreign currency derivative contracts that were not settled are recorded at fair value on the condensed consolidated balance sheets.

Foreign currency derivative contracts are marked-to-market at the end of each reporting period with gains and losses recognized as other income (expense) to offset the gains or losses resulting from the settlement or remeasurement of the underlying foreign currency denominated receivables and payables. While the contract or notional amount is often used to express the volume of foreign currency derivative contracts, the amounts potentially subject to credit risk are generally limited to the amounts, if any, by which the counterparties obligations under the agreements exceed the obligations of the Company to the counterparties.

Details on outstanding foreign currency derivative contracts related primarily to intercompany receivables and payables are presented below (in thousands):

	October 31, 2012	January 31, 2012
Notional amount of foreign currency derivative contracts	$ 416,096	$ 186,336
Fair value of foreign currency derivative contracts	$ 211	$ (1,930)

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The fair value of the Company s outstanding derivative instruments are summarized below (in thousands):

		Fair Value of Derivative Instruments	
	Balance Sheet Location	October 31, 2012	January 31, 2012
Derivative Assets			
Derivatives not designated as hedging instruments:			
Foreign currency derivative contracts	Prepaid expenses and other current assets	$ 1,220	$ 621
Derivative Liabilities			
Derivatives not designated as hedging instruments:			
Foreign currency derivative contracts	Accrued expenses and other current liabilities	$ 1,009	$ 2,551

The effect of the derivative instruments not designated as hedging instruments on the condensed consolidated statements of operations for the three and nine months ended October 31, 2012 and 2011, respectively are summarized below (in thousands):

Derivatives Not Designated as Hedging Instruments	Gains (Losses) on Derivative Instruments Recognized in Income		
		Three Months Ended October 31,	
	Location	2012	2011
Foreign currency derivative contracts	Other income (expense)	$ 8,079	$ (2,977)

Derivatives Not Designated as Hedging Instruments	Gains (Losses) on Derivative Instruments Recognized in Income		
		Nine Months Ended October 31,	
	Location	2012	2011
Foreign currency derivative contracts	Other income (expense)	$ 9,673	$ (3,937)

Strategic Investments

The Company has four investments in marketable equity securities measured using quoted prices in their respective active markets and certain interests in non-marketable equity and debt securities that are collectively considered strategic investments. As of October 31, 2012, the fair value of the Company s marketable equity securities of $4.2 million includes an unrealized gain of $1.0 million. As of January 31, 2012, the Company had three investments in marketable equity securities. The fair value of the Company s marketable equity securities of $5.6 million included an unrealized gain of $3.4 million. These investments are recorded in other assets, net on the condensed consolidated balance sheets.

The Company s interest in non-marketable equity and debt securities consists of noncontrolling equity and debt investments in privately-held companies. The Company s investments in these privately-held companies are reported at cost or marked down to fair value when an event or circumstance indicates an other-than-temporary decline in value has occurred. These investments are valued using significant unobservable inputs or data in an inactive market and the valuation requires the Company s judgment due to the absence of market price and inherent lack of liquidity.

As of October 31, 2012 and January 31, 2012, the carrying value that approximates the fair value of the Company s investments in privately-held companies was $46.0 million and $48.3 million, respectively. These investments are recorded in other assets, net on the condensed consolidated balance sheets.

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Investment Income

Investment income consists of interest income, realized gains, and realized losses on the Company s cash, cash equivalents and marketable securities. The components of investment income are presented below (in thousands):

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2012	2011	2012	2011
Interest income	$ 4,063	$ 5,093	$ 13,727	$ 16,611
Realized gains	894	601	4,448	4,374
Realized losses	(1,070)	(558)	(2,654)	(2,682)
Total investment income	$ 3,887	$ 5,136	$ 15,521	$ 18,303

3. Property and Equipment

Property and equipment consisted of the following (in thousands):

	October 31, 2012	January 31, 2012
Land	$ 248,263	$ 248,263
Building improvements	49,572	43,868
Computers, equipment and software	305,216	232,460
Furniture and fixtures	34,093	25,250
Leasehold improvements	172,569	137,587
	809,713	687,428
Less accumulated depreciation and amortization	(225,874)	(159,482)
	$ 583,839	$ 527,946

Depreciation and amortization expense totaled $26.4 million and $17.9 million for the three months ended October 31, 2012 and 2011, respectively, and $72.1 million and $49.4 million for the nine months ended October 31, 2012 and 2011, respectively.

Computers, equipment and software at October 31, 2012 and January 31, 2012 included a total of $129.1 million and $105.1 million acquired under capital lease agreements, respectively. Accumulated amortization relating to computers, equipment and software under capital leases totaled $50.4 million and $31.7 million, respectively, at October 31, 2012 and January 31, 2012. Amortization of assets under capital leases is included in depreciation and amortization expense.

In November 2010, the Company purchased approximately 14 acres of undeveloped real estate in San Francisco, California, including entitlements and improvements associated with the land. In addition to the amounts reflected in the table above, the Company recorded $23.3 million related to the perpetual parking rights and classified such rights as a purchased intangible asset as it represents an intangible right to use the existing garage. The Company has capitalized pre-construction activities related to the development of the land, including interest costs and property taxes since the November 2010 purchase. During the first quarter of fiscal 2013, the Company suspended pre-construction activity. The pre-construction costs capitalized in fiscal 2013 through the suspension date were $5.7 million. The total carrying value of the land, building improvements and perpetual parking rights was $321.1 million as of October 31, 2012. The Company continues to evaluate its future needs for office facilities space and its options for the undeveloped real estate.

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4. Business Combinations

Rypple

On February 1, 2012, the Company acquired for cash the outstanding stock of 2Catalyze, Inc., (Rypple), a provider of social performance management applications. The Company acquired Rypple to, among other things, enable customers to engage and align their employees and teams with a social performance management solution, extending the employee social network to reach every employee. The Company has included the financial results of Rypple in the consolidated financial statements from the date of acquisition, which have not been material to date. The acquisition date fair value of the consideration transferred for Rypple was approximately $50.6 million, which consisted of the following:

Fair value of consideration transferred (in thousands)	
Cash	$ 50,166
Fair value of stock options assumed	470
Total	$ 50,636

The fair value of the stock options assumed by the Company was determined using the Black-Scholes option pricing model. The share conversion ratio of 0.011 was applied to convert Rypple options to the Company s options.

The following table summarizes the estimated fair values of assets acquired and liabilities assumed as of the date of acquisition:

(in thousands)	
Net tangible assets	$ 758
Deferred tax liability	(1,671)
Intangible assets	5,970
Goodwill	45,579
Net assets acquired	$ 50,636

The excess of purchase consideration over the fair value of net tangible and identifiable intangible assets acquired was recorded as goodwill. The fair values assigned to tangible and identifiable intangible assets acquired and liabilities assumed are based on management s estimates and assumptions. The estimated fair values of assets acquired and liabilities assumed are considered preliminary and are based on the information that was available as of the date of the acquisition. The Company believes that the information provides a reasonable basis for estimating the fair values of assets acquired and liabilities assumed, but certain items such as current and noncurrent income taxes payable and deferred taxes may be subject to change as additional information is received and certain tax returns are finalized. Thus the provisional measurements of fair value set forth above are subject to change. The Company expects to finalize the valuation as soon as practicable, but not later than one-year from the acquisition date.

The following table sets forth the components of identifiable intangible assets acquired and their estimated useful lives as of the date of acquisition:

(in thousands)	**Fair value**	**Useful Life**
Developed technology	$ 4,970	3 years
Customer relationships	1,000	1 year
Total intangible assets subject to amortization	$ 5,970	

Developed technology represents the estimated fair value of Rypple s social performance management technology. Customer relationships represent the fair values of the underlying relationships and agreements with Rypple customers. The goodwill balance is primarily attributed to the assembled workforce and expanded market opportunities when integrating Rypple s social performance management technology with the Company s other product offerings. The goodwill balance is deductible for U.S. income tax purposes.

The Company assumed unvested options with a fair value of $2.2 million. Of the total consideration, $0.5 million was allocated to the purchase consideration and $1.7 million was allocated to future services and will be expensed over the remaining service periods on a straight-line basis.

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Buddy Media, Inc.

On August 13, 2012, the Company acquired the outstanding stock of Buddy Media, Inc. (Buddy), a social media marketing platform. The Company acquired Buddy for the assembled workforce, expected synergies and expanded market opportunities when integrating Buddy s social media marketing platform with the Company s current offerings. The acquisition date fair value of the consideration transferred for Buddy was approximately $735.8 million, which consisted of the following:

Fair value of consideration transferred (in thousands, except per share data)	
Cash	$ 497,500
Common stock (1,392,774 shares)	202,161
Fair value of stock options and restricted stock awards assumed	36,092
Total	$ 735,753

The value of the share consideration for the Company s common stock was based on the closing price of $145.15 on the day of the acquisition. The fair value of the stock options and restricted stock awards assumed by the Company was determined using the Black-Scholes option pricing model. The share conversion ratio of 0.146 was applied to convert Buddy s options and restricted stock awards to the Company s options and restricted stock awards.

The following table summarizes the estimated fair values of assets acquired and liabilities assumed as of the date of acquisition:

(in thousands)	
Current assets	$ 35,609
Other noncurrent assets	3,424
Current and noncurrent liabilities	(16,437)
Deferred revenue	(3,281)
Deferred tax liability	(2,436)
Intangible assets	78,340
Goodwill	640,534
Net assets acquired	$ 735,753

The excess of purchase consideration over the fair value of net tangible and identifiable intangible assets acquired was recorded as goodwill. The fair values assigned to tangible and identifiable intangible assets acquired and liabilities assumed are based on management s estimates and assumptions. The estimated fair values of assets acquired and liabilities assumed are considered preliminary and are based on the information that was available as of the date of the acquisition. The Company believes that the information provides a reasonable basis for estimating the fair values of assets acquired and liabilities assumed, but certain items such as current and noncurrent income taxes payable and deferred taxes may be subject to change as additional information is received and certain tax returns are finalized. Thus the provisional measurements of fair value set forth above are subject to change. The Company expects to finalize the valuation as soon as practicable, but not later than one-year from the acquisition date.

The following table sets forth the components of identifiable intangible assets acquired and their estimated useful lives as of the date of acquisition:

(in thousands)	**Fair value**	**Useful Life**
Developed technology	$ 65,210	5 years
Customer relationships	11,030	5 years
Trade name and trademark	2,100	5 years

Total intangible assets subject to amortization	$ 78,340

Developed technology represents the estimated fair value of Buddy s social media marketing platform. Customer relationships represent the fair values of the underlying relationships and agreements with Buddy customers. The trade name and trademark represents the fair value of the brand and name recognition associated with the marketing of Buddy s service offerings. The goodwill balance is primarily attributed to the assembled workforce and expanded market opportunities when integrating Buddy s social media marketing platform with the Company s other social media marketing product offerings. The goodwill balance is not deductible for U.S. income tax purposes.

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The Company assumed unvested options and restricted stock awards with a fair value of $67.4 million. Of the total consideration, $36.1 million was allocated to the purchase consideration and $31.3 million was allocated to future services and will be expensed over the remaining service periods on a straight-line basis.

The amounts of revenue and earnings of Buddy included in the Company s condensed consolidated statement of operations from the acquisition date of August 13, 2012 to the period ending October 31, 2012 are as follows:

(in thousands)	
Total revenues	$ 9,087
Loss	$ (18,251)

This loss includes approximately $12.0 million of stock-based expense.

The following pro forma financial information summarizes the combined results of operations for the Company and Buddy, which was significant for the purposes of unaudited pro forma financial information disclosure, as though the companies were combined as of the beginning of the Company s fiscal years presented.

The pro forma financial information was as follows:

	Three Months Ended October 31,		Nine Months Ended October 31,	
(in thousands)	2012	2011	2012	2011
Total revenues	$ 789,630	$ 592,171	$ 2,236,652	$ 1,653,204
Loss	$ (210,333)	$ (12,845)	$ (278,164)	$ (37,047)

The pro forma financial information for all periods presented has been calculated after adjusting the results of Buddy to reflect the business combination accounting effects resulting from this acquisition including the amortization expenses from acquired intangible assets, the stock-based compensation expense for unvested stock options and restricted stock awards assumed and the related tax effects as though the acquisition occurred as of the beginning of the Company s fiscal years 2013 and 2012. The pro forma financial information is for informational purposes only and is not indicative of the results of operations that would have been achieved if the acquisition had taken place at the beginning of the Company s fiscal 2012.

The pro forma financial information for the three and nine months ended October 31, 2012 and 2011 combined the historical results of the Company for the three and nine months ended October 31, 2012 and 2011, the adjusted historical results of Buddy for the three and nine months ended September 30, 2012 and 2011, due to differences in reporting periods and considering the date the Company acquired Buddy, and the effects of the pro forma adjustments listed above.

GoInstant, Inc.

On September 4, 2012, the Company acquired for cash the outstanding stock of GoInstant, Inc. (GoInstant) a provider of co-browsing technology that allows two or more people to collaboratively browse the same website together. The Company acquired GoInstant to, among other things, deliver its customers an easy to use co-browse experience. The Company has included the financial results of GoInstant in the consolidated financial statements from the date of acquisition, which have not been material to date. The acquisition date fair value of the consideration transferred for GoInstant was approximately $50.6 million, which consisted of the following:

Fair value of consideration transferred (in thousands)	
Cash	$ 49,221
Fair value of stock options assumed	1,336
Total	$ 50,557

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The fair value of the stock options assumed by the Company was determined using the Black-Scholes option pricing model. The share conversion ratio of 0.086 was applied to convert GoInstant s options to the Company s options.

The following table summarizes the estimated fair values of assets acquired and liabilities assumed as of the date of acquisition:

(in thousands)	
Net tangible assets	$ 473
Deferred tax liability	(1,771)
Developed technology	6,560
Goodwill	45,295
Net assets acquired	$ 50,557

The excess of purchase consideration over the fair value of net tangible and identifiable intangible assets acquired was recorded as goodwill. The fair values assigned to tangible and identifiable intangible assets acquired and liabilities assumed are based on management s estimates and assumptions. The estimated fair values of assets acquired and liabilities assumed are considered preliminary and are based on the information that was available as of the date of the acquisition. The Company believes that the information provides a reasonable basis for estimating the fair values of assets acquired and liabilities assumed, but certain items such as current and noncurrent income taxes payable and deferred taxes may be subject to change as additional information is received and certain tax returns are finalized. Thus the provisional measurements of fair value set forth above are subject to change. The Company expects to finalize the valuation as soon as practicable, but not later than one-year from the acquisition date.

The developed technology represents the estimated fair value of GoInstant s co-browsing technology and has an estimated useful life of three years. The goodwill balance is primarily attributed to the assembled workforce and expanded market opportunities when integrating GoInstant s co-browsing technology with the Company s other product offerings. The goodwill balance is deductible for U.S. income tax purposes.

The Company assumed unvested options with a fair value of $6.2 million. Of the total consideration, $1.3 million was allocated to the purchase consideration and $4.9 million was allocated to future services and will be expensed over the remaining service periods on a straight-line basis.

Other Business Combinations

During the nine months ended October 31, 2012, the Company acquired four companies for $10.1 million in cash, net of cash acquired, and has included the financial results of these companies in its condensed consolidated financial statements from the date of each respective acquisition. The Company accounted for these transactions as business combinations. In allocating the purchase consideration based on estimated fair values, the Company recorded $4.1 million of acquired intangible assets with useful lives of one to three years, $7.3 million of goodwill, $0.3 million of net tangible liabilities and $1.0 million of deferred tax liabilities. The majority of this goodwill balance is deductible for U.S. income tax purposes. With the exception of Buddy, none of the aforementioned business combinations, individually and in the aggregate, were material to the pro forma combined historical results of operations of the Company.

Goodwill

Goodwill represents the excess of the purchase price in a business combination over the fair value of net tangible and intangible assets acquired. Goodwill amounts are not amortized, but rather tested for impairment at least annually during the fourth quarter.

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Goodwill consisted of the following (in thousands):

Balance as of January 31, 2012	$ 785,381
Buddy Media	640,534
GoInstant	45,295
Rypple	45,579
Other acquisitions and adjustments	8,365
Balance as of October 31, 2012	$ 1,525,154

There was no impairment of goodwill for the three or nine months ended October 31, 2012.

5. Notes Payable

Convertible Senior Notes

In January 2010, the Company issued at par value $575.0 million of 0.75% convertible senior notes (the Notes) due January 15, 2015. Interest is payable semi-annually in arrears on January 15 and July 15 of each year, commencing July 15, 2010.

The Notes are governed by an Indenture dated as of January 19, 2010, between the Company, as issuer, and U.S. Bank National Association, as trustee. The Notes do not contain any financial covenants or any restrictions on the payment of dividends, the incurrence of senior debt or other indebtedness, or the issuance or repurchase of securities by the Company. The Notes are unsecured and rank senior in right of payment to the Company s future indebtedness that is expressly subordinated in right of payment to the Notes and rank equal in right of payment to the Company s existing and future unsecured indebtedness that is not so subordinated and are effectively subordinated in right of payment to any of the Company s cash equal to the principal amount of the Notes, and secured indebtedness to the extent of the value of the assets securing such indebtedness and are structurally subordinated to all existing and future indebtedness and liabilities incurred by our subsidiaries, including trade payables.

If converted, holders will receive cash equal to the principal amount of the Notes, and at the Company s election, cash and/or shares of the Company s common stock for any amounts in excess of the principal amounts.

The initial conversion rate is 11.7147 shares of common stock per $1,000 principal amount of Notes, subject to anti-dilution adjustments. The initial conversion price is $85.36 per share of common stock. Throughout the term of the Notes, the conversion rate may be adjusted upon the occurrence of certain events, including for any cash dividends. Holders of the Notes will not receive any cash payment representing accrued and unpaid interest upon conversion of a Note. Accrued but unpaid interest will be deemed to be paid in full upon conversion rather than cancelled, extinguished or forfeited. Holders may convert their Notes under the following circumstances:

- during any fiscal quarter, if, for at least 20 trading days during the 30 consecutive trading day period ending on the last trading day of the immediately preceding fiscal quarter, the last reported sales price of the Company s common stock for such trading day is greater than or equal to 130% of the applicable conversion price on such trading day share of common stock on such last trading day;
- in certain situations, when the trading price of the Notes is less than 98% of the product of the sale price of the Company s common stock and the conversion rate;
- upon the occurrence of specified corporate transactions described under the Notes Indenture, such as a consolidation, merger or binding share exchange; or

at any time on or after October 15, 2014.

