NETEZZA CORP
Form 10-Q
September 09, 2010

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549
FORM 10-Q

(Mark One)

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

For the quarterly period ended July 31, 2010

OR

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

For the transition period from to

Commission file number 001-33445

NETEZZA CORPORATION

(Exact Name of Registrant as Specified in Its Charter)

Delaware	**04-3527320**
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

26 Forest Street Marlborough, MA	**01752**
(Address of Principal Executive Offices)	(Zip Code)

(508) 382-8200

(Registrant s Telephone Number, Including Area Code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. þ Yes o 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). o Yes o 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 o	Accelerated filer þ	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

As of August 31, 2010, there were 62,761,108 shares of the registrant s common stock outstanding.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NETEZZA CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)
(In thousands, except share and per share data)

	July 31, 2010	January 31, 2010
ASSETS		
Current assets		
Cash and cash equivalents	$ 66,567	$ 40,638
Short-term marketable securities	69,777	64,020
Accounts receivable	32,376	53,450
Inventory	32,160	28,708
Deferred tax assets, net	17,168	14,490
Restricted cash	60	60
Prepaid expenses and other current assets	9,456	4,675
Total current assets	227,564	206,041
Property and equipment, net	11,012	8,469
Deferred tax assets, net	10,290	12,048
Goodwill	2,000	2,000
Intangible assets, net	3,561	4,056
Long-term marketable securities	42,224	49,769
Restricted cash	439	639
Other long-term assets	906	575
Total assets	$ 297,996	$ 283,597
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities		
Accounts payable	$ 6,537	$ 12,604
Accrued expenses	9,767	5,906
Accrued compensation and benefits	7,906	6,776
Current portion of deferred revenue	44,799	49,665
Total current liabilities	69,009	74,951
Long-term deferred revenue	11,665	8,727
Other long-term liabilities	2,332	2,326
Total long-term liabilities	13,997	11,053
Total liabilities	83,006	86,004
Commitments and contingencies (Note 9)		

Stockholders equity:		
Preferred stock, $0.001 par value; 5,000,000 shares authorized at July 31, 2010 and January 31, 2010; none outstanding		
Common stock, $0.001 par value; 500,000,000 shares authorized at July 31, 2010 and January 31, 2010, 62,344,123 and 61,021,370 shares issued at July 31, 2010 and January 31, 2010, respectively	62	61
Treasury stock, at cost; 226,415 and 139,062 shares at July 31, 2010 and January 31, 2010, respectively	(1,202)	(14)
Additional paid-in-capital	255,094	242,901
Accumulated other comprehensive loss	(1,388)	(1,924)
Accumulated deficit	(37,576)	(43,431)
Total stockholders equity	214,990	197,593
Total liabilities and stockholders equity	$ 297,996	$ 283,597

See accompanying Notes to Condensed Consolidated Financial Statements

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NETEZZA CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)
(In thousands, except per share amounts)

	Three Months Ended July 31,		Six Months Ended July 31,	
	2010	**2009**	**2010**	**2009**
Revenue				
Product	$ 47,276	$ 29,969	$ 90,113	$ 62,671
Services	16,531	13,965	31,868	26,630
Total revenue	63,807	43,934	121,981	89,301
Cost of revenue				
Product	17,259	11,123	32,704	23,467
Services	5,316	3,420	9,646	6,895
Total cost of revenue	22,575	14,543	42,350	30,362
Gross margin	41,232	29,391	79,631	58,939
Operating expenses				
Sales and marketing	20,922	15,729	40,072	30,405
Research and development	10,951	9,297	21,780	20,917
General and administrative	4,408	3,974	8,958	7,950
Total operating expenses	36,281	29,000	70,810	59,272
Operating income (loss)	4,951	391	8,821	(333)
Interest income	243	197	529	507
Interest expense		25		50
Other income (expense), net	(87)	247	(133)	378
Income before income tax expense	$ 5,107	$ 810	$ 9,217	$ 502
Income tax expense	1,923	80	3,361	9
Net income	$ 3,184	$ 730	$ 5,856	$ 493
Net income per share				
Basic	$ 0.05	$ 0.01	$ 0.10	$ 0.01
Diluted	$ 0.05	$ 0.01	$ 0.09	$ 0.01
Weighted average common shares outstanding				
Basic	61,941	60,232	61,569	60,104
Diluted	65,938	62,847	65,283	62,675

See accompanying Notes to Condensed Consolidated Financial Statements

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NETEZZA CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(In thousands)

	Six Months Ended July 31, 2010	2009
Cash flows from operating activities		
Net income	$ 5,856	$ 493
Adjustments to reconcile net income to net cash provided by (used in) operating activites		
Depreciation and amortization	3,094	3,635
Stock-based compensation expense	6,429	4,705
Benefit from deferred income taxes, net	(1,042)	(138)
Gain on bargain purchase from acquisition of business		(365)
Gain on trading securities	(165)	(288)
Loss on auction rate securities written put right	151	140
Amortization and accretion of discount and premium on marketable securities	119	
Changes in assets and liabilities, net of acquisitions		
Accounts receivable	21,117	3,057
Inventory	(4,644)	242
Other assets	(5,249)	1,642
Accounts payable	(6,221)	(2,673)
Accrued compensation and benefits	893	(833)
Accrued expenses	4,286	(1,277)
Deferred revenue	(1,928)	(9,283)
Net cash provided by (used in) operating activities	22,696	(943)
Cash flows from investing activities		
Purchase of investments	(73,217)	
Sales, redemptions and maturities of investments	75,735	1,725
Acquisition of business, net of cash acquired		(2,007)
Purchases of property and equipment	(3,941)	(1,821)
Change in other long-term assets		(425)
Decrease in restricted cash	200	354
Net cash used in investing activities	(1,223)	(2,174)
Cash flows from financing activities		
Proceeds from issuance of common stock, net	4,577	784
Net cash provided by financing activities	4,577	784
Net increase (decrease) in cash and cash equivalents	26,050	(2,333)
Effect of exchange rate changes on cash and cash equivalents	(121)	395
Cash and cash equivalents, beginning of period	40,638	111,635

Cash and cash equivalents, end of period	$	66,567	$	109,697
Non-cash financing transaction				
Common stock swap for exercise of stock options	$	1,188	$	
Supplemental disclosure of cash flow information				
Cash paid for taxes	$	3,173	$	288

See accompanying Notes to Condensed Consolidated Financial Statements

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NETEZZA CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Nature of the Business

Netezza Corporation (the Company) is a provider of data warehouse, analytic and monitoring appliances. The Company s TwinFin and Skimmer data warehouse products integrate database, server and storage platforms in a purpose-built unit to enable detailed queries and analyses on large volumes of stored data. The Company also offers its Mantra® database activity-monitoring appliance that provides a solution for the monitoring and auditing of access to this critical stored data. The results of these queries and analyses, often referred to as business intelligence, provide organizations with actionable information to improve their business operations. The Company s data warehouse appliances were designed specifically for analysis of terabytes or petabytes of data at higher performance levels and at a lower total cost of ownership with greater ease of use than can be achieved via traditional data warehouse systems. The Company s data warehouse appliances perform faster, deeper and more iterative analyses on larger amounts of detailed data, giving customers greater insight into trends and anomalies in their businesses, thereby enabling them to make better strategic decisions.

2. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying condensed consolidated financial statements include those of the Company and its wholly owned subsidiaries, after elimination of all intercompany accounts and transactions. The Company has prepared the accompanying condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States of America (GAAP).

The condensed consolidated balance sheet at January 31, 2010 was derived from audited financial statements, but does not include all disclosures required by GAAP. The accompanying unaudited financial statements as of July 31, 2010 and for the three and six months ended July 31, 2010 and 2009 have been prepared by the Company, pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations. However, the Company believes that the disclosures are adequate to make the information presented not misleading. These condensed consolidated financial statements should be read in conjunction with the Company s audited consolidated financial statements and the notes thereto included in its Annual Report on Form 10-K for the fiscal year ended January 31, 2010, filed with the SEC on April 1, 2010.

In the opinion of management, all adjustments, consisting only of normal recurring adjustments, necessary to present a fair statement of the Company s financial position as of July 31, 2010, results of operations for the three and six months ended July 31, 2010 and 2009 and cash flows for the six months ended July 31, 2010 and 2009 have been made. The results of operations for the three and six months ended July 31, 2010 and the cash flows for the six months ended July 31, 2010 are not necessarily indicative of the results of operations and cash flows that may be expected for the year ending January 31, 2011 or any future periods.

The Company s fiscal year ends on January 31. When the Company refers to a particular fiscal year, the Company is referring to the fiscal year ended January 31 of that year. For example, fiscal 2011 refers to the fiscal year ending January 31, 2011.