For 20 trading days during the 30 consecutive trading days ended July 31, 2012, the Company s common stock traded at a price exceeding 130% of the conversion price of $85.36 per share applicable to the Notes. Accordingly, the Notes were convertible at the option of the holder for the Company s common shares as of October 31, 2012 and were classified as a current liability on the Company s condensed consolidated balance sheet. For 20 trading days during the 30 consecutive trading days ended October 31, 2012, the Company s common stock traded at a price exceeding 130% of the conversion price of $85.36 per share applicable to the Notes. Accordingly, the Notes will remain convertible at the holders option for the quarter ending January 31, 2013 and will remain classified as a current liability on the Company s condensed consolidated balance sheet so long as the Notes are convertible.

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Holders of the Notes have the right to require the Company to purchase with cash all or a portion of the Notes upon the occurrence of a fundamental change, such as a change of control, at a purchase price equal to 100% of the principal amount of the Notes plus accrued and unpaid interest. Following certain corporate transactions that constitute a change of control, the Company will increase the conversion rate for a holder who elects to convert the Notes in connection with such change of control in certain circumstances.

In accounting for the issuance of the Notes, the Company separated the Notes into liability and equity components. The carrying amount of the liability component was calculated by measuring the fair value of a similar liability that does not have an associated convertible feature. The carrying amount of the equity component representing the conversion option was determined by deducting the fair value of the liability component from the par value of the Notes as a whole. The excess of the principal amount of the liability component over its carrying amount (debt discount) is amortized to interest expense over the term of the Notes. The equity component is not remeasured as long as it continues to meet the conditions for equity classification.

In accounting for the transaction costs related to the Note issuance, the Company allocated the total amount incurred to the liability and equity components based on their relative values. Transaction costs attributable to the liability component are being amortized to expense over the term of the Notes, and transaction costs attributable to the equity component were netted with the equity component in temporary stockholders equity and stockholders equity. Additionally, the Company recorded a deferred tax liability of $51.1 million in connection with the Notes.

The Notes consisted of the following (in thousands):

	October 31, 2012	January 31, 2012
Liability component :		
Principal	$ 574,890	$ 574,890
Less: debt discount, net (1)	(59,999)	(78,741)
Net carrying amount	$ 514,891	$ 496,149

(1) Included in the condensed consolidated balance sheets within 0.75% convertible senior notes and is amortized over the remaining life of the Notes using the effective interest rate method.

As of October 31, 2012, the remaining life of the Notes is approximately 2.25 years.

The following table sets forth total interest expense recognized related to the Notes prior to capitalization of interest (in thousands):

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2012	2011	2012	2011
Contractual interest expense	$ 1,078	$ 1,078	$ 3,234	$ 3,234
Amortization of debt issuance costs	331	331	993	992
Amortization of debt discount	6,358	6,000	18,742	17,690
	$ 7,767	$ 7,409	$ 22,969	$ 21,916
Effective interest rate of the liability component	5.86%	5.86%	5.86%	5.86%

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Note Hedges

To minimize the impact of potential economic dilution upon conversion of the Notes, the Company entered into convertible note hedge transactions with respect to its common stock (the Note Hedges). The Company paid, in January 2010, an aggregate amount of $126.5 million for the Note Hedges. The Note Hedges cover approximately 6.7 million shares of the Company s common stock at a strike price that corresponds to the initial conversion price of the Notes, also subject to adjustment, and are exercisable upon conversion of the Notes. The Note Hedges will expire upon the maturity of the Notes. The Note Hedges are intended to reduce the potential economic dilution upon conversion of the Notes in the event that the market value per share of the Company s common stock, as measured under the Notes, at the time of exercise is greater than the conversion price of the Notes. The Note Hedges are separate transactions and are not part of the terms of the Notes. Holders of the Notes will not have any rights with respect to the Note Hedges. The Company initially recorded a deferred tax asset of $51.4 million in connection with these Note Hedges.

Warrants

Separately, the Company in January 2010 also entered into warrant transactions (the Warrants), whereby the Company sold warrants to acquire, subject to anti-dilution adjustments, up to 6.7 million shares of the Company s common stock at a strike price of $119.51 per share. The Company received aggregate proceeds of $59.3 million from the sale of the Warrants. As the average market value per share of the Company s common stock for the reporting period, as measured under the Warrants, exceeds the strike price of the Warrants, the Warrants would have a dilutive effect on the Company s earnings/loss per share. The Warrants were anti-dilutive for the three and nine months ended October 31, 2012 based on the Company s net loss for the three and nine months ended October 31, 2012. The Warrants are separate transactions, entered into by the Company and are not part of the terms of the Notes or Note Hedges. Holders of the Notes and Note Hedges will not have any rights with respect to the Warrants.

Interest Expense

Interest expense consists of interest on the Company s capital lease commitments and the Notes, net of amounts capitalized. In accounting for the Notes at the time of issuance in January 2010, the carrying amount of the liability component was calculated by measuring the fair value of a similar liability that did not have an associated convertible feature. The excess of the principal amount of the liability component over its carrying amount is amortized, using an effective interest rate of 5.86%, to interest expense over the term of the Notes.

6. Other Balance Sheet Accounts

Prepaid Expenses and Other Current Assets

Prepaid expenses and other current assets consisted of the following (in thousands):

	October 31, 2012	January 31, 2012
Deferred professional services costs	$ 4,974	$ 10,399
Prepaid income taxes	17,526	12,785
Prepaid expenses and other current assets	95,100	57,135
	$ 117,600	$ 80,319

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Capitalized Software, net

Capitalized software consisted of the following (in thousands):

	October 31, 2012	January 31, 2012
Capitalized internal-use software development costs, net of accumulated amortization of $66,327 and $50,300, respectively	$ 57,866	$ 41,442
Acquired developed technology, net of accumulated amortization of $160,311 and $99,886, respectively	167,271	146,970
	$ 225,137	$ 188,412

Capitalized internal-use software amortization expense totaled $6.0 million and $4.0 million for the three months ended October 31, 2012 and 2011, respectively. Acquired developed technology amortization expense totaled $24.0 million and $17.4 million for the three months ended October 31, 2012 and 2011, respectively. Capitalized internal-use software amortization expense totaled $16.0 million and $11.5 million for the nine months ended October 31, 2012 and 2011, respectively. Acquired developed technology amortization expense totaled $60.4 million and $44.3 million for the nine months ended October 31, 2012 and 2011, respectively.

During the three months ended October 31, 2012 and 2011, the Company capitalized $0.9 million and $0.6 million, respectively, of stock-based expenses related to capitalized internal-use software development and deferred professional services costs and capitalized $2.6 million and $1.7 million for the nine months ended October 31, 2012 and 2011, respectively.

Other Assets, net

Other assets consisted of the following (in thousands):

	October 31, 2012	January 31, 2012
Deferred professional services costs, noncurrent portion	$ 1,573	$ 3,935
Long-term deposits	14,425	13,941
Purchased intangible assets, net of accumulated amortization of $26,697 and $17,868, respectively	51,447	46,110
Acquired intellectual property, net of accumulated amortization of $6,091 and $3,139, respectively	14,851	15,020
Strategic investments	50,251	53,949
Other	21,253	22,194
	$ 153,800	$ 155,149

Purchased intangible assets amortization expense for the three months ended October 31, 2012 and 2011, was $3.0 million and $1.7 million, respectively, and for the nine months ended October 31, 2012 and 2011, was $8.8 million and $5.2 million, respectively. Acquired intellectual property amortization expense for the three months ended October 31, 2012 and 2011, was $1.0 million and $0.7 million, respectively, and for the nine months ended October 31, 2012 and 2011, was $3.0 million and $1.6 million, respectively.

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Accrued Expenses and Other Liabilities

Accrued expenses and other liabilities consisted of the following (in thousands):

	October 31, 2012	January 31, 2012
Accrued compensation	$ 230,662	$ 228,466
Accrued other liabilities	142,647	121,957
Accrued income and other taxes payable	75,468	100,471
Accrued professional costs	13,044	21,993
Accrued rent	62,446	29,555
	$ 524,267	$ 502,442

7. Stockholders Equity

The Company maintains the following stock plans: the 2006 Inducement Equity Incentive Plan (the Inducement Plan), the 2004 Equity Incentive Plan, 2004 Employee Stock Purchase Plan and the 2004 Outside Directors Stock Plan. These plans, other than the 2004 Outside Directors Stock Plan and the Inducement Plan, provide for annual automatic increases on February 1 to the shares reserved for issuance. The expiration of the 1999 Stock Option Plan (1999 Plan) in fiscal 2010 did not affect awards outstanding, which continue to be governed by the terms and conditions of the 1999 Plan.

On February 1, 2012, 3.5 million additional shares were reserved under the 2004 Equity Incentive Plan and 1.0 million additional shares were reserved under the 2004 Employee Stock Purchase Plan pursuant to the automatic increase in each respective plan.

On June 7, 2012, 400,000 additional shares were reserved under the Inducement Plan.

In September 2011, the Company s Board of Directors amended and restated the 2004 Employee Stock Purchase Plan (the ESPP). In conjunction with the amendment of the ESPP, the Company s Board of Directors determined that the offerings under the ESPP would commence, beginning with a twelve month offering period starting in December 2011. As of October 31, 2012, $34.7 million has been held on behalf of employees for future purchases under the plan and is recorded in accrued expenses and other liabilities. Employees purchased 338,306 shares in the three months ended July 31, 2012 for $30.7 million under the ESPP.

Prior to February 1, 2006, options issued under the Company s stock option plans generally had a term of 10 years. After February 1, 2006, options issued have a term of 5 years.

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Stock activity excluding the ESPP is as follows:

		Options Outstanding		
	Shares Available for Grant	Outstanding Stock Options	Weighted-Average Exercise Price	Aggregate Intrinsic Value (in thousands)
Balance as of January 31, 2012	3,440,993	11,184,907	$ 79.78	
Increase in shares authorized:				
2004 Equity Incentive Plan	3,500,000	0	0.00	
2Catalyze, Inc. Amended 2008 Stock Option Plan	30,177	0	0.00	
2006 Inducement Equity Incentive Plan	400,000	0	0.00	
Buddy Media, Inc. 2007 Equity Incentive Plan	430,494	0	0.00	
GoInstant, Inc. Stock Option Plan	46,889	0	0.00	
Options granted under all plans	(1,319,554)	1,319,554	103.51	
Restricted stock activity	(1,636,563)	0	0.00	
Stock grants to board and advisory board members	(20,850)	0	0.00	
Exercised	0	(2,759,141)	53.83	
1999 Plan shares expired	(68,317)	0	0.00	
Cancelled	487,486	(487,486)	105.08	
Balance as of October 31, 2012	5,290,755	9,257,834	$ 89.56	$ 524,397
Vested or expected to vest		9,031,912	$ 88.78	$ 518,573
Exercisable as of October 31, 2012		4,290,187	$ 63.35	$ 354,838

The total intrinsic value of the options exercised during the nine months ended October 31, 2012 and 2011 was $257.8 million and $198.0 million, respectively. The intrinsic value is the difference between the current market value of the stock and the exercise price of the stock option.

The weighted-average remaining contractual life of vested and expected to vest options is approximately 2.9 years.

As of October 31, 2012, options to purchase 4,290,187 shares were vested at a weighted average exercise price of $63.35 per share and had a remaining weighted-average remaining contractual life of approximately 1.9 years. The total intrinsic value of these vested options as of October 31, 2012 was $354.8 million.

The following table summarizes information about stock options outstanding as of October 31, 2012:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number Outstanding	Weighted-Average Remaining Contractual Life (Years)	Weighted-Average Exercise Price	Number of Shares	Weighted-Average Exercise Price
$1.10 to $25.97	2,092,315	2.0	$ 19.40	1,818,398	$ 20.32
$27.40 to $65.44	1,955,853	1.9	60.19	1,245,908	58.77
$65.68 to $108.25	1,595,931	3.7	101.90	170,708	75.54
$111.86 to $140.28	837,570	4.0	129.05	184,653	129.92
$142.50	1,763,921	3.0	142.50	772,816	142.50
$143.46 to $152.13	994,064	4.2	146.81	97,704	149.47

$153.50	18,180	4.4	153.50	0	0.00
	9,257,834	2.9	$ 89.56	4,290,187	$ 63.35

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Restricted stock activity is as follows:

	Restricted Stock Outstanding		
	Outstanding	Weighted-Average Exercise Price	Aggregate Intrinsic Value (in thousands)
Balance as of January 31, 2012	4,962,263	$ 0.001	
Granted	2,066,607	0.001	
Cancelled	(409,194)	0.001	
Acquired plan shares expired	(3,645)	0.001	
Vested and converted to shares	(992,359)	0.001	
Balance as of October 31, 2012	5,623,672	$ 0.001	$ 820,944
Expected to vest	5,386,476		$ 786,318

The restricted stock, which upon vesting entitles the holder to one share of common stock for each share of restricted stock, has an exercise price of $0.001 per share, which is equal to the par value of the Company s common stock, and generally vest over 4 years.

The weighted-average fair value of the restricted stock issued for the nine months ended October 31, 2012 and 2011 was $144.68 and $135.19, respectively.

Common Stock

The following number of shares of common stock were reserved and available for future issuance at October 31, 2012:

Options outstanding	9,257,834
Restricted stock awards and units outstanding	5,623,672
Stock available for future grant:	
2004 Equity Incentive Plan	4,479,013
2006 Inducement Equity Incentive Plan	256,742
2004 Employee Stock Purchase Plan	1,661,683
2004 Outside Directors Stock Plan	555,000
0.75% Convertible senior notes	6,734,664
Warrants	6,735,953
	35,304,561

8. Income Taxes

Effective Tax Rate

For the nine months ending October 31, 2012, the Company reported a tax expense of $147.9 million, which resulted in a negative effective tax rate of 145 percent. The Company s effective tax rate substantially differed from the federal statutory tax rate of 35 percent primarily due to a one-time, non-cash charge to record a valuation allowance for a significant portion of the Company s deferred tax assets.

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The Company regularly assesses the need for a valuation allowance against its deferred tax assets. In making that assessment, the Company considers both positive and negative evidence related to the likelihood of realization of the deferred tax assets to determine, based on the weight of available evidence, whether it is more-likely-than-not that some or all of the deferred tax assets will not be realized. In evaluating the need for a valuation allowance, the Company considers its cumulative loss in recent years as a significant piece of negative evidence. As a result, in the third quarter the Company determined that the negative evidence outweighed the positive evidence as of October 31, 2012 and recorded a one-time, non-cash charge to income tax expense in the third quarter of fiscal 2013 in the amount of $149.1 million to establish a valuation allowance against a significant portion of its July 31, 2012 deferred tax assets balance. Additionally, the Company recorded $25.9 million related to the quarterly change in the valuation allowance for the three months ended October 31, 2012. This accounting treatment has no effect on the Company s actual ability to utilize deferred tax assets such as loss carryforwards and tax credits to reduce future cash tax payments. The Company will continue to assess the likelihood that the deferred tax assets will be realizable at each reporting period and the valuation allowance will be adjusted accordingly.

For the nine months ended October 31, 2011, the Company reported a tax benefit of $18.3 million, which resulted in an effective tax rate of 71 percent. The Company s effective tax rate was higher than the federal statutory tax rate of 35 percent primarily due to federal and California tax credits and the impact of the Radian6 acquisition. The tax benefit was partially offset by foreign tax expense and non-deductible amounts. The effect on the tax rate was magnified because of the relatively small pretax loss.

Tax Benefits Related to Stock-Based Compensation

The total income tax benefit in the accompanying condensed consolidated statements of operations related to stock-based awards was $81.5 million and $53.9 million for the nine months ended October 31, 2012 and 2011, respectively. However, the majority of the tax benefit was not recognized as a result of the valuation allowance.

Unrecognized Tax Benefits and Other Considerations

The Company records liabilities related to its uncertain tax positions. Tax positions for the Company and its subsidiaries are subject to income tax audits by multiple tax jurisdictions throughout the world. The Company believes that it has provided adequate reserves for its income tax uncertainties in all open tax years. In the next 12 months, it is reasonably possible that the unrecognized tax benefits may decrease by approximately $4.0 million due to lapsing of the statute of limitations.

9. Earnings/Loss Per Share

Basic earnings/loss per share is computed by dividing net income (loss) by the weighted-average number of common shares outstanding for the fiscal period. Diluted earnings/loss per share is computed giving effect to all potential weighted average dilutive common stock, including options, restricted stock units, warrants and the convertible senior notes. The dilutive effect of outstanding awards and convertible securities is reflected in diluted earnings per share by application of the treasury stock method. Diluted loss per share for the three and nine months ended October 31, 2012 and 2011 is the same as basic loss per share as there is a net loss in these periods and inclusion of potentially issuable shares would be anti-dilutive.

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A reconciliation of the denominator used in the calculation of basic and diluted earnings/loss per share is as follows (in thousands):

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2012	2011	2012	2011
Numerator:				
Net loss	$ (220,297)	$ (3,756)	$ (249,601)	$ (7,494)
Denominator:				
Weighted-average shares outstanding for basic loss per share	142,203	135,847	139,959	134,824
Effect of dilutive securities:				
Convertible senior notes	0	0	0	0
Employee stock awards	0	0	0	0
Warrants	0	0	0	0
Adjusted weighted-average shares outstanding and assumed conversions for diluted loss per share	142,203	135,847	139,959	134,824

The weighted-average number of shares outstanding used in the computation of basic and diluted earnings/loss per share does not include the effect of the following potential outstanding common stock. The effects of these potentially outstanding shares were not included in the calculation of diluted earnings/loss per share because the effect would have been anti-dilutive (in thousands):

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2012	2011	2012	2011
Stock awards	7,094	7,204	7,300	7,332
Warrants	6,736	6,736	6,736	6,736
Convertible senior notes	6,735	6,735	6,735	6,735

10. Commitments

Letters of Credit

As of October 31, 2012, the Company had a total of $25.1 million in letters of credit outstanding substantially in favor of certain landlords for office space. These letters of credit renew annually and mature at various dates through April 2030.

Leases

The Company leases facilities space and certain fixed assets under non-cancelable operating and capital leases with various expiration dates.