Use of Estimates

The preparation of these financial statements in conformity with GAAP requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue and expenses, and disclosure

of contingent assets and liabilities. On an ongoing basis, management evaluates these estimates and judgments, including those related to revenue recognition, the write down of inventory to net realizable value, stock-based compensation, income taxes, goodwill and acquired intangible assets. The Company bases these estimates on historical and anticipated results and trends and on various other assumptions that the Company believes are reasonable under the circumstances, including assumptions as to future events. These estimates form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. By their nature, estimates are subject to an inherent degree of uncertainty. Actual results may differ from the Company s estimates.

Revenue Recognition

The Company derives revenue from the sale of its products and related services. Revenue is recognized when persuasive evidence of an arrangement exists, delivery has occurred, the sales price is fixed or determinable and collectability of the related receivable is probable. This policy is applicable to all revenue transactions, including sales to resellers and end users. The following summarizes the major terms of the Company s contractual relationships with end users and resellers and the manner in which these transactions are accounted.

The Company s product offerings include the sale of hardware with its embedded propriety software. Revenue from these transactions is recognized upon shipment unless shipping terms or local laws do not allow the title and risk of loss to transfer at shipping point. In those cases, the Company defers revenue until title and risk of loss transfer to the customer. The Company does not customarily offer a right of return on its product sales and any acceptance criteria is normally based upon published specifications. In cases where a right of return is granted, the Company defers revenue until such rights expire. If acceptance criteria are not based on published specifications with which the Company can ensure compliance, the Company defers revenue until acceptance has been confirmed or the right of return expires. Customers may purchase a standard maintenance agreement which typically commences upon product delivery. The Company also provides a 90-day standard product warranty.

The Company s service revenue consists of installation, maintenance, training and professional services. Installation and professional services are not considered essential to the functionality of the Company s products as these services do not customize or alter the product capabilities and could be performed by customers or third party vendors. Installation and professional services revenue is recognized upon completion of installation or requested services. Maintenance revenue is recognized ratably over the contract period. Training revenue is recognized upon the completion of the training or expiration.

The Company s service revenue also consists of software customization and consulting service contracts. Services revenues are recognized either as services are performed and billed to customers for time and material arrangements or on the percentage-of-completion method for fixed fee contracts. Percentage-of-completion is measured by the percentage of software customization or consulting hours incurred to date to total estimated hours. This method is used because management has determined that past experience has shown expended hours to be the best measure of progress on these engagements. Revisions in total estimated hours are reflected in the accounting period in which the required revisions become known. Anticipated losses on contracts are charged to income in their entirety when such losses become evident.

For sales through resellers and distributors, the Company delivers the product directly to the end user customer to which the product has been sold. Revenue recognition on reseller and distributor arrangements is accounted for as described above.

In October 2009, the Financial Accounting Standards Board (FASB) issued an accounting standard for multiple-deliverable revenue arrangements which changes the requirements for establishing separate units of accounting in a multiple element arrangement and requires the allocation of arrangement consideration to each deliverable to be based on the relative selling price. Concurrently with issuing this standard, the FASB also issued an accounting standard which excludes software that is contained on a tangible product from the scope of software revenue guidance if the software component and the non-software component function together to deliver the tangible product s essential functionality. The standard is effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. Early adoption and retrospective application are also permitted.

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The Company adopted these standards on a prospective basis as of the beginning of fiscal 2011 for new and materially modified arrangements originating on or after February 1, 2010. As a result, net revenues for the six months ended July 31, 2010 were approximately $2.9 million higher than the net revenues that would have been recorded under the previous accounting rules. The increase in revenues was due to recognition of revenue for products for which a new or materially modified contract was entered into during the six months ended July 31, 2010 where the product contained undelivered elements for which the Company was unable to demonstrate fair value under the previous standards. Had the Company adopted these standards on a prospective basis as of the beginning of fiscal 2010 for new and materially modified arrangements originating on or after February 1, 2009, net revenues for the six months ended July 31, 2009 would have been approximately $1.2 million higher. Under the new standards the Company allocates the total consideration for an arrangement among the separable elements of the arrangement based upon the relative selling price of each element. Arrangement consideration allocated to undelivered elements is deferred until delivery.

Beginning in fiscal 2011, when a sales arrangement contains multiple elements and software and non-software components function together to deliver the tangible product s essential functionality, the Company allocates revenue to each element based on a selling price hierarchy. The selling price for a deliverable is based on its vendor-specific objective evidence (VSOE) if available, third party evidence (TPE) if VSOE is not available, or best estimated selling price (BESP) if neither VSOE nor TPE is available. The Company then recognizes revenue on each deliverable in accordance with its policies for product and service revenue recognition.

VSOE of fair value is based upon the amount charged when an element is sold separately. VSOE of the fair value of maintenance services may also be determined based on a substantive maintenance renewal clause, if any, within a customer contract. The Company s current pricing practices are influenced primarily by product type, purchase volume and maintenance term. The Company reviews services revenue sold separately and maintenance renewal rates on a periodic basis and updates, when appropriate, the Company s VSOE of fair value for such services to ensure that it reflects the Company s recent pricing experience. TPE of selling price is established by evaluating largely interchangeable competitor products or services in stand-alone sales to similarly situated customers. However, as the Company s products contain a significant element of proprietary technology and its solutions offer substantially different features and functionality than other available products, the comparable pricing of products with similar functionality typically cannot be obtained. As the Company is unable to reliably determine what competitors products selling prices are on a stand-alone basis, the Company is not typically able to determine TPE.

When the Company is unable to establish selling price using VSOE or TPE, the Company uses BESP in its allocation of arrangement consideration. The objective of BESP is to determine the price at which the Company would transact a sale if the product or service was sold on a stand-alone basis. The Company determines BESP for a product or service by considering multiple factors including, but not limited to, overall market conditions, including geographic or regional specific market factors; pricing practices, including pricing in different geographies and for different purchase volumes; internal costs; and competitor pricing strategies. The determination of BESP is a formal process within the Company that includes review and approval by the Company s management. The Company reviews its determination of BESP on a periodic basis and updates it, when appropriate, to ensure that it reflects the Company s recent pricing experience.

The Company evaluates all deliverables in an arrangement to determine whether they represent separate units of accounting. A deliverable constitutes a separate unit of accounting when it has stand-alone value and there are no customer-negotiated refunds or return rights for the delivered elements. The new standards do not change the units of accounting for the Company s revenue transactions.

In multiple element arrangements where software deliverables that are not more-than-incidental are included, revenue is allocated to each separate unit of accounting for each of the non-software deliverables and to the software deliverables as a group using the relative selling prices within the selling price hierarchy of each of the deliverables in the arrangement based on the selling price hierarchy described above. If the arrangement contains more than one software deliverable, the arrangement consideration allocated to the software deliverables as a group is then allocated among the individual software deliverables using the guidance for recognizing software revenue, as amended.

The Company limits the amount of revenue recognition for delivered elements to the amount that is not contingent on the future delivery of products or services, future performance obligation, or subject to customer-specific return or refund privileges.

For transactions entered into prior to February 1, 2010, the Company allocates revenue for multiple element arrangements for which VSOE exists for undelivered elements but not for the delivered elements, using the residual method . Under the residual method, the fair values of the undelivered elements are initially deferred. The residual contract amount is then allocated to and recognized for the delivered elements. Thereafter, the amount deferred for the undelivered element is recognized when those elements are delivered. For arrangements in which VSOE does not exist for each undelivered element, revenue for the entire arrangement is deferred and not recognized until delivery of all the elements without VSOE has occurred, unless the only undelivered element is maintenance in which case the entire contract is recognized ratably over the maintenance period.

Foreign Currency Translation

The functional currency for the Company s foreign subsidiaries is the applicable local currency. For financial reporting purposes, assets and liabilities of subsidiaries outside the United States of America are translated into U.S. dollars using period-end exchange rates. Revenue and expense accounts are translated at the average rates in effect during the period. The effects of foreign currency translation adjustments are included in accumulated other comprehensive income as a component of stockholders equity. Transaction (losses) gains for the three and six months ended July 31, 2010 were approximately $(102,000) and $(144,000), respectively, and for the three and six months ended July 31, 2009 were $193,000 and $156,000, respectively. These losses or gains are recorded as other income (expense), net in the condensed consolidated statements of operations.

Concentration of Credit Risk and Significant Customers

The Company maintains its cash in bank deposit accounts at high quality financial institutions. The individual balances, at times, may exceed federally insured limits. However, the Company does not believe that it is subject to unusual credit risk beyond the normal credit risk associated with commercial banking relationships.

Financial instruments which potentially expose the Company to concentrations of credit risk consist of accounts receivable. Management believes its credit policies are prudent and reflect normal industry terms and business risk. At July 31, 2010, one customer accounted for 18% of accounts receivable. At January 31, 2010, two customers accounted for 16% and 15% of accounts receivable, respectively. One customer accounted for 10% or greater of the Company s total revenue in the six months ended July 31, 2010 and no customer accounted for 10% or greater in the six months ended July 31, 2009.

Stock-Based Compensation

Stock-based compensation cost is measured at the grant date based on the fair value of the award and is recognized as expense over the vesting period. The Company has selected the Black-Scholes option pricing model to determine fair value of stock option awards. Determining the fair value of stock-based awards at the grant date requires judgment, including estimating the expected life of the stock awards and the volatility of the underlying common stock. Changes to the assumptions may have a significant impact on the fair value of stock options, which could have a material impact on the Company s financial statements. In addition, judgment is also required in estimating the amount of stock-based awards that are expected to be forfeited. Should the Company s actual forfeiture rates differ significantly from the Company s estimates, the Company s stock-based compensation expense and results of operations could be materially impacted. The calculation of compensation cost for options issued prior to the Company s initial public offering in July 2007 required the Company s Board of Directors, with input from management, to estimate the fair market value of the Company s common stock on the date of grant of those options. These estimates of fair market value were determined based upon a number of objective and subjective factors and were, therefore, inherently subjective estimates.

For stock options and restricted stock granted to employees the Company recognizes compensation cost on a straight-line basis over the awards vesting periods for those awards that contain only a service vesting feature. For

awards with a performance condition vesting feature, the Company recognizes compensation cost on a graded-vesting basis over the awards expected vesting periods.

The Company accounts for stock-based compensation expense for non-employees using the fair value method which requires the award to be re-measured at each reporting date until the award is vested. The Company estimates the fair value using the Black-Scholes option pricing model, and records the fair value of non-employee stock options as an expense using the graded-vesting basis over the term of the option.

The fair value of each option granted during the three and six months ended July 31, 2010 and 2009 was estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions:

	Three Months Ended July 31,		Six Months Ended July 31,	
	2010	2009	2010	2009
Dividend yield	None	None	None	None
Expected volatility	59.6%	56.8%	58.2%	56.7%
Risk-free interest rate	1.89%	2.41%	2.17%	1.95%
Expected life (in years)	5.0	5.0	5.0	5.0
Weighted-average fair value at grant date	$ 7.15	$ 3.89	$ 6.43	$ 3.03

For the three and six months ended July 31, 2010 and 2009, the expected volatility assumption used in the Black-Scholes option-pricing model was a blended rate based on the historical trading activity of the Company s common stock since the initial public offering and an analysis of peer group volatility. The expected life assumption is based on the simplified method. The simplified method is based on the vesting period and contractual term for each vesting tranche of awards. The average mid-point between the vesting date and the expiration date for each vesting period is used as the expected term under this method. The risk-free interest rate used in the Black-Scholes model is based on the implied yield curve available on U.S. Treasury zero-coupon issues at the date of grant with a remaining term equal to the Company s expected term assumption. The Company has never declared or paid a cash dividend and has no current plans to pay cash dividends. Management has made an estimate of expected forfeitures of equity awards and the Company is recognizing compensation costs only for those awards expected to vest.

The amounts included in the condensed consolidated statements of operations for the three and six months ended July 31, 2010 and 2009 relating to stock-based compensation expense are as follows (in thousands):

	Three Months Ended July 31,		Six Months Ended July 31,	
	2010	2009	2010	2009
Cost of product	$ 30	$ 11	$ 53	$ 22
Cost of services	185	98	331	195
Sales and marketing	1,172	816	2,194	1,566
Research and development	892	683	1,720	1,317
General and administrative	1,150	839	2,110	1,582
	$ 3,429	$ 2,447	$ 6,408	$ 4,682

Net Income Per Share

The Company computes basic net income per share by dividing its net income for the period by the weighted average number of common shares outstanding during the period, excluding the dilutive effects of common stock equivalents. Diluted net income per share includes the dilutive effect of stock options and restricted stock under the treasury stock method.

The components of the net income per share were as follows (in thousands except per share amounts):

	Three Months Ended July 31,		Six Months Ended July 31,	
	2010	2009	2010	2009
Net income	$ 3,184	$ 730	$ 5,856	$ 493
Weighted average shares used to compute net income per share:				
Basic	61,941	60,232	61,569	60,104
Dilutive effect of stock options and restricted stock	3,997	2,615	3,714	2,571
Diluted	65,938	62,847	65,283	62,675
Net income per share:				
Basic	$ 0.05	$ 0.01	$ 0.10	$ 0.01
Diluted	$ 0.05	$ 0.01	$ 0.09	$ 0.01

The following stock options to purchase common stock have been excluded from the computation of diluted net income per share for the periods presented because including the stock options would be anti-dilutive.

	Three Months Ended July 31,		Six Months Ended July 31,	
	2010	2009	2010	2009
Options to purchase common stock	1,835	8,007	2,725	7,672

Comprehensive Income

Comprehensive income consists of net income, adjustments to stockholders equity for foreign currency translation adjustments and net unrealized gains or losses from investments. For the purposes of comprehensive income disclosures, the Company does not record tax provisions or benefits for the net changes in the foreign currency translation adjustment, as the Company intends to permanently reinvest undistributed earnings in its foreign subsidiaries. Accumulated other comprehensive loss consists of foreign exchange gains and losses and net unrealized gains or losses from investments.

The components of comprehensive income are as follows (in thousands):

	Three Months Ended July 31,		Six Months Ended July 31,	
	2010	2009	2010	2009
Net income	$ 3,184	$ 730	$ 5,856	$ 493
Other comprehensive income:				
Foreign currency adjustment, net of tax of $0	(126)	223	(151)	189
Net unrealized gain from investments, net of tax of $0	637	112	687	1,219
Total comprehensive income	$ 3,695	$ 1,065	$ 6,392	$ 1,901

Recent Accounting Pronouncements

In January 2010, the FASB issued an update requiring reporting entities to provide new disclosures and clarifications of currently required disclosures related to fair value measurements. The new disclosures require reporting entities to disclose separately the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurements and describe the reasons for the transfers. Additionally, in the Level 3 reconciliations, a reporting entity should present separately information about purchases, sales, issuances and settlements. The update also

clarifies that a reporting entity needs to use judgment in determining the appropriate classes of assets and liabilities, and should provide disclosures about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements in Level 2 and Level 3. The new disclosures and clarifications of existing disclosures are effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances, and settlements in the rollforward

of activity in Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. This new guidance only requires additional disclosures and will not have a material impact on the Company s consolidated financial statements.

In October 2009, the FASB issued an accounting standard for multiple-deliverable revenue arrangements, which amends previously issued guidance to require that an entity use an estimated selling price when VSOE or acceptable third-party evidence does not exist for any products or services included in a multiple element arrangement. The arrangement consideration should be allocated among the products and services based upon their relative selling prices, thus eliminating the use of the residual method of allocation. This standard also requires expanded qualitative and quantitative disclosures regarding significant judgments made and changes made to revenue recognition policies in applying this guidance. This standard is effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. Early adoption and retrospective application are also permitted. The Company adopted the guidance beginning February 1, 2010, as described in *Revenue Recognition* above.

In October 2009, the FASB issued an accounting standard for certain revenue arrangements that include software elements. This standard amends previously issued guidance to exclude tangible products containing software components and non-software components that function together to deliver the product s essential functionality. Entities that sell joint hardware and software products that meet this exception will be required to follow the guidance for multiple-deliverable revenue arrangements. This standard is effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. Early adoption and retrospective application are also permitted. The Company adopted the guidance beginning February 1, 2010, as described in *Revenue Recognition* above.

From time to time, new accounting pronouncements are issued by the FASB and subsequently adopted by the Company as of the specified effective date. Unless otherwise discussed in these notes, the Company believes that the impact of recently issued standards, which are not yet effective, will not have a material impact on the Company s consolidated results of operations and financial condition upon adoption.

3. Fair Value Measurements

The accounting standard for fair value measurements provides a framework for measuring fair value under GAAP and requires expanded disclosures regarding fair value measurements. Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. The accounting standard also establishes a fair value hierarchy that requires an entity to maximize the use of observable inputs, where available, and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

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

Level 2 Observable inputs, other than Level 1 prices, such as quoted prices in active markets for similar assets and liabilities, quoted prices for identical or similar assets and liabilities in markets that are not active, or other inputs that are observable or can be corroborated by observable market data.

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. This includes certain pricing models, discounted cash flow methodologies and similar techniques that use significant unobservable inputs.