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As of October 31, 2012, the future minimum lease payments under non-cancelable operating and capital leases are as follows (in thousands):

	Capital Leases	Operating Leases
Fiscal Period:		
Remaining three months of fiscal 2013	$ 7,862	$ 36,284
Fiscal 2014	31,589	137,530
Fiscal 2015	11,063	111,851
Fiscal 2016	7,775	91,770
Fiscal 2017	6,972	77,737
Thereafter	2,471	440,989
Total minimum lease payments	67,732	$ 896,161
Less: amount representing interest	(3,948)	
Present value of capital lease obligations	$ 63,784	

The Company s agreements for the facilities and certain services provide the Company with the option to renew. The Company s future contractual obligations would change if the Company exercised these options.

11. Legal Proceedings

In the ordinary course of business, the Company is involved in various legal proceedings and claims related to alleged infringement of third-party patents and other intellectual property rights, commercial, employment, wage and hour, and other claims.

In general, the resolution of a legal matter could prevent the Company from offering its service to others, could be material to the Company s financial condition or cash flows, or both, or could otherwise adversely affect the Company s operating results.

The Company makes a provision for a liability relating to legal matters when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. These provisions are reviewed at least quarterly and adjusted to reflect the impacts of negotiations, estimated settlements, legal rulings, advice of legal counsel and other information and events pertaining to a particular matter. In management s opinion, resolution of all current matters is not expected to have a material adverse impact on the Company s condensed consolidated results of operations, cash flows or financial position. However, depending on the nature and timing of any such dispute, an unfavorable resolution of a matter could materially affect the Company s future results of operations or cash flows, or both, of a particular quarter.

12. Related-Party Transactions

In January 1999, the salesforce.com/foundation, also referred to as the Foundation, a non-profit public charity, was chartered to build philanthropic programs that are focused on youth and technology. The Company s chairman is the chairman of the Foundation. He, two of the Company s employees and one of the Company s board members hold four of the Foundation s nine board seats. The Company does not control the Foundation s activities, and accordingly, the Company does not consolidate the Foundation s statement of activities with its financial results.

Since the Foundation s inception, the Company has provided at no charge certain resources to Foundation employees such as office space. The value of these items was in excess of $150,000 for the quarter ended October 31, 2012.

In addition to the resource sharing with the Foundation, the Company issued the Foundation warrants in August 2002 to purchase shares of the Company s common stock. All of the warrants were exercised in prior years. As of October 31, 2012, the Foundation held 81,000 shares of salesforce.com common stock. Additionally, the Company has donated subscriptions to the Company s service to other qualified non-profit organizations. The Company also allows an affiliate of the Foundation to resell the Company s service to large non-profit organizations. The Company does not charge the affiliate for the subscriptions. The fair value of the subscriptions was in excess of $3.6 million for the quarter ended October 31, 2012. The Company plans to continue these programs.

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

The following discussion in Management s Discussion and Analysis of Financial Condition and Results of Operations (MD&A) contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the Securities Act), and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act). Forward-looking statements consist of, among other things, trend analyses, statements regarding future events, future financial performance, our anticipated growth, the effect of general economic and market conditions, our business strategy and our plan to build our business, including our strategy to be the leading provider of enterprise cloud computing applications and platforms and to lead the industry shift to the social enterprise, our service performance and security, the expenses associated with new data centers, additional data center capacity, real estate and office facilities space, our operating results, new features and services, our strategy of acquiring or making investments in complementary companies, services and technologies, and intellectual property rights, our ability to successfully integrate acquired businesses and technologies, and the continued growth and ability to maintain deferred revenue and unbilled deferred revenue, our ability to protect our intellectual property rights, our ability to develop our brands, the effect of evolving government regulations, the effect of foreign currency exchange rate and interest rate fluctuations on our financial results, the valuation of deferred tax assets, the potential availability of additional tax assets in the future and related matters, the impact of expensing stock options, the sufficiency of our capital resources, and potential litigation involving us, all of which are based on current expectations, estimates, and forecasts, and the beliefs and assumptions of our management. Words such as expects, anticipates, aims, projects, intends, plans, believes, estimates, seeks, assumes, may, should, variations of such words, and similar expressions are also intended to identify such forward-looking statements. These forward-looking statements are subject to risks, uncertainties and assumptions that are difficult to predict. Therefore, actual results may differ materially and adversely from those expressed in any forward-looking statements. Readers are directed to risks and uncertainties identified below, under Risk Factors and elsewhere in this report, for factors that may cause actual results to be different than those expressed in these forward-looking statements. Except as required by law, we undertake no obligation to revise or update publicly any forward-looking statements for any reason.

Overview

We are a leading provider of enterprise cloud computing services and are dedicated to helping customers transform themselves into social enterprises. Social enterprises leverage social, mobile and open technologies to place their customers and employees at the center of their business and to engage and collaborate with them in new and powerful ways. Our technologies are targeted at businesses of all sizes and industries worldwide.

We were founded in February 1999 and began offering our enterprise customer relationship management (CRM) application service in February 2000. Since then, we have augmented our CRM service with new editions, services and enhanced features. Over the last few years, we have both developed and acquired several mobile, social and open technologies. In fiscal 2012, we introduced the concept of the social enterprise. We believe that employees, customers and partners are interacting in entirely new ways via social networks, and companies need a new set of enterprise capabilities to be successful in the social world.

Our objective is to help companies put customers at the center of their businesses and transform themselves into social enterprises by leveraging our applications and platforms. Key elements of our strategy include:

- Strengthening our existing Sales Cloud and Service Cloud applications, extending our Marketing Cloud offering and expanding into other new functional areas within the social enterprise;
- Leading the industry transformation to the social enterprise;
- Pursuing new customers and new territories aggressively;
- Deepening relationships with our existing customer base; and
- Encouraging the development of third-party applications on our cloud computing platforms.

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We believe the factors that will influence our ability to achieve our objectives include: our prospective customers willingness to migrate to enterprise cloud computing services; the performance and security of our service; our ability to continue to release, and gain customer acceptance of, new and improved features; our ability to successfully integrate acquired businesses and technologies; successful customer adoption and utilization of our service; acceptance of our service in markets where we have few customers; the emergence of additional competitors in our market and improved product offerings by existing and new competitors; the location of new data centers; third-party developers willingness to develop applications on our platforms; our ability to attract new personnel and retain and motivate current personnel; and general economic conditions which could affect our customers ability and willingness to purchase our services, delay the customers purchasing decision or affect renewal rates.

To address these factors, we will need to, among other things, continue to add substantial numbers of paying subscriptions, upgrade our customers to fully featured versions such as our Unlimited Edition or arrangements such as a Social Enterprise License Agreement, provide high quality technical support to our customers, encourage the development of third-party applications on our platforms and continue to focus on retaining customers at the time of renewal. Our plans to invest for future growth include the continuation of the expansion of our data center capacity, the hiring of additional personnel, particularly in direct sales, other customer-related areas and research and development, the expansion of domestic and international selling and marketing activities, continuing to develop our brands, the addition of distribution channels, the upgrade of our service offerings, the development of new services, the integration acquired technologies, the expansion of our Marketing Cloud service offerings and the additions to our global infrastructure to support our growth.

We also regularly evaluate acquisitions or investment opportunities in complementary businesses, joint ventures, services and technologies, and intellectual property rights in an effort to expand our service offerings. We expect to continue to make such investments and acquisitions in the future and we plan to reinvest a significant portion of our incremental revenue in fiscal 2013 to grow our business and continue our leadership role in the cloud computing industry. As a result of our aggressive growth plans, specifically our hiring plan and acquisition activities, we have incurred significant expenses from equity awards and amortization of purchased intangibles which have resulted in net losses on a GAAP basis. As we continue with our growth plan, we anticipate we will have net losses on a GAAP basis for the next several quarters.

In November 2010, we purchased approximately 14 acres of undeveloped real estate in San Francisco, California, including entitlements and improvements associated with the land. We have capitalized all pre-construction activities related to the development of the land, including interest costs and property taxes since the November 2010 purchase. During the first quarter of fiscal 2013, we suspended pre-construction activity. The total carrying value of the land, building improvements and perpetual parking rights was $321.1 million as of October 31, 2012. We continue to evaluate our future needs for office facilities space and our options for the undeveloped real estate.

We expect marketing and sales costs, which were 53 percent of our total revenues for the nine months ended October 31, 2012 and 52 percent for the same period a year ago, to continue to represent a substantial portion of total revenues in the future as we seek to add and manage more paying subscribers, and build greater brand awareness.

On August 13, 2012, we acquired the outstanding stock of Buddy Media, Inc., (Buddy), a social media marketing platform. We acquired Buddy for the assembled workforce, expected synergies and expanded market opportunities when integrating Buddy s social media marketing platform with our current offerings. The financial results of Buddy are included in our condensed consolidated financial statements from the date of acquisition. The total purchase price for Buddy was $735.8 million.

We regularly assess the need for a valuation allowance against our deferred tax assets. In making that assessment, we consider both positive and negative evidence related to the likelihood of realization of the deferred tax assets to determine, based on the weight of available evidence, whether it is more-likely-than-not that some or all of the deferred tax assets will not be realized. In evaluating the need for a valuation allowance, we considered our cumulative loss in recent years as a significant piece of negative evidence and, to a lesser extent, our expected GAAP losses in the near-term. As a result in the third quarter, we determined that the negative evidence outweighed the positive evidence as of October 31, 2012 and recorded a one-time, non-cash charge to income tax expense in the third quarter of fiscal 2013 in the amount of $149.1 million to establish a valuation allowance against a significant portion of our deferred tax assets. This accounting treatment has no effect on our actual ability to utilize deferred tax assets such as loss carryforwards and tax credits to reduce future cash tax payments. We will continue to assess the likelihood that the deferred tax assets will be realizable at each reporting period and the valuation allowance will be adjusted accordingly.

Fiscal Year

Our fiscal year ends on January 31. References to fiscal 2013, for example, refer to the fiscal year ending January 31, 2013.

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Sources of Revenues

We derive our revenues from two sources: (1) subscription revenues, which are comprised of subscription fees from customers accessing our enterprise cloud computing services and from customers purchasing additional support beyond the standard support that is included in the basic subscription fees; and (2) related professional services such as process mapping, project management, implementation services and other revenue. Other revenue consists primarily of training fees. Subscription and support revenues accounted for approximately 94 percent of our total revenues during the nine months ended October 31, 2012. Subscription revenues are driven primarily by the number of paying subscribers, varying service types, the price of our service and service renewal rates. We define a customer as a separate and distinct buying entity (e.g., a company, a distinct business unit of a large corporation, a partnership, etc.) that has entered into a contract to access our enterprise cloud computing services. We define a subscription as a unique user account purchased by a customer for use by its employees or other customer-authorized users, and we refer to each such user as a subscriber. The number of paying subscriptions at each of our customers ranges from one to hundreds of thousands. None of our customers accounted for more than five percent of our revenues during the nine months ended October 31, 2012 and 2011.

Subscription and support revenues are recognized ratably over the contract terms beginning on the commencement dates of each contract. The typical subscription and support term is 12 to 24 months, although terms range from one to 60 months. Our subscription and support contracts are non-cancelable, though customers typically have the right to terminate their contracts for cause if we materially fail to perform. We generally invoice our customers in advance, in annual or quarterly installments, and typical payment terms provide that our customers pay us within 30 days of invoice. Amounts that have been invoiced are recorded in accounts receivable and in deferred revenue, or in revenue depending on whether the revenue recognition criteria have been met. In general, we collect our billings in advance of the subscription service period.

Professional services and other revenues consist of fees associated with consulting and implementation services and training. Our consulting and implementation engagements are typically billed on a time and materials basis. We also offer a number of training classes on implementing, using and administering our service that are billed on a per person, per class basis. Our typical professional services payment terms provide that our customers pay us within 30 days of invoice.

In determining whether professional services can be accounted for separately from subscription and support revenues, we consider a number of factors, which are described in Critical Accounting Policies and Estimates Revenue Recognition below. Prior to February 1, 2011, the deliverables in multiple-deliverable arrangements were accounted for separately if the delivered items had standalone value and there was objective and reliable evidence of fair value for the undelivered items. If the deliverables in a multiple-deliverable arrangement could not be accounted for separately, the total arrangement fee was recognized ratably as a single unit of accounting over the contracted term of the subscription agreement. A significant portion of our multiple-deliverable arrangements were accounted for as a single unit of accounting because we did not have objective and reliable evidence of fair value for certain of our deliverables. Additionally, in these situations, we deferred the direct costs of a related professional service arrangement and amortized those costs over the same period as the professional services revenue was recognized.

In October 2009, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2009-13, *Revenue Recognition (Topic 605), Multiple-Deliverable Revenue Arrangements a consensus of the FASB Emerging Issues Task Force* (ASU 2009-13) which amended the previous multiple-deliverable arrangements accounting guidance. Pursuant to the new guidance, objective and reliable evidence of fair value of the deliverables to be delivered is no longer required in order to account for deliverables in a multiple-deliverable arrangement separately. Instead, arrangement consideration is allocated to deliverables based on their relative selling price. In the first quarter of fiscal 2012, we adopted this new accounting guidance on a prospective basis. We applied the new accounting guidance to those multiple-deliverable arrangements entered into or materially modified on or after February 1, 2011 which was the beginning of our fiscal 2012.

Seasonal Nature of Deferred Revenue and Accounts Receivable

Deferred revenue primarily consists of billings to customers for our subscription service. Over 90 percent of the value of our billings to customers is for our subscription and support service. We generally invoice our customers in either quarterly or annual cycles. In the fourth quarter of fiscal 2012, we introduced greater operational discipline around annual invoicing, for both new business and renewals which resulted in an increase in deferred revenue. The fourth quarter of fiscal 2013 marks the one year anniversary of this operational shift, therefore, we expect the incremental benefit to deferred revenue from annual invoicing to be lower than it was in the fourth quarter of fiscal 2012. Occasionally, we bill customers for their multi-year contract on a single invoice which results in an increase in noncurrent deferred revenue. There is a disproportionate weighting towards annual billings in the fourth quarter, primarily as a result of large enterprise account buying patterns. Our fourth quarter has historically been our strongest quarter for new business and renewals. The year on year compounding effect of this seasonality in both billing patterns and overall new and renewal business causes the value of invoices that we generate in the fourth quarter for both new business and renewals to increase as a proportion of our total annual billings.

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Accordingly, the sequential quarterly changes in accounts receivable and the related deferred revenue during the first three quarters of our fiscal year are not necessarily indicative of the billing activity that occurs in the fourth quarter as displayed below:

(in thousands)	April 30, 2012	July 31, 2012	October 31, 2012
Fiscal 2013			
Accounts receivable, net	$ 371,395	$ 446,917	$ 418,590
Deferred revenue, current and noncurrent	1,334,716	1,337,184	1,291,703

(in thousands)	April 30, 2011	July 31, 2011	October 31, 2011	January 31, 2012
Fiscal 2012				
Accounts receivable, net	$ 270,816	$ 342,397	$ 312,331	$ 683,745
Deferred revenue, current and noncurrent	915,133	935,266	917,821	1,380,295

(in thousands)	April 30, 2010	July 31, 2010	October 31, 2010	January 31, 2011
Fiscal 2011				
Accounts receivable, net	$ 183,612	$ 228,550	$ 258,764	$ 426,943
Deferred revenue, current and noncurrent	664,529	683,019	694,557	934,941

Unbilled Deferred Revenue

The deferred revenue balance on our condensed consolidated balance sheet does not represent the total contract value of annual or multi-year, non-cancelable subscription agreements. Unbilled deferred revenue was approximately $3.0 billion as of October 31, 2012 and approximately $2.2 billion as of January 31, 2012. Unbilled deferred revenue represents future billings under our subscription agreements that have not been invoiced and, accordingly, are not recorded in deferred revenue. We expect that the amount of unbilled deferred revenue will change from quarter to quarter for several reasons, including the specific timing and duration of large customer subscription agreements, varying billing cycles of subscription agreements, the specific timing of customer renewals, foreign currency fluctuations, the timing of when unbilled deferred revenue is to be recognized as revenue, and changes in customer financial circumstances. For multi-year subscription agreements billed annually, the associated unbilled deferred revenue is typically high at the beginning of the contract period, zero just prior to renewal, and increases if the agreement is renewed. Low unbilled deferred revenue attributable to a particular subscription agreement is often associated with an impending renewal and may not be an indicator of the likelihood of renewal or future revenue from such customer. Accordingly, we expect that the amount of aggregate unbilled deferred revenue will change from year-to-year depending in part upon the number and dollar amount of subscription agreements at particular stages in their renewal cycle. Such fluctuations are not a reliable indicator of future revenues.

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Cost of Revenues and Operating Expenses

Cost of Revenues. Cost of subscription and support revenues primarily consists of expenses related to hosting our service and providing support, the costs of data center capacity, depreciation or operating lease expense associated with computer equipment and software, allocated overhead and amortization expense associated with capitalized software related to our services and acquired developed technologies. We allocate overhead such as information technology infrastructure, rent and occupancy charges based on headcount. Employee benefit costs and taxes are allocated based upon a percentage of total compensation expense. As such, general overhead expenses are reflected in each cost of revenue and operating expense category. Cost of professional services and other revenues consists primarily of employee-related costs associated with these services, including stock-based expenses, the cost of subcontractors and allocated overhead. The cost of providing professional services is significantly higher as a percentage of the related revenue than for our enterprise cloud computing subscription service due to the direct labor costs and costs of subcontractors.

We intend to continue to invest additional resources in our enterprise cloud computing services. For example, we plan to open additional data centers and expand our current data centers in the future. Additionally, as we acquire new businesses and technologies, the amortization expense associated with this activity will be included in cost of revenues. The timing of these additional expenses will affect our cost of revenues, both in terms of absolute dollars and as a percentage of revenues, in the affected periods.

Research and Development. Research and development expenses consist primarily of salaries and related expenses, including stock-based expenses, the costs of our development and test data center and allocated overhead. We continue to focus our research and development efforts on adding new features and services, integrating acquired technologies, increasing the functionality and enhancing the ease of use of our enterprise cloud computing services. Our proprietary, scalable and secure multi-tenant architecture enables us to provide all of our customers with a service based on a single version of our application. As a result, we do not have to maintain multiple versions, which enables us to have relatively lower research and development expenses as compared to traditional enterprise software companies. We expect that in the future, research and development expenses will increase in absolute dollars as we improve and extend our service offerings, develop new technologies and integrate acquired businesses and technologies.