The following table summarizes the composition of the Company s investments at July 31, 2010 and January 31, 2010 (in thousands):

					Classification on Balance Sheet	
					Short Term	Long Term
July 31, 2010	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Aggregate Fair Value	Marketable Securities	Marketable Securities
Available-for-sale U.S. treasury and government agency securities	$ 82,755	$ 38	$	$ 82,793	$ 69,777	$ 13,016
Available-for-sale auction rate securities	$ 30,125	$	$ (917)	$ 29,208	$	$ 29,208
	$ 112,880	$ 38	$ (917)	$ 112,001	$ 69,777	$ 42,224

					Classification on Balance Sheet	
					Short Term	Long Term
January 31, 2010	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Aggregate Fair Value	Marketable Securities	Marketable Securities
Available-for-sale U.S. treasury and government agency securities	$ 65,879	$	$	$ 65,879	$ 50,860	$ 15,019
Available-for-sale auction rate securities	$ 36,325	$	$ (1,575)	$ 34,750	$	$ 34,750
Trading auction rate securities	$ 13,325	$	$ (165)	$ 13,160	$ 13,160	$
	$ 115,529	$	$ (1,740)	$ 113,789	$ 64,020	$ 49,769

The following table details the fair value measurements within the fair value hierarchy of the Company s financial assets and liabilities at July 31, 2010 (in thousands):

	Total Fair Value at July 31, 2010	Fair Value Measurements at Reporting Date Using		
		Level 1	Level 2	Level 3
Financial Assets:				
Money market funds	$ 42,302	$ 42,302	$	$
U.S. treasury and government agency securities	95,975	95,975		
Certificates of deposit	499	499		

Auction rate securities	29,208			29,208
	$ 167,984	$ 138,776	$	$ 29,208
Financial Liabilities:				
Foreign currency forward contracts	$ 241		$ 241	
	$ 241	$	$ 241	$

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The following table reflects the activity for the Company s major classes of assets measured at fair value using Level 3 inputs (in thousands):

	Auction Rate Securities
Balance as of January 31, 2010	$ 47,910
Transfers in from Level 1	
Unrealized gains included in accumulated other comprehensive loss	658
Realized gains included in other income (expense), net	165
Sales or redemptions of securities	(19,525)
Balance as of July 31, 2010	$ 29,208

At July 31, 2010, auction rate securities (ARS) represented 17% of total financial assets measured at fair value.

At July 31, 2010, the Company grouped money market funds and certificates of deposit using a Level 1 valuation because market prices were readily available. At July 31, 2010, the foreign currency forward contract valuation inputs were based on quoted prices and quoted pricing intervals from public data and did not involve management judgment. Accordingly, these have been classified within Level 2 of the fair value hierarchy. At July 31, 2010, the fair value of the Company s assets grouped using a Level 3 valuation consisted of ARS, most of which were AAA-rated bonds collateralized by federally guaranteed student loans. ARS are long-term variable rate bonds tied to short-term interest rates that are reset through a Dutch auction process that typically occurs every 7 to 35 days. Historically, the carrying value (par value) of the ARS approximated fair market value due to the resetting of variable interest rates.

Beginning in late February 2008, however, the auctions for ARS then held by the Company were unsuccessful. As a result, the interest rates on ARS reset to the maximum rate per the applicable investment offering statements. The Company will not be able to liquidate affected ARS until a future auction on these investments is successful, a buyer is found outside the auction process, the securities are called or refinanced by the issuer, or the securities mature. Due to the Company s inability to quickly liquidate these investments, the Company has reclassified those investments with failed auctions that have not been subsequently liquidated as long-term assets in its consolidated balance sheet based on management s estimate of its inability to liquidate these investments within the next twelve months. Due to these liquidity issues, the Company performed a discounted cash flow analysis to determine the estimated fair value of these investments. The discounted cash flow analysis performed by the Company considered the timing of expected future successful auctions, the impact of extended periods of maximum interest rates, collateralization of underlying security investments and the creditworthiness of the issuer. The discounted cash flow analysis at July 31, 2010 included the following assumptions:

Expected Term	3 Years
Illiquidity Discount	1.5-1.8%
Discount Rate	1.4%

The discount rate was determined using a proxy based upon the current market rates for successful auctions within the AAA-rated ARS market. The expected term was based on management s estimate of future liquidity. The illiquidity discount was based on the levels of federal insurance (FFELP) backing for each security, with a greater percentage of FFELP backing resulting in a lower illiquidity discount.

On November 7, 2008, the Company accepted an offer from UBS AG (UBS), one of the Company s brokers, which provided the Company with rights (the Put Right) to sell UBS $15.8 million of its ARS investments at par, which were purchased through UBS, at any time during a two-year period beginning June 30, 2010. In addition, UBS agreed to provide a no net cost loan equal to 75% of the par value of the Company s ARS positions with UBS should the Company desire such a loan before June 30, 2010. Before accepting the Put Right, the Company had the intent and ability to hold these securities until a successful auction or another liquidating event occurred and had previously recognized the unrealized loss as a temporary impairment and recorded the decline in value in accumulated other

comprehensive loss. As a result of accepting the Put Right, the Company entered into a separate financial instrument that had been recorded as an asset that was initially measured at its fair value. The Company elected to apply the fair value option for accounting for financial assets and liabilities to the Put Right and

accordingly recorded changes in fair value of the Put Right through earnings. The Company also elected to classify the ARS investment subject to the Put Right from available-for-sale to trading securities and accordingly recorded changes in fair value through earnings. The Company recorded the fair value of the Put Right, $1.3 million, as an unrealized gain in other income (expense), net in the fiscal year ended January 31, 2009. The Company recorded the changes in the fair value of the Put Right during the three and six months ended July 31, 2010 of approximately $(144,000) and $(151,000), respectively, and during the three and six months ended July 31, 2009 of approximately $(155,000) and $141,000, respectively, as unrealized gain (loss) in the other income (expense), net section of its condensed consolidated statement of operations. During the three months ended July 31, 2010, the Company exercised the Put Right and liquidated its existing ARS positions with UBS at par. As a result, the Company has recorded $0 for the fair value of the Put Right in its consolidated balance sheet as of July 31, 2010 and will not record future charges with respect to the Put Right in the future.

The Company considered the following factors in determining whether the impairment related to its available-for-sale securities was other-than-temporary or temporary: (i) the intent of the Company to sell the security; (ii) whether it is more likely than not that the Company will be required to sell the security before recovering its cost; and (iii) whether or not the Company is expected to recover the security s entire amortized cost basis. The Company specifically noted that it had a cash, cash equivalents and marketable securities balance of approximately $149.4 million in investments other than ARS, and that the Company expects to generate positive cash flow on an annual basis. Additionally, the Company believed that the present value of expected future cash flows consisting of interest payments and the return of principal was sufficient to recover the amortized cost basis of the securities and expected to collect these cash flows. Therefore, the Company does not believe that the decline in value of its available-for-sale securities was other than temporary, or that any portion of the temporary decline was the result of a credit loss. As a result, as of July 31, 2010, the Company recorded an unrealized loss of $0.9 million related to the temporary impairment of the available-for-sale securities, which was included in accumulated other comprehensive loss within stockholders equity.

4. Inventory

Inventory consists of the following (in thousands):

	July 31, 2010	January 31, 2010
Raw materials	$ 3,030	$ 2,102
Finished goods	29,130	26,606
	$ 32,160	$ 28,708

5. Goodwill and Acquired Intangible Assets

Goodwill

The carrying amount of goodwill of the Company was $2.0 million as of both July 31, 2010 and January 31, 2010. The Company s goodwill resulted from the acquisition of NuTech Solutions, Inc. in May 2008. Goodwill is not amortized, but instead is reviewed for impairment at least annually in the fourth quarter or more frequently when events and circumstances occur indicating that the recorded goodwill may be impaired. The Company considers its business to be one reporting unit for purposes of performing its goodwill impairment analysis. The Company s annual goodwill impairment test did not result in an impairment in fiscal 2009 or 2010.

There was no change in the carrying amount of goodwill for the six months ended July 31, 2010.

Acquired Intangible Assets

The carrying amount of acquired identifiable intangible assets was $3.6 million as of July 31, 2010 and $4.1 million as of January 31, 2010. Intangible assets acquired in a business combination are recorded under the

purchase method of accounting at their estimated fair values at the date of acquisition. The Company amortizes acquired intangible assets over their estimated useful lives.

Acquired intangible assets consist of the following as of July 31, 2010 (in thousands):

	Cost	Accumulated Amortization	Net
Developed technology	$ 3,210	$ (958)	$ 2,252
Order backlog	300	(300)	0
Customer relationships	1,460	(529)	931
Trademark and tradename	590	(212)	378
	$ 5,560	$ (1,999)	$ 3,561

Amortization of acquired intangible assets was approximately $0.2 million and $0.3 million for the three months ended July 31, 2010 and 2009, respectively, and $0.5 million and $0.5 million for the six months ended July 31, 2010 and 2009, respectively.

The following is the expected future amortization expense of the Company s acquired intangible assets as of July 31, 2010 for the respective fiscal years ending January 31 (in thousands):

2011 (remaining six months)	$ 463
2012	918
2013	920
2014	918
2015	294
Thereafter	48
Total	$ 3,561

The weighted average useful life of acquired intangible assets is six years.

6. Accrued Expenses

Accrued expenses consist of the following (in thousands) as of:

	July 31, 2010	January 31, 2010
Corporate taxes	$ 1,816	$ 792
Sales meetings and events	696	1,015
Legal/audit/compliance	808	893
Rent/phone/utilities	1,082	1,080
Partner fees	1,879	268
Travel and entertainment	605	298
Other	2,881	1,560
	$ 9,767	$ 5,906

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7. Stock Incentive Plans

Non-employee Awards

From time to time, the Company issues equity instruments to non-employees, including warrants and options to purchase common stock. The Company is required to re-measure the value of the awards at each reporting period until the vesting date. The Company records the value of the shares using the graded-vesting basis over the period of time services are provided. Stock-based compensation expense for non-employees for the three months ended July 31, 2010 and 2009 was approximately $11,000 and $17,000, respectively. Stock-based compensation expense for non-employees for the six months ended July 31, 2010 and 2009 was approximately $21,000 and $23,000, respectively.

At July 31, 2010, non-employees held nonstatutory options to purchase 22,500 shares of common stock, of which 18,125 were fully vested and exercisable.

Restricted Common Stock Awards

From time to time, the Company awards its non-employee directors restricted common stock awards under the Company s 2007 Stock Incentive Plan. The vesting term of these awards is one year, assuming continued service. The vested shares under these awards cannot be sold until the director s separation from the Company, or upon an earlier acquisition of the Company. The Company amortizes the fair market value of the awards at the time of the grant to expense over the period of vesting. Recipients of restricted stock awards have the right to vote such shares and may also receive dividends. The fair value of restricted stock awards is determined based on the number of shares granted and the market value of the Company s common stock on the grant date, adjusted for any forfeiture factor.

The following table summarizes the Company s restricted stock activity during the six months ended July 31, 2010:

	Shares	Par value	Weighted Average Grant Date Fair Value
Non-vested as of January 31, 2010	57,808	$ 0.001	$ 7.76
Granted	42,168	$ 0.001	$ 13.28
Vested	(55,933)	$ 0.001	$ 7.70
Cancelled			
Non-vested as of July 31, 2010	44,043	$ 0.001	$ 13.12

Restricted Common Stock Units

The Company awards its employees and officers restricted common stock units under the Company s 2007 Stock Incentive Plan. Restricted stock units represent the right to receive shares of common stock in the future, with the right to future delivery of the shares contingent upon satisfaction of specified conditions. The restricted stock units are valued based on the Company s stock price on the grant date. For restricted stock units that contain only a service-based vesting feature, the Company recognizes compensation cost on a straight-line basis over the award s vesting periods. For restricted stock units with a performance-based vesting feature, the Company recognizes compensation cost on a graded-vesting basis over the award s expected vesting periods, commencing when achievement of the performance condition is deemed probable. Each period management evaluates the criteria established in each grant to determine the probability that the performance condition will be achieved. As of July 31, 2010, the number of performance-based vesting restricted stock units outstanding was 202,500.

The following table summarizes the Company s restricted stock unit activity during the six months ended July 31, 2010:

	Units	Par value	Weighted Average Grant Date Fair Value	Aggregate Intrinsic Value
Outstanding units as of January 31, 2010	0			
Granted	763,000	$ 0.001	$ 11.20	
Vested	0			
Cancelled	(1,000)	$ 0.001	$ 11.20	
Outstanding units as of July 31, 2010	762,000	$ 0.001	$ 11.20	$11.8 million

Stock Options

The following table summarizes stock option activity for the six months ended July 31, 2010:

	Shares Available for Grant	Number of Options Outstanding	Weighted Average Exercise Price	Weighted Average Remaining Life in Years	Aggregate Intrinsic Value
Outstanding at January 31, 2010	3,422,236	11,815,522	$ 7.00		
Options granted	(279,500)	279,500	$ 12.54		
Restricted stock units and awards granted	(805,168)		$ 0.00		
Exercised		(1,280,585)	$ 4.50		
Forfeited, cancelled or expired (1)	322,800	(356,725)	$ 10.31		
Outstanding at July 31, 2010	2,660,368	10,457,712	$ 7.34	5.51 years	$85.3 million
Exercisable at July 31, 2010		4,966,822	$ 6.44	5.38 years	$45.0 million
Vested and expected to vest at July 31, 2010		10,182,606	$ 7.31	5.50 years	$83.4 million

(1) Options cancelled under the Company s 2000 Stock

Incentive Plan
(the 2000 Plan)
after July 24,
2007 are not
considered
available for
grant, as the
Company is no
longer granting
options under
this plan.
During the six
months ended
July 31, 2010,
options for
34,925 shares
granted under
the 2000 Plan
were cancelled.

The aggregate intrinsic value in the table above was calculated as the difference between the exercise price of the stock options and the fair value of the underlying common stock as of July 31, 2010, which was $15.50 per share. The aggregate intrinsic value of options exercised for the six months ended July 31, 2010 and 2009 was $11.7 million and $3.1 million, respectively.

At July 31, 2010, unrecognized compensation expense related to unvested stock options, unvested restricted stock awards and unvested restricted stock units was $24.9 million, $0.5 million and $7.6 million, respectively, which is expected to be recognized over a weighted-average period of 2.8, 0.87 and 3.31 years, respectively.

8. Income Taxes

The Company recorded income tax expense of approximately $1.9 million and $80,000 for the three months ended July 31, 2010 and 2009, respectively, and income tax expense of approximately $3.4 million and $9,000 for the six months ended July 31, 2010 and 2009, respectively. The Company s effective income tax rate was 38% and 10% for the three months ended July 31, 2010 and 2009, respectively, and 36% and 2% for the six months ended July 31, 2010 and 2009, respectively. The effective income tax rate is based upon the estimated income for the year, the estimated composition of the income in different jurisdictions and adjustments, if any, in the applicable quarterly periods for potential tax consequences, benefits, resolution of tax audits or other tax contingencies.

For the three months and six months ended July 31, 2010, the effective income tax rate was greater than the U.S. federal statutory tax rate of 35%, primarily due to the effects of accounting for stock-based compensation and state taxes, as well as the offsetting effects of the federal manufacturers deduction and the utilization of state tax credits. For the three months and six months ended July 31, 2009, the effective income tax rate was less than the U.S. federal statutory tax rate of 35%, primarily due to the utilization of federal tax credits and the effects of purchase accounting from our acquisition of Tizor Systems, Inc., as well as the offsetting effects of accounting for stock-based compensation and state taxes.

The Company s income tax provision for the three and six months ended July 31, 2010 consisted of federal, state and foreign taxes owed in relation to income generated. The Company s income tax provision for the three and six months ended July 31, 2009 consisted primarily of taxes owed in relation to income generated by its foreign subsidiaries.

The Company continued to provide a full valuation allowance for foreign net operating losses for NuTech Solutions, Inc., acquired by Netezza in May 2008, with operations in Germany and Poland, as the Company believes it is more likely than not that the future tax benefits from accumulated net operating losses will not be realized. The Company continues to assess the need for the valuation allowance at each balance sheet date based on all available evidence. However, it is possible that the more likely than not criterion could be met in a future period, which could result in the reversal of a significant portion or all of the valuation allowance. Any reversal of the valuation allowance associated with the NuTech acquisition would be recorded as a tax benefit.

9. Commitments and Contingencies

Legal

On November 20, 2009, the Company filed a complaint against Intelligent Integration Systems, Inc., (IISi), a former solutions provider to Netezza, in Superior Court in Suffolk County, Massachusetts. The complaint alleges that IISi breached an agreement with the Company, as well as breach of implied covenant of good faith and fair dealing, intentional interference with contractual relations and beneficial business relations and violations of the Massachusetts fair business practices act. The Company s complaint against IISi seeks unspecified monetary damages, a declaration that the Company s termination of the agreement with IISi was in accordance with the terms of that agreement and the return of the Company s property and proprietary information from IISi, costs and attorneys fees. On January 22, 2010, IISi filed an answer and counterclaim in response to the Company s complaint, in which IISi alleges that the Company breached its contract with IISi, breach of the covenant of good faith and fair dealing, misappropriation of trade secrets, unjust enrichment, business defamation, intentional interference with contractual relations and violations of the Massachusetts fair business practices act. In its counterclaim, IISi seeks unspecified monetary damages, an injunction requiring the Company to return its trade secrets and proprietary information, costs and attorneys fees. On August 18, 2010, the court issued a partial summary judgment ruling that the Company had breached its agreement with IISi by terminating the agreement without good cause, but did not rule on damages for such breach or on IISi s remaining counterclaims, such as its allegation that we misappropriated IISi s trade secrets. On September 7, 2010, IISi filed a motion for preliminary injunction seeking, among other things, to prohibit the Company from marketing, distributing or using products allegedly containing IISi s trade secrets, including the Company s geospatial product and IISi s extended SQL toolkit, or any versions or portions of those products. IISi s motion further seeks to prohibit the Company from marketing, distributing or using any products that perform the functions of those products for a period of three years. The parties have not conducted the Company s full discovery with respect to IISi s counterclaims and damages for termination of the agreement have not been determined. The Company denies that it used trade secrets or proprietary information of IISi and intends to vigorously contest ISSi s motion for preliminary injunction and to vigorously defend itself against IISi s remaining counterclaims, to which the Company continues to believe it has meritorious defenses.