Marketing and Sales. Marketing and sales expenses are our largest cost and consist primarily of salaries and related expenses, including stock-based expenses, for our sales and marketing staff, including commissions, payments to partners, marketing programs and allocated overhead. Marketing programs consist of advertising, events, corporate communications, brand building and product marketing activities.

We plan to continue to invest in marketing and sales by expanding our domestic and international selling and marketing activities, building brand awareness, attracting new customers and sponsoring additional marketing events. The timing of these marketing events, such as our annual and largest event, Dreamforce, will affect our marketing costs in a particular quarter. We expect that in the future, marketing and sales expenses will increase in absolute dollars and continue to be our largest cost.

General and Administrative. General and administrative expenses consist of salaries and related expenses, including stock-based expenses, for finance and accounting, legal, internal audit, human resources and management information systems personnel, legal costs, professional fees, other corporate expenses and allocated overhead. We expect that in the future, general and administrative expenses will increase in absolute dollars as we invest in our infrastructure and we incur additional employee related costs, professional fees and insurance costs related to the growth of our business and international expansion. We expect general and administrative costs as a percentage of total revenues to either remain flat or decrease for the next several quarters.

Stock-Based Expenses. Our cost of revenues and operating expenses include stock-based expenses related to equity plans for employees and non-employee directors. We recognize our stock-based compensation as an expense in the statement of operations based on their fair values and vesting periods. These charges have been significant in the past and we expect that they will increase as our stock price increases, as we hire more employees and seek to retain existing employees.

During the nine months ended October 31, 2012, we recognized stock-based expense of $271.8 million. As of October 31, 2012, the aggregate stock compensation remaining to be amortized to costs and expenses was $970.8 million. We expect this stock compensation balance to be amortized as follows: $103.6 million during the remaining three months of fiscal 2013; $379.2 million during fiscal 2014; $306.0 million during fiscal 2015; $161.4 million during fiscal 2016; and $20.6 million during fiscal 2017. The expected amortization reflects only outstanding stock awards as of October 31, 2012 and assumes no forfeiture activity. We expect to continue to issue stock-based awards to our employees in future periods.

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Amortization of Purchased Intangibles from Business Combinations. Our cost of revenues and operating expenses include amortization of acquisition-related intangible assets, such as the amortization of the cost associated with an acquired company s research and development efforts, trade names, customer lists and customer relationships. We expect this expense to increase as we acquire more companies.

Critical Accounting Estimates

Our condensed consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States. The preparation of these condensed consolidated financial statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, costs and expenses, and related disclosures. On an ongoing basis, we evaluate our estimates and assumptions. Our actual results may differ from these estimates under different assumptions or conditions.

We believe that of our significant accounting policies, which are described in note 1 to our condensed consolidated financial statements, the following accounting policies involve a greater degree of judgment and complexity. Accordingly, these are the policies we believe are the most critical to aid in fully understanding and evaluating our condensed consolidated financial condition and results of operations.

Revenue Recognition. We derive our revenues from two sources: (1) subscription revenues, which are comprised of subscription fees from customers accessing our enterprise cloud computing services and from customers purchasing additional support beyond the standard support that is included in the basic subscription fee; and (2) related professional services such as process mapping, project management, implementation services and other revenue. Other revenue consists primarily of training fees.

We commence revenue recognition when all of the following conditions are satisfied:

- There is persuasive evidence of an arrangement;
- The service has been or is being provided to the customer;
- The collection of the fees is reasonably assured; and
- The amount of fees to be paid by the customer is fixed or determinable.

Our subscription service arrangements are non-cancelable and do not contain refund-type provisions.

Subscription and Support Revenues

Subscription and support revenues are recognized ratably over the contract terms beginning on the commencement date of each contract, which is the date our service is made available to customers. Amounts that have been invoiced are recorded in accounts receivable and in deferred revenue or revenue, depending on whether the revenue recognition criteria have been met.

Professional Services and Other Revenues

The majority of our professional services contracts are on a time and material basis. When these services are not combined with subscription revenues as a single unit of accounting, as discussed below, these revenues are recognized as the services are rendered for time and material contracts, and when the milestones are achieved and accepted by the customer for fixed price contracts. Training revenues are recognized after the services are performed.

Multiple-Deliverable Arrangements

We enter into arrangements with multiple-deliverables that generally include subscription, premium support, and professional services.

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Prior to February 1, 2011, the deliverables in multiple-deliverable arrangements were accounted for separately if the delivered items had standalone value and there was objective and reliable evidence of fair value for the undelivered items. If the deliverables in a multiple-deliverable arrangement could not be accounted for separately, the total arrangement fee was recognized ratably as a single unit of accounting over the contracted term of the subscription agreement. A significant portion of our multiple-deliverable arrangements were accounted for as a single unit of accounting because we did not have objective and reliable evidence of fair value for certain of our deliverables. Additionally, in these situations, we deferred the direct costs of a professional services arrangement and amortized those costs over the same period as the professional services revenue is recognized.

In October 2009, the FASB issued Accounting Standards Update No. 2009-13, *Revenue Recognition (Topic 605), Multiple-Deliverable Revenue Arrangements a consensus of the FASB Emerging Issues Task Force* (ASU 2009-13) which amended the previous multiple-deliverable arrangements accounting guidance. Pursuant to the updated guidance, objective and reliable evidence of fair value of the deliverables to be delivered is no longer required in order to account for deliverables in a multiple-deliverable arrangement separately. Instead, arrangement consideration is allocated to deliverables based on their relative selling price.

In the first quarter of fiscal 2012, we adopted this updated accounting guidance on a prospective basis. We have applied the updated accounting guidance to those multiple-deliverable arrangements entered into or materially modified on or after February 1, 2011 which was the beginning of fiscal 2012.

The adoption of this updated accounting guidance did not have a material impact on our financial condition, results of operations or cash flows for the fiscal year ended January 31, 2012 As of October 31, 2012, the deferred professional services revenue and deferred costs under the previous accounting guidance are $13.1 million and approximately $6.0 million, respectively, which will continue to be recognized over the related remaining subscription period.

Under the updated accounting guidance, in order to treat deliverables in a multiple-deliverable arrangement as separate units of accounting, the deliverables must have standalone value upon delivery. If the deliverables have standalone value upon delivery, we account for each deliverable separately. Subscription services have standalone value as such services are often sold separately. In determining whether professional services have standalone value, we consider the following factors for each professional services agreement: availability of the services from other vendors, the nature of the professional services, the timing of when the professional services contract was signed in comparison to the subscription service start date, and the contractual dependence of the subscription service on the customer s satisfaction with the professional services work. To date, we have concluded that all of the professional services included in multiple-deliverable arrangements executed have standalone value.

Under the updated accounting guidance, when multiple-deliverables included in an arrangement are separated into different units of accounting, the arrangement consideration is allocated to the identified separate units based on a relative selling price hierarchy. We determine the relative selling price for a deliverable based on its vendor-specific objective evidence of selling price (VSOE), if available, or our best estimate of selling price (BESP), if VSOE is not available. We have determined that third-party evidence (TPE) is not a practical alternative due to differences in our service offerings compared to other parties and the availability of relevant third-party pricing information. The amount of revenue allocated to delivered items is limited by contingent revenue, if any.

For certain professional services, we have established VSOE as a consistent number of standalone sales of this deliverable have been priced within a reasonably narrow range. We have not established VSOE for our subscription services due to lack of pricing consistency, the introduction of new services and other factors. Accordingly, we use our BESP to determine the relative selling price.

We determined BESP by considering our overall pricing objectives and market conditions. Significant pricing practices taken into consideration include our discounting practices, the size and volume of our transactions, the customer demographic, the geographic area where our services are sold, our price lists, our go-to-market strategy, historical standalone sales and contract prices. The determination of BESP is made through consultation with and approval by management, taking into consideration the go-to-market strategy. As our go-to-market strategies evolve, we may modify our pricing practices in the future, which could result in changes in relative selling prices, including both VSOE and BESP.

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Deferred Revenue. The deferred revenue balance does not represent the total contract value of annual or multi-year, non-cancelable subscription agreements. Deferred revenue primarily consists of billings or payments received in advance of revenue recognition from subscription service described above and is recognized as the revenue recognition criteria are met. We generally invoice customers in annual or quarterly installments. Deferred revenue is influenced by several factors, including seasonality, the compounding effects of renewals, invoice duration, invoice timing and new business linearity within the quarter.

As a result of the updated accounting guidance previously described, billings against professional services arrangements entered into prior to February 1, 2011 were generally added to deferred revenue and recognized over the remaining related subscription contract term.

Deferred revenue that will be recognized during the succeeding twelve month period is recorded as current deferred revenue and the remaining portion is recorded as noncurrent.

Deferred Commissions. We defer commission payments to our direct sales force. The commissions are deferred and amortized to sales expense over the non-cancelable terms of the related subscription contracts with our customers, which are typically 12 to 24 months. The commission payments, which are paid in full the month after the customer s service commences, are a direct and incremental cost of the revenue arrangements. The deferred commission amounts are recoverable through the future revenue streams under the non-cancelable customer contracts. We believe this is the preferable method of accounting as the commission charges are so closely related to the revenue from the non-cancelable customer contracts that they should be recorded as an asset and charged to expense over the same period that the subscription revenue is recognized.

During the nine months ended October 31, 2012, we deferred $115.6 million of commission expenditures and we amortized $111.1 million to sales expense. During the same period a year ago, we deferred $80.3 million of commission expenditures and we amortized $76.5 million to sales expense. Deferred commissions on our condensed consolidated balance sheets totaled $181.1 million at October 31, 2012 and $176.6 million at January 31, 2012.

Strategic Investments. We report our investments in non-marketable equity and debt securities, which consist of minority equity and debt investments in privately-held companies, at cost or fair value when an event or circumstance indicates an other-than-temporary decline in value has occurred. Management evaluates financial results, earnings trends, technology milestones and subsequent financing of these companies, as well as the general market conditions to identify indicators of other-than-temporary impairment.

Business Combinations. Accounting for business combinations requires us to make significant estimates and assumptions, especially at the acquisition date with respect to intangible assets and assets acquired and liabilities assumed and pre-acquisition contingencies. We use our best estimates and assumptions to accurately assign fair value to the tangible and intangible assets acquired and liabilities assumed at the acquisition date.

Examples of critical estimates in valuing certain of the intangible assets and goodwill we have acquired include but are not limited to:

- future expected cash flows from subscription and support contracts, professional services contracts, other customer contracts and acquired developed technologies and patents;
- expected costs to develop the in-process research and development into commercially viable products and estimated cash flows from the projects when completed;
- the acquired company s trade name, trademark and existing customer relationship, as well as assumptions about the period of time the acquired trade name and trademark will continue to be used in our offerings;
- uncertain tax positions and tax related valuation allowances assumed; and

discount rates.

Unanticipated events and circumstances may occur that may affect the accuracy or validity of such assumptions, estimates or actual results.

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Stock-Based Awards. We recognize the fair value of our stock awards on a straight-line basis over the requisite service period of the award which is the vesting term of generally four years for stock options and restricted stock awards and one year for shares issued pursuant to our Employee Stock Purchase Plan (ESPP). The fair value of each award is estimated on the date of grant using the Black-Scholes option pricing model. The estimated forfeiture rate applied is based on historical forfeiture rates. Inputs into the Black-Scholes option pricing model include:

- The estimated life for the stock options which is estimated based on an actual analysis of expected life. The estimated life for shares issued pursuant to our ESPP is based on the two purchase periods within the 12 month offering period;
- The risk free interest rate which is based on the rate for a U.S. government security with the same estimated life at the time of the option grant and the stock purchase rights; and
- The future stock price volatility which is estimated considering both our observed option-implied volatilities and our historical volatility calculations. We believe this is the best estimate of the expected volatility over the expected life of our stock options and stock purchase rights.

Income Taxes. We use the liability method of accounting for income taxes. Under this method, deferred tax assets and liabilities are determined based on temporary differences between the financial statement and tax basis of assets and liabilities and net operating loss and credit carryforwards using enacted tax rates in effect for the year in which the differences are expected to reverse. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Valuation allowances are established when necessary to reduce deferred tax assets to the amounts more likely than not expected to be realized.

Our effective tax rate could be adversely affected by changes in the mix of earnings and losses in countries with differing statutory tax rates, certain non-deductible expenses as a result of acquisitions, compensation, the valuation of deferred tax assets and liabilities and changes in tax laws and accounting principles.

Results of Operations

The following tables set forth selected data for each of the periods indicated (in thousands):

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2012	2011	2012	2011
Revenues:				
Subscription and support	$ 740,600	$ 549,182	$ 2,083,313	$ 1,531,965
Professional services and other	47,798	35,078	132,201	102,661
Total revenues	788,398	584,260	2,215,514	1,634,626
Cost of revenues:				
Subscription and support	134,183	96,306	361,446	260,693
Professional services and other	52,065	32,259	138,771	91,848
Total cost of revenues	186,248	128,565	500,217	352,541
Gross profit	602,150	455,695	1,715,297	1,282,085
Operating expenses:				
Research and development	114,074	76,049	308,292	214,734
Marketing and sales	428,507	304,571	1,178,456	842,043
General and administrative	113,757	85,232	318,452	254,016
Total operating expenses	656,338	465,852	1,805,200	1,310,793
Loss from operations	(54,188)	(10,157)	(89,903)	(28,708)

Investment income	3,887	5,136	15,521	18,303
Interest expense	(8,190)	(3,859)	(22,593)	(11,376)
Other income (expense)	(4,360)	30	(4,776)	(4,001)
Loss before benefit from (provision for) income taxes	(62,851)	(8,850)	(101,751)	(25,782)
Benefit from (provision for) income taxes	(157,446)	5,094	(147,850)	18,288
Net loss	$ (220,297)	$ (3,756)	$ (249,601)	$ (7,494)

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	As of	
	October 31, 2012	January 31, 2012
Balance Sheet Data:		
Cash, cash equivalents and marketable securities	$ 1,416,050	$ 1,447,174
Deferred revenue, current and noncurrent	1,291,703	1,380,295

Unbilled deferred revenue was approximately $3.0 billion as of October 31, 2012 and $2.2 billion as of January 31, 2012. Unbilled deferred revenue represents future billings under our non-cancelable subscription agreements that have not been invoiced and, accordingly, are not recorded in deferred revenue.

Cost of revenues and marketing and sales expenses include the following amounts related to amortization of purchased intangibles from business combinations:

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2012	2011	2012	2011
Cost of revenues	$ 23,247	$ 17,469	$ 58,363	$ 42,937
Marketing and sales	2,995	953	8,829	4,499

Cost of revenues and operating expenses include the following amounts related to stock-based awards:

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2012	2011	2012	2011
Cost of revenues	$ 9,336	$ 4,138	$ 24,453	$ 12,168
Research and development	21,984	12,197	53,740	31,224
Marketing and sales	55,304	29,123	142,072	80,024
General and administrative	18,488	11,548	51,530	35,742

Benefit from (provision for) income taxes include the following amounts related to a one-time, non-cash charge to record a valuation allowance:

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2012	2011	2012	2011
Benefit from (provision for) income taxes	$ (149,147)	$ 0	$ (149,147)	$ 0

Revenues by geography were as follows:

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2012	2011	2012	2011
Americas	$ 547,399	$ 397,118	$ 1,540,326	$ 1,104,052
Europe	133,791	103,864	376,694	300,315
Asia Pacific	107,208	83,278	298,494	230,259
	$ 788,398	$ 584,260	$ 2,215,514	$ 1,634,626

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The following tables set forth selected condensed consolidated statements of operations data for each of the periods indicated as a percentage of total revenues:

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2012	2011	2012	2011
Revenues:				
Subscription and support	94%	94%	94%	94%
Professional services and other	6	6	6	6
Total revenues	100	100	100	100
Cost of revenues:				
Subscription and support	17	16	17	16
Professional services and other	7	6	6	6
Total cost of revenues	24	22	23	22
Gross profit	76	78	77	78
Operating expenses:				
Research and development	15	13	14	13
Marketing and sales	54	52	53	52
General and administrative	14	15	14	15
Total operating expenses	83	80	81	80
Loss from operations	(7)	(2)	(4)	(2)
Investment income	0	1	1	1
Interest expense	(1)	(1)	(1)	(1)
Other income (expense)	0	0	0	0
Loss before benefit from (provision for) income taxes	(8)	(2)	(4)	(2)
Benefit from (provision for) income taxes	(20)	1	(7)	1
Net loss	(28)%	(1)%	(11)%	(1)%

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2012	2011	2012	2011
Amortization of purchased intangibles:				
Cost of revenues	3%	3%	3%	3%
Marketing and sales	0	0	0	0

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2012	2011	2012	2011
Stock-based awards:				
Cost of revenues	1%	1%	1%	1%
Research and development	3	2	2	2
Marketing and sales	7	5	6	5
General and administrative	2	2	2	2

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2012	2011	2012	2011
One-time tax item:				

Benefit from (provision for) income taxes	(19)%	0%	(7)%	0%

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2012	**2011**	**2012**	**2011**
Revenues by geography:				
Americas	69%	68%	70%	68%
Europe	17	18	17	18
Asia Pacific	14	14	13	14
	100%	100%	100%	100%

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Three Months Ended October 31, 2012 and 2011

Revenues.

(In thousands)	Three Months Ended October 31, 2012	2011	Variance Dollars	Percent
Subscription and support	$ 740,600	$ 549,182	$ 191,418	35%
Professional services and other	47,798	35,078	12,720	36%
Total revenues	$ 788,398	$ 584,260	$ 204,138	35%

Total revenues were $788.4 million for the three months ended October 31, 2012, compared to $584.3 million during the same period a year ago, an increase of $204.1 million, or 35 percent. Subscription and support revenues were $740.6 million, or 94 percent of total revenues, for the three months ended October 31, 2012, compared to $549.2 million, or 94 percent of total revenues, during the same period a year ago. The increase in subscription and support revenues was due primarily to new customers, upgrades and additional subscriptions from existing customers and improved renewal rates as compared to a year ago. The price per user per month for our three primary offerings, Professional Edition, Enterprise Edition and Unlimited Edition, in the quarter ended October 31, 2012 has generally remained consistent relative to prior periods. Professional services and other revenues were $47.8 million, or six percent of total revenues, for the three months ended October 31, 2012, compared to $35.1 million, or six percent of total revenues, for the same period a year ago. The increase in professional services and other revenues was due primarily to the higher demand for services from an increased number of customers.