Guarantees and Indemnification Obligations

The Company enters into standard indemnification agreements in the ordinary course of business. Pursuant to these agreements, the Company indemnifies and agrees to reimburse the indemnified party for losses incurred by the indemnified party, generally the Company s customers, in connection with any patent, copyright, trade secret or other proprietary right infringement claim by any third party with respect to the Company s products. The term of these

indemnification agreements is generally perpetual. Based on historical information and information known as of July 31, 2010, the Company does not expect it will incur any significant liabilities under these indemnification agreements.

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10. Industry Segment and Geographic Information

The Company is organized as, and operates in, one reportable segment: the development and sale of data warehouse appliances. The Company s chief operating decision-maker is its Chief Executive Officer. The Company s Chief Executive Officer reviews financial information presented on a consolidated basis, accompanied by information about revenue by geographic region, for purposes of evaluating financial performance and allocating resources. The Company and its Chief Executive Officer evaluate performance based primarily on revenue in the geographic locations in which the Company operates. Revenue is attributed by geographic location based on the location of the end customer.

Revenue, classified by the major geographic areas in which the Company s customers are located, was as follows (in thousands):

	Three Months Ended July 31,		Six Months Ended July 31,	
	2010	**2009**	**2010**	**2009**
United States	$ 48,223	$ 36,629	$ 94,993	$ 70,321
International	15,584	7,305	26,988	18,980
Total	$ 63,807	$ 43,934	$ 121,981	$ 89,301

The following table summarizes the Company s long-lived assets, consisting of the net book value of the Company s property and equipment, by geographic location (in thousands):

	July 31, 2010	January 31, 2010
United States	$ 10,584	$ 8,234
International	428	235
Total	$ 11,012	$ 8,469

Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

Cautionary Statement

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the unaudited condensed consolidated financial statements and the notes thereto included elsewhere in this Quarterly Report on Form 10-Q and the audited consolidated financial statements and notes thereto and management s discussion and analysis of financial condition and results of operations included in the Company s Annual Report on Form 10-K for the year ended January 31, 2010, which was filed with the Securities and Exchange Commission (SEC) on April 1, 2010. This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended. These statements are often identified by the use of words such as may, will, expect, believe, anticipate, intend, could, estimate, or continue, and similar expressions or variations. Such forward-looking statements are subject to risks, uncertainties and other factors that could cause actual results and the timing of certain events to differ materially from future results expressed or implied by such forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those identified below, and those discussed in the section titled Risk Factors , set forth in Part II, Item 1A of this Quarterly Report on Form 10-Q. The forward-looking statements in this Quarterly Report on Form 10-Q represent our views as of the date of this Quarterly Report on Form 10-Q. We anticipate that subsequent events and developments will cause our views to change. However, while we may elect to update these forward-looking statements at some point in the future, we have no current intention of doing so except to the extent required by applicable law. You should, therefore, not rely

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on these forward-looking statements as representing our views as of any date subsequent to the date of this Report on Form 10-Q.

Overview

We were founded in August 2000 to develop data warehouse appliances that enable real-time business intelligence. Our appliances integrate database, server and storage platforms in a purpose-built unit to enable detailed queries and analyses on large volumes of stored data. We also offer database activity-monitoring appliances that provide a solution for the monitoring and auditing of access to this critical stored data. The results of these queries and analyses on this critical data provide organizations with actionable information to improve their business operations. The amount of data that is being generated and stored by organizations is exploding. Organizations have seen significant growth in the users of business intelligence, an increasing number and sophistication of data queries, a need for real-time data availability, the need for advanced analytical techniques and the need for data auditing and monitoring capabilities. As the volume of data continues to grow, enterprises have recognized the value of analyzing such data to significantly improve their operations and competitive position. This increasing amount of data and the importance of data analysis have led to a heightened demand for data warehouses that provide the critical framework for data-driven enterprise decision-making and business intelligence, as well as solutions for security and monitoring of this stored data. Many traditional data warehouse systems were initially designed to aggregate and analyze smaller quantities of data, using general-purpose database, server and storage platforms manually integrated as a data warehouse system. Such patchwork architectures are often used by default to store and analyze data, despite the fact that they are not optimized to handle terabytes of constantly growing and changing data and as a result, are not as effective in handling the in-depth analyses that large businesses are now requiring of their data warehouse systems. The increasing number of users accessing the data warehouse and the sophistication of the queries employed by these users is making the strain of using these legacy systems even more challenging for many organizations.

Business intelligence solutions are still in their early stages of growth and their continued adoption and growth in the marketplace remain uncertain. Additionally, our appliance approach requires our customers to run their data warehouses in new and innovative ways and often requires our customers to replace their existing equipment and supplier relationships, which they may be unwilling to do, especially in light of the often critical nature of the components and systems involved and the significant capital and other resources they may have previously invested. Furthermore, purchases of our products involve material changes to established purchasing patterns and policies. Even if prospective customers recognize the need for our products, they may not select one of our appliance solutions because they may choose to wait for the introduction of products and technologies that serve as a replacement or substitute for, or represent an improvement over, our appliance solutions. Therefore, our future success also depends on our ability to maintain our leadership position in the data warehouse market and to proactively address the needs of the market and our customers to further drive the adoption of business intelligence and to sustain our competitive advantage versus competing approaches to business intelligence and alternate product offerings.

There was a significant deterioration in economic conditions over the past two fiscal years in many of the countries and regions in which we do business. Although there has recently been improvement in these economic conditions and this improvement continued during the six months ended July 31, 2010, they have caused some of our current or prospective customers to reduce their information technology spending, causing them to modify, delay or cancel plans to purchase our products. In addition, some of our traditional competitors have introduced their own integrated data warehousing solutions which may cause our sales cycles to be delayed and may have an adverse impact on our business, operating results and financial condition.

We are headquartered in Marlborough, Massachusetts. Our personnel and operations are also located throughout the United States, as well as in the United Kingdom, Germany, Australia, Japan, Korea, Italy, Poland, France, Ireland, Singapore, India and Spain. We expect to continue to add personnel in the United States and internationally to provide additional geographic sales and technical support coverage.

Revenue

We derive our revenue from sales of products and related services. We sell our data warehouse appliances worldwide to large global enterprises, mid-market companies and government agencies through our direct sales

force as well as indirectly via distribution partners. To date, we have derived the substantial majority of our revenue from customers located in the United States. For the six months ended July 31, 2010 and 2009, U.S. customers accounted for approximately 78% and 79% of our overall revenue, respectively. For fiscal 2010, 2009 and 2008, U.S. customers accounted for approximately 80%, 74% and 80% our revenue, respectively.

Product Revenue. The significant majority of our revenue is generated through the sale of our appliances, primarily to companies in the following vertical industries: telecommunications, digital media, retail, financial services, outsourced analytics, government and health and life sciences. Our future revenue growth will depend in significant part upon further sales of our appliances to our existing customer base. In addition, increasing our sales to new customers in existing vertical industries we currently serve and in other vertical industries that depend upon high-performance data analysis is an important element of our strategy. We consider the further development of our direct and indirect sales channels in domestic and international markets to be a key to our future revenue growth and the global acceptance of our products. Our future revenue growth will also depend on our ability to sustain the high levels of customer satisfaction generated by providing high-touch, high-quality support. In addition, the market for our products is characterized by rapid technological change, frequent new product introductions and evolving industry standards. Our future revenue growth is dependent on the successful development and introduction of new products and enhancements, including the continued market acceptance of our new generation TwinFin appliance which represents the substantial majority of our revenues in the six months ended July 31, 2010. Such new introductions and enhancements could reduce demand for our existing products and cause customers to delay purchasing decisions until such new products and enhancements are introduced. To address these risks we will seek to expand our sales and marketing efforts, continue to pursue research and development as well as acquisition opportunities to expand and enhance our product offering.