Revenues in Europe and Asia Pacific accounted for $241.0 million, or 31 percent of total revenues, for the three months ended October 31, 2012, compared to $187.1 million, or 32 percent of total revenues, during the same period a year ago, an increase of $53.9 million, or 29 percent. The increase in revenues outside of the Americas was the result of the increasing acceptance of our service, our focus on marketing our services internationally and improved renewal rates. However, the value of the U.S. dollar relative to foreign currencies negatively impacted U.S. dollar revenues outside of the Americas for the three months ended October 31, 2012 as compared to the same period a year ago. Foreign currency negatively impacted our aggregate revenues by $14.0 million compared to the same period a year ago.

Cost of Revenues.

(In thousands)	Three Months Ended October 31, 2012	2011	Variance Dollars
Subscription and support	$ 134,183	$ 96,306	$ 37,877
Professional services and other	52,065	32,259	19,806
Total cost of revenues	$ 186,248	$ 128,565	$ 57,683
Percent of total revenues	24%	22%	

Cost of revenues was $186.2 million, or 24 percent of total revenues, for the three months ended October 31, 2012, compared to $128.6 million, or 22 percent of total revenues, during the same period a year ago, an increase of $57.7 million. The increase in absolute dollars was primarily due to an increase of $19.6 million in employee-related costs, an increase of $5.2 million in stock-based expenses, an increase of $11.4 million in service delivery costs, primarily due to our efforts to increase data center capacity, an increase of $11.1 million in depreciation and amortization expenses, $5.8 million of which related to the amortization of purchased intangible assets and an increase of $4.4 million in allocated overhead. We have increased our headcount since October 31, 2011 to meet the higher demand for services from our customers. A majority of the increase in headcount was due to the acquisitions.

We intend to continue to invest additional resources in our enterprise cloud computing services and data center capacity. Additionally, the amortization of purchased intangible assets will increase as we acquire additional businesses and technologies. We also plan to add additional employees in our professional services group to facilitate the adoption of our services. The timing of these expenses will affect our cost of revenues, both in terms of absolute dollars and as a percentage of revenues in future periods.

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Research and Development.

(In thousands)	Three Months Ended October 31, 2012	2011	Variance Dollars
Research and development	$ 114,074	$ 76,049	$ 38,025
Percent of total revenues	15%	13%	

Research and development expenses were $114.1 million, or 15 percent of total revenues, for the three months ended October 31, 2012, compared to $76.0 million, or 13 percent of total revenues, during the same period a year ago, an increase of $38.0 million. The increase in absolute dollars was primarily due to an increase of $24.5 million in employee-related costs, an increase of $9.8 million in stock-based expenses and an increase of $3.2 million in our development and test data center. We increased our research and development headcount by 39 percent since October 31, 2011 in order to improve and extend our service offerings and develop new technologies. Some of the increase in headcount was due to acquired businesses.

Marketing and Sales.

(In thousands)	Three Months Ended October 31, 2012	2011	Variance Dollars
Marketing and sales	$ 428,507	$ 304,571	$ 123,936
Percent of total revenues	54%	52%	

Marketing and sales expenses were $428.5 million, or 54 percent of total revenues, for the three months ended October 31, 2012, compared to $304.6 million, or 52 percent of total revenues, during the same period a year ago, an increase of $123.9 million. The increase in absolute dollars was primarily due to increases of $74.8 million in employee-related costs, including amortization of deferred commissions, $26.2 million in stock-based expenses, $10.2 million in advertising, marketing and event costs, $7.2 million in allocated overhead and $2.2 million in depreciation and amortization expenses, $2.0 million of which related to the amortization of purchased intangible assets. Our marketing and sales headcount increased by 32 percent since October 31, 2011 as we hired additional sales personnel to focus on adding new customers and increasing penetration within our existing customer base. Some of the increase in headcount was due to acquired businesses.

General and Administrative.

(In thousands)	Three Months Ended October 31, 2012	2011	Variance Dollars
General and administrative	$ 113,757	$ 85,232	$ 28,525
Percent of total revenues	14%	15%	

General and administrative expenses were $113.8 million, or 14 percent of total revenues, for the three months ended October 31, 2012, compared to $85.2 million, or 15 percent of total revenues, during the same period a year ago, an increase of $28.5 million. The increase was primarily due to increases of $18.1 million in employee-related costs, $6.9 million in stock-based expenses and increases in depreciation and amortization. Our general and administrative headcount increased by 22 percent since October 31, 2011 as we added personnel to support our growth.

Loss from operations.

(In thousands)	Three Months Ended October 31, 2012	2011	Variance Dollars
Loss from operations	$ (54,188)	$ (10,157)	$ (44,031)

Percent of total revenues	(7)%	(2)%

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Loss from operations for the three months ended October 31, 2012 was $54.2 million and included $105.1 million of stock-based expenses and $26.2 million of amortization of purchased intangibles. During the same period a year ago, loss from operations was $10.2 million and included $57.0 million of stock-based expenses and $18.4 million of amortization of purchased intangibles.

Investment income.

(In thousands)	Three Months Ended October 31, 2012	2011	Variance Dollars
Investment income	$ 3,887	$ 5,136	$ (1,249)
Percent of total revenues	0%	1%	

Investment income consists of income on cash and marketable securities balances. Investment income was $3.9 million for the three months ended October 31, 2012 and was $5.1 million during the same period a year ago. The decrease was primarily due to an increase in realized losses from sales of marketable securities, the decrease in marketable securities balances and lower interest rates.

Interest expense.

(In thousands)	Three Months Ended October 31, 2012	2011	Variance Dollars
Interest expense	$ (8,190)	$ (3,859)	$ (4,331)
Percent of total revenues	(1)%	(1)%	

Interest expense consists of interest on our convertible senior notes and capital leases. Interest expense, net of interest costs capitalized, was $8.2 million for the three months ended October 31, 2012 and was $3.9 million during the same period a year ago. During the three months ended October 31, 2012, we capitalized $0.2 million of interest costs related to capital projects. Capitalized interest during the same period a year ago was $4.2 million. During the first quarter of fiscal 2013, we suspended pre-construction activity, which includes capitalized interest costs, on the undeveloped real estate in San Francisco, California.

Benefit from (provision for) income taxes.

(In thousands)	Three Months Ended October 31, 2012	2011	Variance Dollars
Benefit from (provision for) income taxes	$ (157,446)	$ 5,094	$ (162,540)
Effective tax rate	251%	58%	

We recorded a tax provision of $157.4 million for the three months ended October 31, 2012, which resulted in a negative effective tax rate of 251 percent. The effective tax rate substantially differed from the federal statutory tax rate of 35 percent primarily due to a one-time, non-cash charge in the amount of $149.1 million to establish a valuation allowance for a significant portion of our deferred tax assets.

We regularly assess the need for a valuation allowance against our deferred tax assets. In making that assessment, we consider both positive and negative evidence related to the likelihood of realization of the deferred tax assets to determine, based on the weight of available evidence, whether it is more-likely-than-not that some or all of the deferred tax assets will not be realized. In evaluating the need for a valuation allowance, we consider our cumulative loss in recent years as a significant piece of negative evidence and, to a lesser extent, our expected GAAP losses in the near-term. As a result, in the third quarter we determined that the negative evidence outweighed the positive evidence as of October 31, 2012 and recorded a one-time, non-cash charge to income tax expense in the third quarter of fiscal 2013 in the amount of $149.1 million to establish a valuation allowance against a significant portion of our deferred tax assets. We will continue to assess the likelihood that the deferred tax assets will be realizable at each reporting period and the valuation allowance will be adjusted accordingly.

We recorded a tax benefit of $5.1 million for the three months ended October 31, 2011, which resulted in an effective tax rate of 58 percent. The effective tax rate was higher than the federal statutory tax rate of 35 percent primarily due to federal and California tax credits and the impact of

the Radian6 acquisition. The tax benefit was partially offset by foreign tax expense and non-deductible amounts. The effect on the tax rate was magnified because of the relatively small pre-tax loss.

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Nine Months Ended October 31, 2012 and 2011

Revenues.

(In thousands)	Nine Months Ended October 31, 2012	2011	Variance Dollars	Percent
Subscription and support	$ 2,083,313	$ 1,531,965	$ 551,348	36%
Professional services and other	132,201	102,661	29,540	29%
Total revenues	$ 2,215,514	$ 1,634,626	$ 580,888	36%

Total revenues were $2.2 billion for the nine months ended October 31, 2012, compared to $1.6 billion during the same period a year ago, an increase of $580.9 million, or 36 percent. Subscription and support revenues were $2.1 billion, or 94 percent of total revenues, for the nine months ended October 31, 2012, compared to $1.5 billion, or 94 percent of total revenues, during the same period a year ago. The increase in subscription and support revenues was due primarily to new customers, upgrades and additional subscriptions from existing customers and improved renewal rates as compared to a year ago. The price per user per month for our three primary offerings, Professional Edition, Enterprise Edition and Unlimited Edition, in the nine months ended October 31, 2012 has remained substantially consistent relative to prior periods. Professional services and other revenues were $132.2 million, or six percent of total revenues, for the nine months ended October 31, 2012, compared to $102.7 million, or six percent of total revenues, for the same period a year ago. The increase in professional services and other revenues was due primarily to the higher demand for services from an increased number of customers.

Revenues in Europe and Asia Pacific accounted for $675.2 million, or 30 percent of total revenues, for the nine months ended October 31, 2012, compared to $530.6 million, or 32 percent of total revenues, during the same period a year ago, an increase of $144.6 million, or 27 percent. The increase in revenues outside of the Americas was the result of the increasing acceptance of our service, our focus on marketing our service internationally and improved renewal rates. However, the value of the U.S. dollar relative to foreign currencies negatively impacted U.S. dollar revenues outside of the Americas for the nine months ended October 31, 2012 as compared to the same period a year ago. Foreign currency negatively impacted our aggregate revenues by $37.4 million compared to the same period a year ago.

Cost of Revenues.

(In thousands)	Nine Months Ended October 31, 2012	2011	Variance Dollars
Subscription and support	$ 361,446	$ 260,693	$ 100,753
Professional services and other	138,771	91,848	46,923
Total cost of revenues	$ 500,217	$ 352,541	$ 147,676
Percent of total revenues	23%	22%	

Cost of revenues was $500.2 million, or 23 percent of total revenues, for the nine months ended October 31, 2012, compared to $352.5 million, or 22 percent of total revenues, during the same period a year ago, an increase of $147.7 million. The increase in absolute dollars was primarily due to an increase of $57.3 million in employee-related costs, an increase of $26.7 million in service delivery costs, primarily due to our efforts in increasing data center capacity, an increase of $31.2 million in depreciation and amortization expenses, $15.4 million of which related to the amortization of acquired developed technology, an increase of $10.4 million in allocated overhead and an increase of $12.3 million in stock-based expenses. We have increased our headcount since October 31, 2011 to meet the higher demand for services from our customers. A majority of the increase in headcount was due to the acquisitions during the nine months ended October 31, 2012. The increase in professional services headcount due to acquisitions resulted in the cost of professional services and other revenues to be in excess of the related revenue for the nine months ended October 31, 2012 by $6.6 million.

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We intend to continue to invest additional resources in our enterprise cloud computing services and data center capacity. The timing of these additional expenses will affect our cost of revenues, both in terms of absolute dollars and as a percentage of revenues in future periods.

Research and Development.

(In thousands)	Nine Months Ended October 31, 2012	2011	Variance Dollars
Research and development	$ 308,292	$ 214,734	$ 93,558
Percent of total revenues	14%	13%	

Research and development expenses were $308.3 million, or 14 percent of total revenues, for the nine months ended October 31, 2012, compared to $214.7 million, or 13 percent of total revenues, during the same period a year ago, an increase of $93.6 million. The increase in absolute dollars was due to an increase of $64.4 million in employee-related costs, an increase of $22.5 million in stock-based expenses and an increase of $5.7 million in test data lab costs. We increased our research and development headcount by 39 percent since October 31, 2011 in order to improve and extend our service offerings and develop new technologies. Some of the increase in headcount was due to acquired businesses.

Marketing and Sales.

(In thousands)	Nine Months Ended October 31, 2012	2011	Variance Dollars
Marketing and sales	$ 1,178,456	$ 842,043	$ 336,413
Percent of total revenues	53%	52%	

Marketing and sales expenses were $1.2 billion, or 53 percent of total revenues, for the nine months ended October 31, 2012, compared to $842.0 million, or 52 percent of total revenues, during the same period a year ago, an increase of $336.4 million. The increase in absolute dollars was primarily due to increases of $230.5 million in employee-related costs, $62.0 million in stock-based expenses, $23.2 million in advertising, marketing and event costs and $16.6 million in allocated overhead. Our marketing and sales headcount increased by 32 percent since October 31, 2011 as we hired additional sales personnel to focus on adding new customers and increasing penetration within our existing customer base. Some of the increase in headcount was due to acquired businesses.

General and Administrative.

(In thousands)	Nine Months Ended October 31, 2012	2011	Variance Dollars
General and administrative	$ 318,452	$ 254,016	$ 64,436
Percent of total revenues	14%	15%	

General and administrative expenses were $318.5 million, or 14 percent of total revenues, for the nine months ended October 31, 2012, compared to $254.0 million, or 15 percent of total revenues, during the same period a year ago, an increase of $64.4 million. The increase was primarily due to increases of $15.8 million in stock-based expenses, $11.0 million in depreciation and amortization, $6.0 million in infrastructure costs and professional and outside service costs and an increase in employee-related costs. Our general and administrative headcount increased by 22 percent since October 31, 2011 as we added personnel to support our growth.

Loss from operations.

			Variance

	Nine Months Ended October 31,		
(In thousands)	**2012**	**2011**	**Dollars**
Loss from operations	$ (89,903)	$ (28,708)	$ (61,195)
Percent of total revenues	(4)%	(2)%	

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Loss from operations for the nine months ended October 31, 2012, was $89.9 million and included $271.8 million of stock-based expenses and $67.2 million of amortization of purchased intangibles. During the same period a year ago, operating loss was $28.7 million and included $159.2 million of stock-based expenses and $47.4 million of amortization of purchased intangibles.

Investment income.

(In thousands)	Nine Months Ended October 31, 2012	2011	Variance Dollars
Investment income	$ 15,521	$ 18,303	$ (2,782)
Percent of total revenues	1%	1%	

Investment income consists of income on cash and marketable securities balances. Investment income was $15.5 million for the nine months ended October 31, 2012, and was $18.3 million during the same period a year ago. The decrease was primarily due to the decrease in marketable securities balances and lower interest rates.

Interest expense.

(In thousands)	Nine Months Ended October 31, 2012	2011	Variance Dollars
Interest expense	$ (22,593)	$ (11,376)	$ (11,217)
Percent of total revenues	(1)%	(1)%	

Interest expense consists of interest on our convertible senior notes and capital leases. Interest expense, net of interest costs capitalized, was $22.6 million for the nine months ended October 31, 2012 and was $11.4 million during the same period a year ago. During the nine months ended October 31, 2012, we capitalized $2.2 million of interest costs related to capital projects. Capitalized interest during the same period a year ago was $12.1 million. During the first quarter of fiscal 2013, we suspended pre-construction activity, which includes capitalized interest costs, on the undeveloped real estate in San Francisco, California.

Benefit from (provision for) Income Taxes.

(In thousands)	Nine Months Ended October 31, 2012	2011	Variance Dollars
Benefit from (provision for) income taxes	$ (147,850)	$ 18,288	$ (166,138)
Effective tax rate	145%	71%	

We recorded a tax provision of $147.9 million for the nine months ended October 31, 2012, which resulted in a negative effective tax rate of 145 percent. The effective tax rate substantially differed from the federal statutory tax rate of 35 percent primarily due to a one-time, non-cash charge to record a valuation allowance during the three months ended October 31, 2012 for a significant portion of our deferred tax assets as described above.

We recorded a tax benefit of $18.3 million for the nine months ended October 31, 2011, which resulted in an effective tax rate of 71 percent. The effective tax rate was higher than the federal statutory tax rate of 35 percent primarily due to federal and California tax credits and a tax benefit related to the Radian6 acquisition. The tax benefit was partially offset by foreign tax expense and non-deductible amounts. The effect on the tax rate was magnified because of the relatively small pre-tax loss.

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New Accounting Pronouncement

In September 2011, the FASB issued Accounting Standards Update No. 2011-08, *Intangibles Goodwill and Other (Topic 350) Testing Goodwill for Impairment* (ASU 2011-08), to allow entities to use a qualitative approach to test goodwill for impairment. ASU 2011-08 permits an entity to first perform a qualitative assessment to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying value. If it is concluded that this is the case, it is necessary to perform the currently prescribed two-step goodwill impairment test. Otherwise, the two-step goodwill impairment test is not required. We plan to adopt ASU 2011-08 by the fourth quarter of fiscal 2013 and do not believe that the adoption will have a material effect on the condensed consolidated financial statements.

Liquidity and Capital Resources

At October 31, 2012, our principal sources of liquidity were cash, cash equivalents and marketable securities totaling $1.4 billion and accounts receivable of $418.6 million.

Net cash provided by operating activities was $455.3 million during the nine months ended October 31, 2012 and $351.2 million during the same period a year ago. Cash provided by operating activities has historically been affected by: the amount of net loss; sales of subscriptions, support and professional services; changes in working capital accounts, particularly increases and seasonality in accounts receivable and deferred revenue as described above, increases in the amount of billings to customers because of increased invoice durations, the timing of commission and bonus payments, and the timing of collections from large enterprise customers; add-backs of non-cash expense items such as depreciation and amortization, amortization of debt discount and the expense associated with stock-based awards. During the nine months ended October 31, 2012, we recorded a non-cash charge to income tax expense in the amount of $149.1 million to establish a valuation allowance against a significant portion of our deferred tax assets. During the nine months ended October 31, 2012 we made a tax payment of approximately $40.0 million as a result of the Radian6 transaction. We also made a payment of approximately $9.7 million as a result of the settlement agreement with respect to a California state wage and hour lawsuit that had been filed against us early in 2011. We entered into a preliminary settlement agreement in the second quarter of fiscal 2012 and recorded the estimated settlement expense in our financial results for fiscal 2012.