Services Revenue. We sell product maintenance, installation, training and professional services to our customers. The percentage of our total revenue derived from services for the six months ended July 31, 2010 and 2009 was 26% and 30%, respectively, and was 30%, 24% and 19% in fiscal 2010, 2009 and 2008, respectively.

Cost of Revenue and Gross Profit

Cost of product revenue consists primarily of amounts paid to our contract manufacturer, in connection with the procurement of hardware components and assembly of those components into our appliance systems. Neither we nor our contract manufacturer enter into long-term supply contracts for our hardware components, which can cause our cost of product revenue to fluctuate. These product costs are recorded when the related product revenue is recognized. Cost of revenue also includes shipping, warehousing and logistics expenses, and inventory write-downs to write down the carrying value of inventory to the lower of cost or market. Shipping, warehousing, logistics costs and inventory write-downs are recognized as incurred.

Cost of services revenue consists primarily of salaries and employee benefits for our support staff and worldwide installation and technical account management teams and amounts paid to third parties to provide on-site hardware service.

Our gross profit has been and will continue to be affected by a variety of factors, including the relative mix of product versus services revenue; our mix of direct versus indirect sales (as sales through our indirect channels may have lower average selling prices and gross profit); and changes in the average selling prices of our products and services, which can be adversely affected by competitive pressures. Additional factors affecting gross profit include the timing of new product introductions, which may reduce demand for our existing product as customers await the arrival of new products and could also result in additional reserves against older product inventory; cost reductions through redesign of existing products; and the cost of our systems hardware. The data warehouse market is highly competitive and we expect this competition to intensify in the future, especially as we move into additional vertical industries. If our market share in such industries increases, we expect pricing pressure to increase, which will reduce product gross margins.

If our customer base continues to grow, it will be necessary for us to continue to make significant upfront investments in our customer service and support infrastructure to support this growth. The rate at which we add new customers will affect the level of these upfront investments. The timing of these additional expenditures could materially affect our cost of revenue, both in absolute dollars and as a percentage of total revenue, in any particular

period. This could cause downward pressure on gross margins.

Operating Expenses

Operating expenses consist of sales and marketing, research and development, and general and administrative expenses. Personnel-related costs are the most significant component of each of these expense categories. Our headcount increased to 469 employees at July 31, 2010 from 425 employees at January 31, 2010 and 381 employees at January 31, 2009.

Sales and Marketing Expenses

Sales and marketing expenses consist primarily of salaries and employee benefits, sales commissions, marketing program expenses and shared overhead and fringe costs, which consist primarily of allocated facilities expenses and allocated corporate employee benefits. We plan to continue to invest in sales and marketing by increasing the number of our sales personnel worldwide, expanding our domestic and international sales and marketing activities, and further building brand awareness. Accordingly, we expect sales and marketing expenses to continue to increase in total dollars although we expect these expenses to be consistent as a percentage of total revenue. Generally, sales personnel are not immediately productive and thus sales and marketing expenses related to new sales hires are not immediately accompanied by higher revenue. Hiring additional sales personnel may reduce short-term operating margins until the sales personnel become productive and generate revenue. Accordingly, the timing of hiring sales personnel and the rate at which they become productive will affect our future performance.

Research and Development Expenses

Research and development expenses consist primarily of salaries and employee benefits, product prototype expenses, shared overhead and fringe costs, which consist primarily of allocated facilities expenses and allocated corporate employee benefits, and depreciation of equipment used in research and development activities. In addition to our U.S. development teams, we use an offshore development team employed by a contract engineering firm in Pune, India. Research and development expenses are recorded as incurred. We devote substantial resources to the development of additional functionality for existing products and the development of new products. We intend to continue to invest significantly in our research and development efforts because we believe they are essential to maintaining and increasing our competitive position. The timing of these additional investments could materially affect our research and development expenses, both in absolute dollars and as a percentage of total revenue, in any particular period.

General and Administrative Expenses

General and administrative expenses consist primarily of salaries and employee benefits, shared overhead and fringe costs, which consist primarily of allocated facilities expenses and allocated corporate employee benefits, fees for professional services such as legal, accounting and compliance, investor relation expenses and insurance premiums, including premiums related to director and officer insurance. We may add to the number of general and administrative employees to ensure we have appropriate infrastructure to support the growth of our organization and to support the demands of public company compliance. Accordingly, we expect general and administrative expenses to continue to increase in total dollars, although we expect these expenses to be consistent as a percentage of total revenue.

Other

Interest Income and Interest Expense

Interest income and interest expense primarily consists of interest income on investments and cash balances and interest expense associated with other long-term liabilities. In addition, interest income includes realized gains and losses on marketable securities.

Other Income (Expense), Net

Other income (expense), net primarily consists of losses or gains on translation of non-U.S. dollar transactions into U.S. dollars, changes in the fair value of foreign currency forward contracts, changes in the fair value of the

auction rate securities put right, unrealized losses or gains on trading securities and losses or gains on disposal of fixed assets.

Critical Accounting Policies and Use of Estimates

Our consolidated financial statements are prepared in accordance with generally accepted accounting principles in the United States, which we refer to as GAAP. These accounting principles require us to make certain estimates, judgments and assumptions that can affect the reported amounts of assets and liabilities as of the dates of the consolidated financial statements, the disclosure of contingencies as of the dates of the consolidated financial statements, and the reported amounts of revenue and expenses during the periods presented. We evaluate these estimates, judgments and assumptions on an ongoing basis. Although we believe that our estimates, judgments and assumptions are reasonable under the circumstances, actual results may differ from those estimates.

We believe that of our significant accounting policies, the following accounting policies involve the most judgment and complexity:

- revenue recognition;
- stock-based compensation;
- inventory valuation;
- accounting for income taxes;
- valuation of investments; and
- valuation of goodwill and acquired intangible assets.

Accordingly, we believe the policies set forth above are the most critical to aid in fully understanding and evaluating our financial condition and results of operations. If actual results or events differ materially from the estimates, judgments and assumptions used by us in applying these policies, our reported financial condition and results of operations could be materially affected. Additional information about these critical accounting policies may be found in the Management s Discussion and Analysis of Financial Condition and Results of Operations section included in our Annual Report on Form 10-K for the fiscal year ended January 31, 2010. The critical accounting policies described in our Annual Report on Form 10-K for the fiscal year ended January 31, 2010 have not materially changed, other than the critical accounting policy titled *Revenue Recognition* which has been modified as a result of changes to our revenue recognition policy required by new accounting guidance adopted during the six months ended July 31, 2010.

Revenue Recognition

We derive revenue from the sale of our products and related services. Revenue is recognized when persuasive evidence of an arrangement exists, delivery has occurred, the sales price is fixed or determinable and collectability of the related receivable is probable. This policy is applicable to all revenue transactions, including sales to resellers and end users. The following summarizes the major terms of our contractual relationships with end users and resellers and the manner in which these transactions are accounted.

Our product offerings include the sale of hardware with its embedded propriety software. Revenue from these transactions is recognized upon shipment unless shipping terms or local laws do not allow the title and risk of loss to transfer at shipping point. In those cases, we defer revenue until title and risk of loss transfer to the customer. We do not customarily offer a right of return on our product sales and any acceptance criteria is normally based upon published specifications. In cases where a right of return is granted, we defer revenue until such rights expire. If acceptance criteria are not based on published specifications with which we can ensure compliance, we defer revenue until acceptance has been confirmed or the right of return expires. Customers may purchase a standard maintenance agreement which typically commences upon product delivery. We also provide a 90-day standard product warranty.

Our service revenue consists of installation, maintenance, training and professional services. Installation and professional services are not considered essential to the functionality of our products as these services do not customize or alter the product capabilities and could be performed by customers or third party vendors. Installation and professional services revenue is recognized upon completion of installation or requested services. Maintenance revenue is recognized ratably over the contract period. Training revenue is recognized upon the completion of the training or expiration.

Our service revenue also consists of software customization and consulting service contracts. Services revenues are recognized either as services are performed and billed to customers for time and material arrangements or on the percentage-of-completion method for fixed fee contracts. Percentage-of-completion is measured by the percentage of software customization or consulting hours incurred to date to total estimated hours. This method is used because we have determined that past experience has shown expended hours to be the best measure of progress on these engagements. Revisions in total estimated hours are reflected in the accounting period in which the required revisions become known. Anticipated losses on contracts are charged to income in their entirety when such losses become evident.

For sales through resellers and distributors, we deliver the product directly to the end user customer to which the product has been sold. Revenue recognition on reseller and distributor arrangements is accounted for as described above.

In October 2009, the Financial Accounting Standards Board, or FASB, issued an accounting standard for multiple-deliverable revenue arrangements which changes the requirements for establishing separate units of accounting in a multiple element arrangement and requires the allocation of arrangement consideration to each deliverable to be based on the relative selling price. Concurrently with issuing this standard, the FASB also issued an accounting standard which excludes software that is contained on a tangible product from the scope of software revenue guidance if the software component and the non-software component function together to deliver the tangible product s essential functionality. The standard is effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. Early adoption and retrospective application are also permitted.