Net cash used in investing activities was $760.6 million during the nine months ended October 31, 2012 and $332.4 million during the same period a year ago. The net cash used in investing activities during the nine months ended October 31, 2012 primarily related to the purchase of Buddy in August 2012, the purchase of GoInstant in September 2012, the purchase of Rypple in February 2012, capital expenditures, investment of cash balances and strategic investments offset by proceeds from sales and maturities of marketable securities. We expect capital expenditures to increase in the remaining three months of fiscal 2013 primarily due to leasehold improvement costs associated with the office lease agreement we signed in January 2012 at 50 Fremont Street, San Francisco, California.

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Net cash provided by financing activities was $210.1 million during the nine months ended October 31, 2012 and $63.4 million during the same period a year ago. Net cash provided by financing activities during the nine months ended October 31, 2012 consisted primarily of $203.9 million of proceeds from equity plans and $28.9 million of excess tax benefits from employee stock plans offset by $22.7 million of principal payments on capital leases.

In January 2010, we issued $575.0 million of 0.75% convertible senior notes due January 15, 2015 (the Notes) and concurrently entered into convertible notes hedges (the Note Hedges) and separate warrant transactions (the Warrants). The Notes will mature on January 15, 2015, unless earlier converted. Upon conversion of any Notes, we will deliver cash up to the principal amount of the Notes and, with respect to any excess conversion value greater than the principal amount of the Notes, shares of our common stock, cash, or a combination of both.

For 20 trading days during the 30 consecutive trading days ended July 31, 2012, our common stock traded at a price exceeding 130% of the conversion price of $85.36 per share applicable to the Notes. Accordingly, the Notes were convertible at the holders option for the quarter ending October 31, 2012. The Notes are classified as a current liability on our condensed consolidated balance sheet as of October 31, 2012. For 20 trading days during the 30 consecutive trading days ended October 31, 2012, our common stock traded at a price exceeding 130% of the conversion price of $85.36 per share applicable to the Notes. Accordingly, the Notes will be convertible at the holders option for the quarter ending January 31, 2013, and will remain classified as a current liability on our condensed consolidated balance sheet.

Our cash, cash equivalents and marketable securities are comprised primarily of corporate notes and other obligations, U.S. treasury, U.S. government and U.S. agency obligations, U.S agency mortgage backed securities, time deposits, money market mutual funds and municipal securities.

As of October 31, 2012, we have a total of $25.1 million in letters of credit outstanding in favor of certain landlords for office space. To date, no amounts have been drawn against the letters of credit, which renew annually and mature at various dates through April 2030.

We do not have any special purpose entities, and other than operating leases for office space and computer equipment, we do not engage in off-balance sheet financing arrangements. Additionally, we currently do not have a bank line of credit.

Our principal commitments consist of obligations under leases for office space and co-location facilities for data center capacity and our development and test data center, and computer equipment and furniture and fixtures. At October 31, 2012, the future non-cancelable minimum payments under these commitments were as follows (in thousands):

	Capital Leases	Operating Leases
Fiscal Period:		
Remaining three months of fiscal 2013	$ 7,862	$ 36,284
Fiscal 2014	31,589	137,530
Fiscal 2015	11,063	111,851
Fiscal 2016	7,775	91,770
Fiscal 2017	6,972	77,737
Thereafter	2,471	440,989
Total minimum lease payments	67,732	$ 896,161
Less: amount representing interest	(3,948)	
Present value of capital lease obligations	$ 63,784	

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Our lease agreements provide us with the option to renew. Our future operating lease obligations would change if we exercised these options and if we entered into additional operating lease agreements as we expand our operations.

We believe our existing cash, cash equivalents and short-term marketable securities and cash provided by operating activities will be sufficient to meet our working capital and capital expenditure needs over the next 12 months.

In the future, we may enter into arrangements to acquire or invest in complementary businesses or joint ventures, services and technologies, and intellectual property rights. We may be required to seek additional equity or debt financing. Additional funds may not be available on terms favorable to us or at all.

Non-GAAP Financial Measures

Regulation S-K Item 10(e), Use of Non-GAAP Financial Measures in Commission Filings, defines and prescribes the conditions for use of non-GAAP financial information. Our measures of non-GAAP gross profit, non-GAAP operating profit, non-GAAP net income and non-GAAP earnings per share each meet the definition of a non-GAAP financial measure.

Non-GAAP gross profit, Non-GAAP operating profit and Non-GAAP net income

We use the non-GAAP measures of non-GAAP gross profit, non-GAAP operating profit and non-GAAP net income to provide an additional view of operational performance by excluding non-cash expenses that are not directly related to performance in any particular period. In addition to our GAAP measures we use these non-GAAP measures when planning, monitoring, and evaluating our performance. We believe that these non-GAAP measures reflect our ongoing business in a manner that allows for meaningful period-to-period comparisons and analysis of trends in our business, as they exclude certain expenses. These certain expenses are excluded because the decisions which gave rise to these expenses are not made to increase revenue in a particular period, but are made for our long-term benefit over multiple periods and we are not able to change or affect these items in any particular period.

We define non-GAAP net income as our total net income excluding the following components, which we believe are not reflective of our ongoing operational expenses. In each case, for the reasons set forth below, we believe that excluding the component provides useful information to investors and others in understanding and evaluating the impact of certain non-cash items to our operating results and future prospects in the same manner as us, in comparing financial results across accounting periods and to those of peer companies and to better understand the impact of these non-cash items on our gross margin and operating performance. Additionally, as significant, unusual or discrete events occur, the results may be excluded in the period in which the events occur.

Stock-Based Expenses. The Company s compensation strategy includes the use of stock-based compensation to attract and retain employees and executives. It is principally aimed at aligning their interests with those of our stockholders and at long-term employee retention, rather than to motivate or reward operational performance for any particular period. Thus, stock-based compensation expense varies for reasons that are generally unrelated to operational decisions and performance in any particular period.

Amortization of Purchased Intangibles. The Company views amortization of acquisition-related intangible assets, such as the amortization of the cost associated with an acquired company s research and development efforts, trade names, customer lists and customer relationships, as items arising from pre-acquisition activities determined at the time of an acquisition. While it is continually viewed for impairment, amortization of the cost of purchased intangibles is a static expense, one that is not typically affected by operations during any particular period.

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Amortization of Debt Discount. Under GAAP, certain convertible debt instruments that may be settled in cash (or other assets) on conversion are required to be separately accounted for as liability (debt) and equity (conversion option) components of the instrument in a manner that reflects the issuer s non-convertible debt borrowing rate. Accordingly, for GAAP purposes we are required to recognize imputed interest expense on the Company s $575 million of convertible subordinated notes that were issued in a private placement in January 2010. The imputed interest rate is approximately 5.9%, while the coupon interest rate is 0.75%. The difference between the imputed interest expense and the coupon interest expense, net of the interest amount capitalized, is excluded from management s assessment of the Company s operating performance because management believes that this non-cash expense is not indicative of ongoing operating performance. Management believes that the exclusion of the non-cash interest expense provides investors an enhanced view of the Company s operational performance.

One-time Tax Items. As a result of the Company assessing the realizability of its deferred tax assets, the Company recorded a one-time, non-cash charge to income tax expense to establish a valuation allowance against a significant portion of those assets. The Company applied significant judgment as part of this analysis including considering the Company s past operating results, cumulative losses and forecasts of future taxable income. As part of establishing a valuation allowance with respect to the Company s deferred tax assets, the Company will assess and record any necessary quarterly changes to the valuation allowance and the corresponding income tax expense or benefit. Management believes that the exclusion of this non-cash charge is appropriate to provide investors with a better view of the Company s operational performance.

Quarterly Change in Valuation Allowance. As part of establishing a valuation allowance, the Company records a quarterly charge related to the change in the valuation allowance. Management believes that the exclusion of any quarterly charge related to the change in the valuation allowance is appropriate to provide investors with a better view of the Company s operational performance.

Income Tax Effects. The company s estimated non-GAAP effective tax rate adjusts for the tax effect of the expense items described above.

We define non-GAAP gross profit as our total revenues less cost of revenues, as reported on our condensed consolidated statement of operations, excluding the portions of stock-based expenses and amortization of purchased intangibles that are included in cost of revenues.

We define non-GAAP operating profit as our non-GAAP gross profit less operating expenses, as reported on our condensed consolidated statement of operations, excluding the portions of stock-based expenses and amortization of purchased intangibles that are included in operating expenses.

Non-GAAP earnings per share

Management uses the non-GAAP earnings per share to provide an additional view of performance by excluding expenses that are not directly related to performance in any particular period in the earnings per share calculation.

We define non-GAAP earnings per share as our non-GAAP net income, which excludes the above components, which we believe are not reflective of our ongoing operational expenses, divided by basic or diluted shares outstanding.

Limitations on the use of Non-GAAP financial measures

A limitation of our non-GAAP financial measures of non-GAAP gross profit, non-GAAP operating profit, non-GAAP net income and non-GAAP earnings per share is that they do not have uniform definitions. Our definitions will likely differ from the definitions used by other companies, including peer companies, and therefore comparability may be limited. Thus, our non-GAAP measures of non-GAAP gross profit, non-GAAP operating profit, non-GAAP net income and non-GAAP earnings per share should be considered in addition to, not as a substitute for, or in isolation from, measures prepared in accordance with GAAP. Additionally, in the case of stock-based expense, if we did not pay a portion of compensation in the form of stock-based expense, the cash salary expense included in costs of revenues and operating expenses would be higher which would affect our cash position.

We compensate for these limitations by reconciling non-GAAP gross profit, non-GAAP operating profit, non-GAAP net income and non-GAAP earnings per share to the most comparable GAAP financial measure. We encourage investors and others to review our financial information in its entirety, not to rely on any single financial measure and to view our non-GAAP financial measures in conjunction with the most comparable GAAP financial measures.

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Our reconciliation of the non-GAAP financial measure of gross profit, operating profit, net income and earnings per share to the most comparable GAAP measure, gross profit, income (loss) from operations, net income (loss) and Diluted earnings (loss) per share for the three an nine months ended October 31, 2012 and 2011 are as follows (in thousands):

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2012	2011	2012	2011
Non-GAAP gross profit				
GAAP gross profit	$ 602,150	$ 455,695	$ 1,715,297	$ 1,282,085
Plus:				
Amortization of purchased intangibles	23,247	17,469	58,363	42,937
Stock-based expenses	9,336	4,138	24,453	12,168
Non-GAAP gross profit	$ 634,733	$ 477,302	$ 1,798,113	$ 1,337,190

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2012	2011	2012	2011
Non-GAAP operating profit				
GAAP loss from operations	$ (54,188)	$ (10,157)	$ (89,903)	$ (28,708)
Plus:				
Amortization of purchased intangibles	26,242	18,422	67,192	47,436
Stock-based expenses	105,112	57,006	271,795	159,158
Non-GAAP operating profit	$ 77,166	$ 65,271	$ 249,084	$ 177,886

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2012	2011	2012	2011
Non-GAAP net income				
GAAP net loss	$ (220,297)	$ (3,756)	$ (249,601)	$ (7,494)
Plus:				
Amortization of purchased intangibles	26,242	18,422	67,192	47,436
Stock-based expenses	105,112	57,006	271,795	159,158
Amortization of debt discount, net	6,358	2,721	17,448	8,191
One-time tax items	149,147	0	149,147	0
Quarterly change in valuation allowance	25,947	0	25,947	0
Less:				
Income tax effect of Non-GAAP items	(42,868)	(25,383)	(117,117)	(75,311)
Non-GAAP net income	$ 49,641	$ 49,010	$ 164,811	$ 131,980

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2012	2011	2012	2011
Non-GAAP diluted earnings per share (a)				
GAAP diluted loss per share	$ (1.55)	$ (0.03)	$ (1.78)	$ (0.06)
Plus:				
Amortization of purchased intangibles	0.17	0.13	0.46	0.33
Stock-based expenses	0.70	0.40	1.84	1.13
Amortization of debt discount, net	0.04	0.02	0.12	0.06
One-time tax items	0.99	0.00	1.01	0.00

Quarterly change in valuation allowance	0.17	0.00	0.18	0.00
Less:				
Income tax effect of Non-GAAP items	(0.19)	(0.18)	(0.71)	(0.53)
Non-GAAP diluted earnings per share	$ 0.33	$ 0.34	$ 1.12	$ 0.93
Shares used in computing diluted net income per share	150,026	142,171	147,604	142,342

(a) Reported GAAP loss per share was calculated using the basic share count. Non-GAAP diluted earnings per share was calculated using the diluted share count.

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The effects of dilutive securities were not included in the GAAP calculation of diluted earnings/loss per share for the three and nine months ended October 31, 2012 because we had a net loss for the period and the effect would have been anti-dilutive. The following table reflects the effect of the dilutive securities on the basic share count used in the GAAP earnings/loss per share calculation to derive the share count used for the non-GAAP diluted earnings per share:

	Three Months Ended October 31,		Nine Months Ended October 31,	
Supplemental Diluted Sharecount Information (in thousands):	**2012**	**2011**	**2012**	**2011**
Weighted-average shares outstanding for GAAP basic earnings per share	142,203	135,847	139,959	134,824
Effect of dilutive securities:				
Convertible senior notes	2,853	2,190	2,727	2,451
Warrants associated with the convertible senior note hedges	1,300	372	1,124	737
Employee stock awards	3,670	3,762	3,794	4,330
Adjusted weighted-average shares outstanding and assumed conversions for Non-GAAP diluted earnings per share	150,026	142,171	147,604	142,342

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Foreign currency exchange risk

Our results of operations and cash flows are subject to fluctuations due to changes in foreign currency exchange rates, particularly changes in the Euro, British Pound Sterling, Canadian Dollar and Japanese Yen. We seek to minimize the impact of certain foreign currency fluctuations by hedging certain balance sheet exposures with foreign currency forward contracts. Any gain or loss from settling these contracts is offset by the loss or gain derived from the underlying balance sheet exposures. In accordance with our policy, the hedging contracts we enter into have maturities of less than three months. Additionally, by policy, we do not enter into any hedging contracts for trading or speculative purposes.

Interest rate sensitivity

We had cash, cash equivalents and marketable securities totaling $1.4 billion at October 31, 2012. This amount was invested primarily in money market funds, time deposits, corporate notes and bonds, government securities and other debt securities with credit ratings of at least triple BBB or better. The cash, cash equivalents and short-term marketable securities are held for working capital purposes. Our investments are made for capital preservation purposes. We do not enter into investments for trading or speculative purposes.

Our cash equivalents and our portfolio of marketable securities are subject to market risk due to changes in interest rates. Fixed rate securities may have their market value adversely impacted due to a rise in interest rates, while floating rate securities may produce less income than expected if interest rates fall. Due in part to these factors, our future investment income may fall short of expectation due to changes in interest rates or we may suffer losses in principal if we are forced to sell securities that decline in market value due to changes in interest rates. However because we classify our debt securities as available for sale, no gains or losses are recognized due to changes in interest rates unless such securities are sold prior to maturity or declines in fair value are determined to be other-than-temporary. Our fixed-income portfolio is subject to interest rate risk.

An immediate increase or decrease in interest rates of 100-basis points at October 31, 2012 could result in a $14.4 million market value reduction or increase of the same amount. This estimate is based on a sensitivity model that measures market value changes when changes in interest rates occur. Fluctuations in the value of our investment securities caused by a change in interest rates (gains or losses on the carrying value) are recorded in other comprehensive income, and are realized only if we sell the underlying securities.

At January 31, 2012, we had cash, cash equivalents and marketable securities totaling $1.4 billion. The fixed-income portfolio was also subject to interest rate risk. Changes in interest rates of 100-basis points would have resulted in market value changes of $12.1 million.

Market Risk and Market Interest Risk

In January 2010, we issued at par value $575.0 million of 0.75% convertible senior notes due 2015 (the Notes). Holders may convert their Notes prior to maturity upon the occurrence of certain circumstances. Upon conversion, we would pay the holder an amount of cash equal to the principal amount of the Notes. Amounts in excess of the principal amount, if any, may be paid in cash or stock at our option. Concurrent with the issuance of the Notes, we entered into separate note hedging transactions and the sale of warrants. These separate transactions were completed to reduce the potential economic dilution from the conversion of the Notes.

For the three months ended October 31, 2012 the Notes were convertible at the option of the noteholder. For 20 trading days during the 30 consecutive trading days ended October 31, 2012, our common stock traded at a price exceeding 130% of the conversion price of $85.36 per share applicable to the Notes. Accordingly, the Notes will be convertible at the holders option for the quarter ending January 31, 2013 and will continue to be classified as a current liability on our condensed consolidated balance sheet.

The Notes have a fixed annual interest rate of 0.75% and therefore, we do not have economic interest rate exposure on the Notes. However, the value of the Notes are exposed to interest rate risk. Generally, the fair value of our fixed interest rate Notes will increase as interest rates fall and decrease as interest rates rise. In addition, the fair value of our Notes is affected by our stock price. The carrying value of our Notes was $514.9 million as of October 31, 2012. This represents the liability component of the $575.0 million principal balance as of October 31, 2012. The total estimated fair value of our Notes at October 31, 2012 was $1.0 billion and the fair value was determined based on the closing trading price per $100 of the Notes as of the last day of trading for the second quarter of fiscal 2013, which was $178.95.

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We have an investment portfolio that includes strategic investments in public and privately-held companies, many of which are in the development stage. When our ownership interests are less than 20 percent and we do not have the ability to exert significant influence, we account for investments in non-marketable equity and debt securities of the privately-held companies using the cost method of accounting. Otherwise, we account for the investments using the equity method of accounting. As of October 31, 2012 and January 31, 2012 the fair value of our investments in privately-held companies was $46.0 million and $48.3 million, respectively.

ITEM 4. CONTROLS AND PROCEDURES

(a) Evaluation of disclosure controls and procedures

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act), as of the end of the period covered by this report (the Evaluation Date).

In designing and evaluating our disclosure controls and procedures, management recognizes that any disclosure controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. In addition, the design of disclosure controls and procedures must reflect the fact that there are resource constraints and that management is required to apply its judgment in evaluating the benefits of possible controls and procedures relative to their costs.

Based on management s evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures are designed to, and are effective to, provide assurance at a reasonable level that the information we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms, and that such information is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosures.

(b) Management s Report on Internal Control Over Financial Reporting

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of any changes in our internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during our most recently completed fiscal quarter. Based on that evaluation, our principal executive officer and principal financial officer concluded that there has not been any material change in our internal control over financial reporting during the quarter covered by this report that materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

In the ordinary course of business, we are involved in various legal proceedings and claims related to alleged infringement of third-party patents and other intellectual property rights, commercial, employment, wage and hour, and other claims.

We have been, and may in the future be, put on notice and/or sued by third parties for alleged infringement of their proprietary rights, including patent infringement. We evaluate these claims and lawsuits with respect to their potential merits, our potential defenses and counter claims, and the expected effect on us. Our technologies may be subject to injunction if they are found to infringe the rights of a third party. In addition, many of our subscription agreements require us to indemnify our customers for third-party intellectual property infringement claims, which could increase the cost to us in the event of adverse rulings on such claims.

The outcome of any litigation, regardless of its merits, is inherently uncertain. Any intellectual property claims and other lawsuits, and the disposition of such claims and lawsuits, could be time-consuming and expensive to resolve, divert our attention from executing our business plan, lead to attempts by third parties to seek similar claims and, in the case of intellectual property claims, require us to change our technology, change our business practices and/or pay monetary damages or enter into short- or long-term royalty or licensing agreements.

In general, the resolution of a legal matter could prevent us from offering our service to others, could be material to our financial condition or cash flows, or both, or could otherwise adversely affect our operating results.

We make a provision for a liability relating to legal matters when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. These provisions are reviewed at least quarterly and adjusted to reflect the impacts of negotiations, estimated settlements, legal rulings, advice of legal counsel and other information and events pertaining to a particular matter. In our opinion, resolution of all current matters is not expected to have a material adverse impact on our consolidated results of operations, cash flows or financial position. However, depending on the nature and timing of any such dispute, an unfavorable resolution of a matter could materially affect our future results of operations or cash flows, or both, of a particular quarter.

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ITEM 1A. RISK FACTORS

The risks and uncertainties described below are not the only ones facing us. Other events that we do not currently anticipate or that we currently deem immaterial also may affect our results of operations, cash flows and financial condition.

Risks Related to Our Business and Industry

Defects or disruptions in our service could diminish demand for our service and subject us to substantial liability.

Because our service is complex and incorporates a variety of hardware and proprietary and third-party software, our service may have errors or defects that could result in unanticipated downtime for our subscribers and harm to our reputation and our business. Internet-based services frequently contain undetected errors when first introduced or when new versions or enhancements are released. We have from time to time found defects in our service and new errors in our service may be detected in the future. In addition, our customers may use our service in unanticipated ways that may cause a disruption in service for other customers attempting to access their data. As we acquire companies, we may encounter difficulty in incorporating the acquired technologies into our service and maintaining the quality standards that are consistent with our brand and reputation. Since our customers use our service for important aspects of their business, any errors, defects, disruptions in service or other performance problems could hurt our reputation and may damage our customers businesses. As a result, customers could elect to not renew, or delay or withhold payment to us, we could lose future sales or customers may make warranty or other claims against us, which could result in an increase in our provision for doubtful accounts, an increase in collection cycles for accounts receivable or the expense and risk of litigation.

Interruptions or delays in service from our third-party data center hosting facilities could impair the delivery of our service and harm our business.

We currently serve our customers from third-party data center hosting facilities located in the United States and other countries. Any damage to, or failure of, our systems generally could result in interruptions in our service. Interruptions in our service may reduce our revenue, cause us to issue credits or pay penalties, cause customers to terminate their subscriptions and adversely affect our renewal rates and our ability to attract new customers. Our business will also be harmed if our customers and potential customers believe our service is unreliable.

As part of our current disaster recovery arrangements, our production environment and all of our customers data is currently replicated in near real-time in a facility located in the United States. Companies and products added through acquisition may be temporarily served through alternate facilities. We do not control the operation of any of these facilities, and they are vulnerable to damage or interruption from earthquakes, floods, fires, power loss, telecommunications failures and similar events. They may also be subject to break-ins, sabotage, intentional acts of vandalism and similar misconduct. Despite precautions taken at these facilities, the occurrence of a natural disaster or an act of terrorism, a decision to close the facilities without adequate notice or other unanticipated problems at these facilities could result in lengthy interruptions in our service. Even with the disaster recovery arrangements, our service could be interrupted.

As we continue to add data centers and add capacity in our existing data centers, we may move or transfer our data and our customers data. Despite precautions taken during this process, any unsuccessful data transfers may impair the delivery of our service.

If our security measures are breached and unauthorized access is obtained to a customer s data or our data or our IT systems, our service may be perceived as not being secure, customers may curtail or stop using our service and we may incur significant legal and financial exposure and liabilities.

Our service involves the storage and transmission of customers proprietary information, and security breaches could expose us to a risk of loss of this information, litigation and possible liability. These security measures may be breached as a result of third-party action, including intentional misconduct by computer hackers, employee error, malfeasance or otherwise and result in someone obtaining unauthorized access to our customers data or our data, including our intellectual property and other confidential business information, or our IT systems. Additionally, third parties may attempt to fraudulently induce employees or customers into disclosing sensitive information such as user names, passwords or other information in order to gain access to our customers data or our data or IT systems. Because the techniques used to obtain unauthorized access, or to sabotage systems, change frequently and generally are not recognized until launched against a target, we may be unable to anticipate these techniques or to implement adequate preventative measures. In addition, our customers may authorize third-party technology providers on our AppExchange directory to access their customer data. Because we do not control the transmissions between our customers and third-party AppExchange technology providers, or the processing of such data by third-party AppExchange technology providers, we cannot ensure the integrity or security of such transmissions or processing. Any security breach could result in a loss of confidence in the security of our service, damage our reputation, negatively impact our future sales, disrupt our business and lead to legal liability.

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Because we recognize revenue from subscriptions for our service over the term of the subscription, downturns or upturns in new business may not be immediately reflected in our operating results.

We generally recognize revenue from customers ratably over the terms of their subscription agreements, which are typically 12 to 24 months. As a result, most of the revenue we report in each quarter is the result of subscription agreements entered into during previous quarters. Consequently, a decline in new or renewed subscriptions in any one quarter may not be reflected in our revenue results for that quarter. Any such decline, however, will negatively affect our revenue in future quarters. Accordingly, the effect of significant downturns in sales and market acceptance of our service, and potential changes in our rate of renewals may not be fully reflected in our results of operations until future periods. Our subscription model also makes it difficult for us to rapidly increase our revenue through additional sales in any period, as revenue from new customers must be recognized over the applicable subscription term.

Our efforts to expand our service beyond the CRM market and to develop our existing service in order to keep pace with technological developments may not succeed and may reduce our revenue growth rate and/or harm our business.

We derive substantially all of our revenue from subscriptions to our CRM enterprise cloud computing application service, and we expect this will continue for the foreseeable future. The market for our Force.com cloud computing platform remains relatively new and it is uncertain whether our efforts will ever result in significant revenue for us. Further, the introduction of new services beyond the CRM market may not be successful, and early stage interest and adoption of such new services may not result in long term success or significant revenue for us. Our efforts to expand our service beyond the CRM market may not succeed and may reduce our revenue growth rate.

Additionally, if we are unable to develop enhancements to and new features for our existing service or new services that keep pace with rapid technological developments, our business will be harmed. The success of enhancements, new features and services depends on several factors, including the timely completion, introduction and market acceptance of the feature or edition. Failure in this regard may significantly impair our revenue growth. In addition, because our service is designed to operate on a variety of network hardware and software platforms using a standard browser, we will need to continuously modify and enhance our service to keep pace with changes in Internet-related hardware, software, communication, browser and database technologies. We may not be successful in either developing these modifications and enhancements or in bringing them to market timely. Furthermore, uncertainties about the timing and nature of new network platforms or technologies, or modifications to existing platforms or technologies, could increase our research and development or service delivery expenses. Any failure of our service to operate effectively with future network platforms and technologies could reduce the demand for our service, result in customer dissatisfaction and harm our business.

If we experience significant fluctuations in our rate of anticipated growth and fail to balance our expenses with our revenue forecasts, our results could be harmed.

Due to our evolving business model and the unpredictability of future general economic and financial market conditions, we may not be able to accurately forecast our rate of growth. We plan our expense levels and investment on estimates of future revenue and future anticipated rate of growth. We may not be able to adjust our spending quickly enough if the addition of new subscriptions or the renewal rate for existing subscriptions falls short of our expectations. A portion of our expenses may also be a fixed cost in nature for some minimum amount of time, such as with a datacenter contract or office lease, so it may not be possible to reduce costs in a timely manner or without the payment of fees to exit certain obligations early.

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As a result, we expect that our revenues, operating results and cash flows may fluctuate significantly on a quarterly basis. Our recent revenue growth rates may not be sustainable and may decline in the future. We believe that period-to-period comparisons of our revenues, operating results and cash flows may not be meaningful and should not be relied upon as an indication of future performance.

We cannot accurately predict subscription renewal or upgrade rates and the impact these rates may have on our future revenue and operating results.

Our customers have no obligation to renew their subscriptions for our service after the expiration of their initial subscription period, which is typically 12 to 24 months, and in fact, some customers have elected not to renew. In addition, our customers may renew for fewer subscriptions, renew for shorter contract lengths, or renew for lower cost editions of our service. We cannot accurately predict renewal rates given our varied customer base of enterprise and small and medium size business customers and the number of multiyear subscription contracts. Our renewal rates may decline or fluctuate as a result of a number of factors, including customer dissatisfaction with our service, customers spending levels, decreases in the number of users at our customers, pricing changes and deteriorating general economic conditions. If our customers do not renew their subscriptions for our service or reduce the number of paying subscriptions at the time of renewal, our revenue will decline and our business will suffer.

Our future success also depends in part on our ability to sell additional features and services, more subscriptions or enhanced editions of our service to our current customers. This may also require increasingly sophisticated and costly sales efforts that are targeted at senior management. Similarly, the rate at which our customers purchase new or enhanced services depends on a number of factors, including general economic conditions and that our customers do not react negatively to any price changes related to these additional features and services. If our efforts to upsell to our customers are not successful and negative reaction occurs, our business may suffer.

We rely on third-party computer hardware and software that may be difficult to replace or which could cause errors or failures of our service.

We rely on computer hardware purchased or leased and software licensed from third parties in order to offer our service, including database software from Oracle Corporation. This hardware and software may not continue to be available at reasonable prices or on commercially reasonable terms, or at all. Any loss of the right to use any of this hardware or software could significantly increase our expenses and otherwise result in delays in the provisioning of our service until equivalent technology is either developed by us, or, if available, is identified, obtained through purchase or license and integrated. Any errors or defects in third-party hardware or software could result in errors or a failure of our service which could harm our business.

Weakened global economic conditions may adversely affect our industry, business and results of operations.

Our overall performance depends in part on worldwide economic conditions. The United States and other key international economies have experienced in the past a downturn in which economic activity was impacted by falling demand for a variety of goods and services, restricted credit, poor liquidity, reduced corporate profitability, volatility in credit, equity and foreign exchange markets, bankruptcies and overall uncertainty with respect to the economy. The European Union continues to face great economic uncertainty which could impact the overall world economy or various other regional economies. These conditions affect the rate of information technology spending and could adversely affect our customers ability or willingness to purchase our enterprise cloud computing services, delay prospective customers purchasing decisions, reduce the value or duration of their subscription contracts, or affect renewal rates, all of which could adversely affect our operating results.

Our quarterly results can fluctuate and our stock price and the value of your investment could decline substantially.

Our quarterly operating results are likely to fluctuate. For example, our fiscal fourth quarter has historically been our strongest quarter for new business and renewals. The year-over-year compounding effect of this seasonality in billing patterns and overall new business and renewal activity causes the value of invoices that we generate in the fourth quarter to continually increase in proportion to our billings in the other three quarters of our fiscal year.

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Additionally, some of the important factors that may cause our revenues, operating results and cash flows to fluctuate from quarter to quarter include:

- our ability to retain and increase sales to existing customers, attract new customers and satisfy our customers requirements;
- the renewal rates for our service;
- the amount and timing of operating costs and capital expenditures related to the operations and expansion of our business;
- changes in deferred revenue balances and unbilled revenue balances, which are not reflected in the balance sheet, due to seasonality, the compounding effects of renewals, invoice duration, invoice timing and new business linearity;
- the number of new employees;
- changes in our pricing policies and terms of contracts, whether initiated by us or as a result of competition;
- the cost, timing and management effort for the introduction of new features to our service;
- the rate of expansion and productivity of our sales force;
- the length of the sales cycle for our service;
- new product and service introductions by our competitors;
- our success in selling our service to large enterprises;
- variations in the revenue mix of editions of our service;
- technical difficulties or interruptions in our service;
- expenses related to our real estate, our office leases and our data center capacity and expansion;
- changes in foreign currency exchange rates;

changes in interest rates and our mix of investments, which would impact our return on our investments in cash and marketable securities;

conditions, particularly sudden changes, in the financial markets have and may continue to impact the value of and access to our investment portfolio;

changes in the effective tax rates due to changes in the mix of earnings and losses in countries with differing statutory tax rates, certain non-deductible expenses as a result of acquisitions, compensation, the valuation of deferred tax assets and liabilities and our ability to utilize them and changes in federal, state or international tax laws and accounting principles;

expenses related to significant, unusual or discrete events which are recorded in the period in which the events occur;

general economic conditions that may adversely affect either our customers ability or willingness to purchase additional subscriptions or upgrade their service, or delay a prospective customers purchasing decision, or reduce the value of new subscription contracts, or affect renewal rates;

timing of additional investments in our enterprise cloud computing application and platform services and in our consulting service;

regulatory compliance costs;

the timing of customer payments and payment defaults by customers;

costs associated with acquisitions and subsequent integration of companies and technologies;

extraordinary expenses such as litigation or other dispute-related settlement payments;

any adverse resolution to income tax audits in any tax jurisdictions throughout the world;

the impact of new accounting pronouncements;

equity issuances, including as consideration in acquisitions or due to the conversion of our outstanding convertible notes at the election of the note holders; and

the timing of stock awards to employees and the related adverse financial statement impact of having to expense those stock awards ratably over their vesting schedules.

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Many of these factors are outside of our control, and the occurrence of one or more of them might cause our operating results to vary widely. As such, we believe that quarter-to-quarter comparisons of our revenues, operating results and cash flows may not be meaningful and should not be relied upon as an indication of future performance.

Additionally, we may fail to meet or exceed the expectations of securities analysts and investors, and the market price of our common stock could decline. If one or more of the securities analysts who cover us adversely change their recommendation regarding our stock, the market price of our common stock could decline. Moreover, our stock price may be based on expectations, estimates or forecasts of our future performance that may be unrealistic or that may not be met. Further, our stock price may fluctuate based on reporting by the financial media, including television, radio and press reports and blogs.

We have recently incurred net losses and expect to incur net losses in the future.

We have incurred net losses in each fiscal quarter since July 31, 2011. In addition, we expect our costs to increase as a result of decisions made for our long-term benefit, such as equity awards and business combinations. If our revenue does not grow to offset these expected increased costs, we will not be able to return to profitability and we may continue to incur net losses, on a U.S. GAAP basis, in the future.

The market in which we participate is intensely competitive, and if we do not compete effectively, our operating results could be harmed.

The market for enterprise cloud computing applications and platform services is highly competitive, rapidly evolving and fragmented, and subject to changing technology, shifting customer needs and frequent introductions of new products and services. We compete primarily with vendors of packaged CRM software and companies offering on-demand CRM applications. We also compete with internally developed applications and face, or expect to face, competition from enterprise software vendors and online service providers who may develop toolsets and products that allow customers to build new applications that run on the customers current infrastructure or as hosted services. Our current competitors include:

- enterprise software application vendors;
- on-demand CRM application service providers;
- traditional platform development environment companies; and
- cloud computing development platform companies.

Many of our current and potential competitors enjoy substantial competitive advantages, such as greater name recognition, longer operating histories and larger marketing budgets, as well as substantially greater financial, technical and other resources. In addition, many of our current and potential competitors have established marketing relationships and access to larger customer bases, and have major distribution agreements with consultants, system integrators and resellers.

As a result, our competitors may be able to respond more quickly and effectively than we can to new or changing opportunities, technologies, standards or customer requirements. Furthermore, because of these advantages, even if our service is more effective than the products that our competitors offer, potential customers might accept competitive products and services in lieu of purchasing our service. For all of these reasons, we may not be able to compete successfully against our current and future competitors.

As we acquire companies or technologies, they could prove difficult to integrate, disrupt our business, dilute stockholder value and adversely affect our operating results and the value of your investment.

As part of our business strategy, we periodically make investments in, or acquisitions of, complementary businesses, joint ventures, services and technologies and intellectual property rights, and we expect that we will continue to make such investments and acquisitions in the future. Acquisitions and investments involve numerous risks, including:

the potential failure to achieve the expected benefits of the combination or acquisition;

difficulties in and the cost of integrating operations, technologies, services and personnel;

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- diversion of financial and managerial resources from existing operations;
- risk of entering new markets in which we have little or no experience or where competitors may have stronger market positions;
- potential write-offs of acquired assets or investments, and potential financial and credit risks associated with acquired customers;
- potential loss of key employees;
- inability to generate sufficient revenue to offset acquisition or investment costs;
- the inability to maintain relationships with customers and partners of the acquired business;
- the difficulty of incorporating acquired technology and rights into our products and services and of maintaining the security standards consistent with our other services;
- potential unknown liabilities associated with the acquired businesses;
- unanticipated expenses related to acquired technology and its integration into existing technology;
- negative impact to our results of operations because of the depreciation and amortization of amounts related to acquired intangible assets, fixed assets and deferred compensation, and the loss of acquired deferred revenue;
- delays in customer purchases due to uncertainty related to any acquisition;
- the need to implement controls, procedures and policies appropriate for a public company at private companies that we acquire;
- challenges caused by distance, language and cultural differences; and
- the tax effects of any such acquisitions.

In addition, if we finance acquisitions by issuing equity or convertible or other debt securities, our existing stockholders may be diluted or we could face constraints related to the terms of and repayment obligation related to the incurrence of indebtedness which could affect the market price of our common stock. Further, if we fail to properly evaluate and execute acquisitions or investments, our business and prospects may be seriously harmed and the value of your investment may decline.

If the market for our technology delivery model and enterprise cloud computing services develops more slowly than we expect, our business could be harmed.

Our success also depends on the willingness of third-party developers to build applications that are complementary to our service. Without the development of these applications, both current and potential customers may not find our service sufficiently attractive. In addition, for those

customers who authorize a third-party technology partner access to their data, we do not provide any warranty related to the functionality, security and integrity of the data transmission or processing. Despite contract provisions to protect us, customers may look to us to support and provide warranties for the third-party applications, which may expose us to potential claims, liabilities and obligations for applications we did not develop or sell.

Supporting our existing and growing customer base could strain our personnel resources and infrastructure, and if we are unable to scale our operations and increase productivity, we may not be able to successfully implement our business plan.

We continue to experience significant growth in our customer base, which has placed a strain on our management, administrative, operational and financial infrastructure. We anticipate that additional investments in our infrastructure, research and development, and real estate spending will be required to scale our operations and increase productivity, to address the needs of our customers, to further develop and enhance our service, to expand into new geographic areas, and to scale with the overall growth of our Company.

We are in the process of upgrading and/or replacing various software systems. If the implementations of these new applications are delayed, or if we encounter unforeseen problems with our new systems or in migrating away from our existing applications and systems, our operations and our ability to manage our business could be negatively impacted.

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Our success will depend in part upon the ability of our senior management to manage our projected growth effectively. To do so, we must continue to increase the productivity of our existing employees and to hire, train and manage new employees as needed. To manage the expected domestic and international growth of our operations and personnel, we will need to continue to improve our operational, financial and management controls, our reporting systems and procedures, and our utilization of real estate. The additional investments we are making will increase our cost base, which will make it more difficult for us to offset any future revenue shortfalls by reducing expenses in the short term. If we fail to successfully scale our operations and increase productivity, we will be unable to execute our business plan.

As more of our sales efforts are targeted at larger enterprise customers, our sales cycle may become more time-consuming and expensive, we may encounter pricing pressure and implementation and customization challenges, and we may have to delay revenue recognition for some complex transactions, all of which could harm our business and operating results.

As we target more of our sales efforts at larger enterprise customers, we will face greater costs, longer sales cycles and less predictability in completing some of our sales. In this market segment, the customer s decision to use our service may be an enterprise-wide decision and, if so, these types of sales would require us to provide greater levels of education regarding the use and benefits of our service, as well as education regarding privacy and data protection laws and regulations to prospective customers with international operations. In addition, larger customers may demand more customization, integration services and features. As a result of these factors, these sales opportunities may require us to devote greater sales support and professional services resources to individual customers, driving up costs and time required to complete sales and diverting our own sales and professional services resources to a smaller number of larger transactions, while potentially requiring us to delay revenue recognition on some of these transactions until the technical or implementation requirements have been met.

Professional services may also be performed by a third party or a combination of our own staff and a third party. Our strategy is to work with third parties to increase the breadth of capability and depth of capacity for delivery of these services to our customers. If a customer is not satisfied with the quality of work performed by us or a third party or with the type of services or solutions delivered, then we could incur additional costs to address the situation, the profitability of that work might be impaired, and the customer s dissatisfaction with our services could damage our ability to obtain additional work from that customer. In addition, negative publicity related to our customer relationships, regardless of its accuracy, may further damage our business by affecting our ability to compete for new business with current and prospective customers.

Periodic changes to our sales organization can be disruptive and may reduce our rate of growth.

We periodically change and make adjustments to our sales organization in response to market opportunities, competitive threats, management changes, product introductions or enhancements, acquisitions, sales performance, increases in sales headcount, cost levels and other internal and external considerations. In the past, these changes sometimes resulted in a temporary lack of focus and reduced productivity; these effects could recur in connection with any future sales changes we might undertake and our rate of revenue growth could be negatively affected. In addition, any significant change to the way we structure our compensation of our sales organization may be disruptive and may affect our revenue growth.

Sales to customers outside the United States expose us to risks inherent in international sales.

We sell our service throughout the world and are subject to risks and challenges associated with international business. For example, sales in Europe and Asia Pacific together represented approximately 32 percent of our total revenues for the year ended January 31, 2012, and we intend to continue to expand our international sales efforts. The risks and challenges associated with sales to customers outside the United States include:

- localization of our service, including translation into foreign languages and associated expenses;
- laws and business practices favoring local competitors;
- compliance with multiple, conflicting and changing governmental laws and regulations, including employment, tax, privacy and data protection laws and regulations;

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- pressure on the creditworthiness of sovereign nations, particularly in Europe, where we have customers and a small balance of our cash, cash equivalents, and marketable securities. Liquidity issues or political actions by sovereign nations could result in decreased values for our cash, cash equivalents and marketable securities balances;
- regional data privacy laws that apply to the transmission of our customers data across international borders;
- treatment of revenue from international sources and changes to tax codes, including being subject to foreign tax laws and being liable for paying withholding income or other taxes in foreign jurisdictions;
- foreign currency fluctuations and controls;
- different pricing environments;
- difficulties in staffing and managing foreign operations;
- different or lesser protection of our intellectual property;
- longer accounts receivable payment cycles and other collection difficulties;
- natural disasters, acts of war, terrorism, pandemics or security breaches; and
- regional economic and political conditions.

Any of these factors could negatively impact our business and results of operations.

Additionally, our international subscription fees are paid either in U.S. dollars or local currency. As a result, fluctuations in the value of the U.S. dollar and foreign currencies may make our service more expensive for international customers, which could harm our business.

We have been and may in the future be sued by third parties for various claims including alleged infringement of proprietary rights.

We are involved in various legal matters arising from the normal course of business activities. These may include claims, suits, government investigations and other proceedings involving alleged infringement of third-party patents and other intellectual property rights, and commercial, labor and employment, wage and hour, and other matters.

The software and Internet industries are characterized by the existence of a large number of patents, trademarks and copyrights and by frequent litigation based on allegations of infringement or other violations of intellectual property rights. We have received in the past and may receive in the future communications from third parties claiming that we have infringed the intellectual property rights of others. In addition we have been, and may in the future be, sued by third parties for alleged infringement of their claimed proprietary rights. Our technologies may be subject to injunction if they are found to infringe the rights of a third party or we may be required to pay damages, or both. Many of our subscription agreements require us to indemnify our customers for third-party intellectual property infringement claims, which would increase the cost to us of an adverse ruling on such a claim.

The outcome of any litigation, regardless of its merits, is inherently uncertain. Any claims and lawsuits, and the disposition of such claims and lawsuits, could be time-consuming and expensive to resolve, divert management attention from executing our business plan, lead to attempts on the part of other parties to pursue similar claims and, in the case of intellectual property claims, require us to change our technology, change our

business practices and/or pay monetary damages or enter into short- or long-term royalty or licensing agreements.

Any adverse determination related to intellectual property claims or other litigation could prevent us from offering our service to others, could be material to our financial condition or cash flows, or both, or could otherwise adversely affect our operating results. In addition, depending on the nature and timing of any such dispute, a resolution of a legal matter could materially affect our future results of operation or cash flows or both.

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In addition, our exposure to risks associated with various claims, including the use of intellectual property, may be increased as a result of acquisitions of other companies. For example, we may have a lower level of visibility into the development process with respect to intellectual property or the care taken to safeguard against infringement risks with respect to the acquired company or technology. In addition, third parties may make infringement and similar or related claims after we have acquired technology that had not been asserted prior to our acquisition.

Any failure to protect our intellectual property rights could impair our ability to protect our proprietary technology and our brand.

If we fail to protect our intellectual property rights adequately, our competitors may gain access to our technology, and our business may be harmed. In addition, defending our intellectual property rights may entail significant expense. Any of our patents, trademarks or other intellectual property rights may be challenged by others or invalidated through administrative process or litigation. While we have some U.S. patents and many U.S. and international patent applications pending, we may be unable to obtain patent protection for the technology covered in our patent applications. In addition, our existing patents and any patents issued in the future may not provide us with competitive advantages, or may be successfully challenged by third parties. Furthermore, legal standards relating to the validity, enforceability and scope of protection of intellectual property rights are uncertain. Effective patent, trademark, copyright and trade secret protection may not be available to us in every country in which our service is available. The laws of some foreign countries may not be as protective of intellectual property rights as those in the U.S., and mechanisms for enforcement of intellectual property rights may be inadequate. Accordingly, despite our efforts, we may be unable to prevent third parties from infringing upon or misappropriating our intellectual property.

We may be required to spend significant resources to monitor and protect our intellectual property rights. We may initiate claims or litigation against third parties for infringement of our proprietary rights or to establish the validity of our proprietary rights. Any litigation, whether or not it is resolved in our favor, could result in significant expense to us and divert the efforts of our technical and management personnel.

Privacy concerns and laws, evolving regulation of the Internet, cross-border data transfers and other domestic or foreign regulations may limit the use and adoption of our solution and adversely affect our business.

As Internet commerce continues to evolve, increasing regulation by federal, state or foreign governments and agencies becomes more likely. For example, we believe increased regulation is occurring in the area of data privacy, and laws and regulations applying to the solicitation, collection, processing or use of personal or consumer information could affect our customers ability to use and share data, potentially reducing demand for our solutions and restricting our ability to store, process and share data with our customers.

Our customers can use our service to store contact and other personal or identifying information regarding their customers and contacts. Federal, state and foreign governments and agencies have adopted or are considering adopting laws and regulations regarding the collection, use and disclosure of personal information obtained from consumers and individuals in addition to laws and regulations that impact the cross-border transfer of personal information. The costs of compliance with, and other burdens imposed by, such laws and regulations that are applicable to the businesses of our customers may limit the use and adoption of our service and reduce overall demand for it, or lead to significant fines, penalties or liabilities for any noncompliance with such privacy laws. Furthermore, privacy concerns may cause our customers customers to resist providing the personal data necessary to allow our customers to use our service effectively. Even the perception of privacy concerns, whether or not valid, may inhibit market adoption of our service in certain industries.

In addition to government activity, privacy advocacy groups and the technology and other industries are considering various new, additional or different self-regulatory standards that may place additional burdens on us. If the gathering of personal information were to be curtailed in this manner, CRM solutions would be less effective, which may reduce demand for our service and harm our business.

If we fail to develop and maintain our brands, our business may suffer.

We believe that developing and maintaining awareness of the salesforce.com brand and our other brands is critical to achieving widespread acceptance of our existing and future services and is an important element in attracting new customers. We have incurred and expect to continue to incur significant expense to build our brands. Brand promotion activities may not yield increased revenue, and even if they do, any increased revenue may not offset the expenses we incurred in building our brands. If we fail to successfully promote and maintain our brands, or incur substantial expenses in an unsuccessful attempt to promote and maintain our brands, we may fail to attract enough new customers or retain our existing customers to the extent necessary to realize a sufficient return on our brand-building efforts, and our business could suffer.

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We may lose key members of our management team or development and operations personnel, and may be unable to attract and retain employees we need to support our operations and growth.

Our success depends substantially upon the continued services of our executive officers and other key members of management, particularly our Chief Executive Officer. From time to time, there may be changes in our executive management team resulting from the hiring or departure of executives. Such changes in our executive management team may be disruptive to our business. We are also substantially dependent on the continued service of our existing development and operations personnel because of the complexity of our service and technologies. We do not have employment agreements with any of our executive officers, key management, development or operations personnel and they could terminate their employment with us at any time. The loss of one or more of our key employees or groups could seriously harm our business.

In the technology industry, there is substantial and continuous competition for engineers with high levels of experience in designing, developing and managing software and Internet-related services, as well as competition for sales executives and operations personnel. We may not be successful in attracting and retaining qualified personnel. We have from time to time experienced, and we expect to continue to experience, difficulty in hiring and retaining highly skilled employees with appropriate qualifications. If we fail to attract new personnel or fail to retain and motivate our current personnel, our business and future growth prospects could be severely harmed.

We may not realize any benefits in connection with our purchase of undeveloped land in San Francisco. If we do not realize any benefits, our financial performance may be negatively impacted.

In November 2010, we purchased approximately 14 acres of undeveloped real estate in San Francisco, California, including entitlements and improvements associated with the land. We may not realize any benefits with respect to the purchase of such real estate. During the first quarter of fiscal 2013, we suspended pre-construction activity on the land. If we commence efforts to develop the real estate, we will be required to devote substantial additional resources in the future, which may impact our liquidity and financial flexibility. In the event that we decide to sell this property, the sale price may be less than the recorded value of the land on our condensed consolidated balance sheet, and our financial results may be negatively impacted.

Natural disasters and other events beyond our control could materially adversely affect us.

Natural disasters or other catastrophic events may cause damage or disruption to our operations, international commerce and the global economy, and thus could have a strong negative effect on us. Our business operations are subject to interruption by natural disasters, fire, power shortages, pandemics and other events beyond our control. Although we maintain crisis management and disaster response plans, such events could make it difficult or impossible for us to deliver our services to our customers, and could decrease demand for our services. The majority of our research and development activities, corporate headquarters, information technology systems, and other critical business operations, are located near major seismic faults in the San Francisco Bay Area. Because we do not carry earthquake insurance for direct quake-related losses, and significant recovery time could be required to resume operations, our financial condition and operating results could be materially adversely affected in the event of a major earthquake or catastrophic event.

Risks Relating to Capitalization Matters

The market price of our common stock is likely to be volatile and could subject us to litigation.

The trading prices of the securities of technology companies have been highly volatile. Accordingly, the market price of our common stock has been and is likely to continue to be subject to wide fluctuations. Factors affecting the market price of our common stock include:

- variations in our operating results, earnings per share, cash flows from operating activities, deferred revenue and other financial metrics and non-financial metrics, and how those results compare to analyst expectations;
- forward looking guidance to industry and financial analysts related to future revenue and earnings per share;

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- the net increases in the number of customers, either independently or as compared with published expectations of industry, financial or other analysts that cover our company;
- changes in the estimates of our operating results or changes in recommendations by securities analysts that elect to follow our common stock;
- announcements of technological innovations, new services or service enhancements, strategic alliances or significant agreements by us or by our competitors;
- announcements by us or by our competitors of mergers or other strategic acquisitions, or rumors of such transactions involving us or our competitors;
- announcements of customer additions and customer cancellations or delays in customer purchases;
- recruitment or departure of key personnel;
- disruptions in our service due to computer hardware, software, network or data center problems;
- the economy as a whole, market conditions in our industry and the industries of our customers;
- trading activity by a limited number of stockholders who together beneficially own a majority of our outstanding common stock;
- the issuance of shares of common stock by us, whether in connection with an acquisition, a capital raising transaction or upon conversion of some or all of our outstanding convertible senior notes; and
- any other factors discussed herein.

In addition, if the market for technology stocks or the stock market in general experiences uneven investor confidence, the market price of our common stock could decline for reasons unrelated to our business, operating results or financial condition. The market price of our common stock might also decline in reaction to events that affect other companies within, or outside, our industry even if these events do not directly affect us. Some companies that have experienced volatility in the trading price of their stock have been the subject of securities class action litigation. If we are the subject of such litigation, it could result in substantial costs and a diversion of management s attention and resources.

Provisions in our amended and restated certificate of incorporation and bylaws, Delaware law and our outstanding convertible notes might discourage, delay or prevent a change of control of our company or changes in our management and, therefore, depress the market price of our common stock.

Our amended and restated certificate of incorporation and bylaws contain provisions that could depress the market price of our common stock by acting to discourage, delay or prevent a change in control of our company or changes in our management that the stockholders of our company may deem advantageous. These provisions among other things:

- establish a classified board of directors so that not all members of our board are elected at one time;

permit the board of directors to establish the number of directors;

provide that directors may only be removed for cause and only with the approval of 66 2/3 percent of our stockholders;

require super-majority voting to amend some provisions in our amended and restated certificate of incorporation and bylaws;

authorize the issuance of blank check preferred stock that our board could use to implement a stockholder rights plan (also known as a poison pill);

eliminate the ability of our stockholders to call special meetings of stockholders;

prohibit stockholder action by written consent, which requires all stockholder actions to be taken at a meeting of our stockholders;

provide that the board of directors is expressly authorized to make, alter or repeal our bylaws; and

establish advance notice requirements for nominations for election to our board or for proposing matters that can be acted upon by stockholders at annual stockholder meetings.

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In addition, Section 203 of the Delaware General Corporation Law may discourage, delay or prevent a change in control of our company. Section 203 imposes certain restrictions on merger, business combinations and other transactions between us and holders of 15 percent or more of our common stock.

In addition, the fundamental change purchase rights applicable to our convertible notes, which will allow note holders to require us to purchase all or a portion of their notes upon the occurrence of a fundamental change, and the provisions requiring an increase to the conversion rate for conversions in connection with a make-whole fundamental change may in certain circumstances delay or prevent a takeover of us and the removal of incumbent management that might otherwise be beneficial to investors.

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

On September 4, 2012, the Company issued 146,324 shares of Company common stock to former stockholders of GoInstant, in a private transaction exempt from the registration requirements of the Securities Act pursuant to Section 4(2) and/or Regulation S under the Securities Act. See Note 4, Business Combinations, of Notes to Condensed Consolidated Financial Statements for further details on the transaction. During the nine months ended October 31, 2012, the Company issued a total of 1,918,059 shares of Company common stock in connection with the acquisition of four companies (including the GoInstant acquisition), all in private transactions exempt from the registration requirements of the Securities Act.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

Exhibits

The Exhibits listed below are filed as part of this Form 10-Q

Index to Exhibits

Exhibit			Incorporated by Reference			
No.	**Exhibit Description**	**Provided Herewith**	**Form**	**SEC File No.**	**Exhibit**	**Filing Date**
3.1	Restated Certificate of Incorporation of salesforce.com, inc.		S-1/A	333-111289	3.2	04/20/2004
3.2	Amended and Restated Bylaws of salesforce.com, inc.		8-K	001-32224	3.1	01/14/2011
10.1	Goinstant, Inc. Stock Option Plan		S-8	333-183885	4.2	09/13/2012
31.1	Certification of Chief Executive Officer pursuant to Exchange Act Rule 13a-14(a) or 15(d)-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	X				
31.2	Certification of Chief Financial Officer pursuant to Exchange Act Rule 13a-14(a) or 15(d)-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	X				
32.1	Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	X				

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Exhibit			Incorporated by Reference			
No.	Exhibit Description	Provided Herewith	Form	SEC File No.	Exhibit	Filing Date
101.INS	XBRL Instance Document					
101.SCH	XBRL Taxonomy Extension Schema Document					
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document					
101.DEF	XBRL Extension Definition					
101.LAB	XBRL Taxonomy Extension Label Linkbase Document					
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document					

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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.

Dated: November 28, 2012

salesforce.com, inc.

/s/ Graham Smith
Graham Smith

Chief Financial Officer

(Principal Financial Officer and Duly Authorized Officer)