We adopted these standards on a prospective basis as of the beginning of fiscal 2011 for new and materially modified arrangements originating on or after February 1, 2010. As a result, net revenues for the six months ended July 31, 2010 were approximately $2.9 million higher than the net revenues that would have been recorded under the previous accounting rules. The increase in revenues was due to recognition of revenue for products for which a new or materially modified contract was entered into during the six months ended July 31, 2010 where the product contained undelivered elements for which we were unable to demonstrate fair value under the previous standards. Had we adopted these standards on a prospective basis as of the beginning of fiscal 2010 for new and materially modified arrangements originating on or after February 1, 2009, net revenues for six months ended July 31, 2009 would have been approximately $1.2 million higher. Under the new standards we allocate the total consideration for an arrangement among the separable elements of the arrangement based upon the relative selling price of each element. Arrangement consideration allocated to undelivered elements is deferred until delivery.

We do not believe the effect of adopting these standards will have a material impact on total revenue recognized in our full fiscal year 2011, however, the impact in any given period will vary depending on the nature and volume of multiple element arrangements entered into during the period.

Beginning in fiscal 2011, when a sales arrangement contains multiple elements and software and non-software components function together to deliver the tangible product s essential functionality, we allocate revenue to each element based on a selling price hierarchy. The selling price for a deliverable is based on its vendor-specific objective evidence, or VSOE, if available, third party evidence, or TPE, if VSOE is not available, or best estimated selling price, or BESP, if neither VSOE nor TPE is available. We then recognize revenue on each deliverable in accordance with its policies for product and service revenue recognition.

VSOE of fair value is based upon the amount charged when an element is sold separately. VSOE of the fair value of maintenance services may also be determined based on a substantive maintenance renewal clause, if any, within a customer contract. Our current pricing practices are influenced primarily by product type, purchase volume

and maintenance term. We review services revenue sold separately and maintenance renewal rates on a periodic basis and update, when appropriate, our VSOE of fair value for such services to ensure that it reflects our recent pricing experience. TPE of selling price is established by evaluating largely interchangeable competitor products or services in stand-alone sales to similarly situated customers. However, as our products contain a significant element of proprietary technology and our solutions offer substantially different features and functionality than other available products, the comparable pricing of products with similar functionality typically cannot be obtained. As we are unable to reliably determine what competitors products selling prices are on a stand-alone basis, we are not typically able to determine TPE.

When we are unable to establish selling price using VSOE or TPE, we use BESP in our allocation of arrangement consideration. The objective of BESP is to determine the price at which the company would transact a sale if the product or service were sold on a stand-alone basis. We determine BESP for a product or service by considering multiple factors including, but not limited to, overall market conditions, including geographic or regional specific market factors; pricing practices, including pricing in different geographies and for different purchase volumes; internal costs; and competitor pricing strategies. The determination of BESP is a formal process within our company that includes review and approval by our management. We review our determination of BESP on a periodic basis and update it, when appropriate, to ensure that it reflects our recent pricing experience.

We evaluate all deliverables in an arrangement to determine whether they represent separate units of accounting. A deliverable constitutes a separate unit of accounting when it has stand-alone value and there are no customer-negotiated refunds or return rights for the delivered elements. The new standards do not change the units of accounting for our revenue transactions.

In multiple element arrangements where software deliverables that are not more-than-incidental are included, revenue is allocated to each separate unit of accounting for each of the non-software deliverables and to the software deliverables as a group using the relative selling prices within the selling price hierarchy of each of the deliverables in the arrangement based on the selling price hierarchy described above. If the arrangement contains more than one software deliverable, the arrangement consideration allocated to the software deliverables as a group is then allocated among the individual software deliverables using the guidance for recognizing software revenue, as amended.

We limit the amount of revenue recognition for delivered elements to the amount that is not contingent on the future delivery of products or services, future performance obligation, or subject to customer-specific return or refund privileges.

For transactions entered into prior to February 1, 2010, we allocate revenue for multiple element arrangements for which VSOE exists for undelivered elements but not for the delivered elements, using the residual method . Under the residual method, the fair values of the undelivered elements are initially deferred. The residual contract amount is then allocated to and recognized for the delivered elements. Thereafter, the amount deferred for the undelivered element is recognized when those elements are delivered. For arrangements in which VSOE does not exist for each undelivered element, revenue for the entire arrangement is deferred and not recognized until delivery of all the elements without VSOE has occurred, unless the only undelivered element is maintenance in which case the entire contract is recognized ratably over the maintenance period.

Results of Operations

The following table sets forth our consolidated results of operations for the periods shown.

	Three Months Ended July 31,		Six Months Ended July 31,		Percentage Change	
	2010	2009	2010	2009	Three Months Ended July 31,	Six Months Ended July 31,
	(in thousands)		(in thousands)			
Revenue						
Product	$ 47,276	$ 29,969	$ 90,113	$ 62,671	58%	44%
Services	16,531	13,965	31,868	26,630	18%	20%
Total revenue	63,807	43,934	121,981	89,301	45%	37%
Cost of revenue						
Product	17,259	11,123	32,704	23,467	55%	39%
Services	5,316	3,420	9,646	6,895	55%	40%
Total cost of revenue	22,575	14,543	42,350	30,362	55%	39%
Gross margin	41,232	29,391	79,631	58,939	40%	35%
Operating expenses						
Sales and marketing	20,922	15,729	40,072	30,405	33%	32%
Research and development	10,951	9,297	21,780	20,917	18%	4%
General and administrative	4,408	3,974	8,958	7,950	11%	13%
Total operating expenses	36,281	29,000	70,810	59,272	25%	19%
Operating income	4,951	391	8,821	(333)	1166%	N/A
Interest income	243	197	529	507	23%	4%
Interest expense		25		50	-100%	-100%
Other income (expense), net	(87)	247	(133)	378	N/A	N/A
Income before income taxes	5,107	810	9,217	502		
Income tax expense (benefit)	1,923	80	3,361	9		
Net income	$ 3,184	$ 730	$ 5,856	$ 493		

Revenue

Total revenue was $63.8 million and $43.9 million in the three months ended July 31, 2010 and 2009, respectively, representing an increase of 45%. Total revenue was $122.0 million and $89.3 million in the six months ended July 31, 2010 and 2009, respectively, representing an increase of 37%.

Product revenue was $47.3 million and $30.0 million for the three months ended July 31, 2010 and 2009, respectively, representing an increase of 58%. This increase was primarily based on increased sales volume and continued deployment of our TwinFin appliance, particularly from our existing customers, rather than price increases. As a result of the adoption of new revenue recognition accounting standards for arrangements with multiple deliverables in the first quarter of fiscal 2011, described above, product revenues were approximately $14.1 million lower than revenues that would have been recorded under previous accounting rules. Product revenue related to existing customer sales increased by $24.2 million in the three months ended July 31, 2010, representing 75% of total product revenue, from 37% in the three months ended July 31, 2009. Product revenue related to new customers represented 25% of total product revenue, from 63% of total product revenue in the three months ended July 31, 2009. Our total installed base of customers was 373 at July 31, 2010.

Product revenue was $90.1 million and $62.7 million for the six months ended July 31, 2010 and 2009, respectively, representing an increase of 44%. This increase was primarily based on increased sales volume and continued deployment of our TwinFin appliance, particularly from our existing customers, rather than price increases. As a result of the adoption of new revenue recognition accounting standards for arrangements with multiple deliverables, described above, product revenues were approximately $2.9 million higher than revenues that would have been recorded under previous accounting rules. Product revenue related to existing customer sales increased by $35.9 million in the six months ended July 31, 2010, representing 75% of total product revenue, from 50% in the six months ended July 31, 2009. Product revenue related to new customers represented 25% of total product revenue, from 50% of total product revenue in the six months ended July 31, 2009.

Geographically, 75% of our product revenue was from customers in the United States and 25% was from international customers for the three months ended July 31, 2010, as compared to 88% of our product revenue from customers in the United States and 12% from international customers for the three months ended July 31, 2009. Geographically, 78% of our product revenue was from customers in the United States and 22% was from international customers for the six months ended July 31, 2010, as compared to 82% of our product revenue from customers in the United States and 18% from international customers for the six months ended July 31, 2009.

Services revenue was $16.5 million and $14.0 million for the three months ended July 31, 2010 and 2009, respectively, representing an increase of 18%. Services revenue was $31.9 million and $26.6 million for the six months ended July 31, 2010 and 2009, respectively, representing an increase of 20%. This increase was the result of maintenance and support services for an expanding installed customer base as a result of the renewal of maintenance and support contracts by existing customers, combined with new product sales during the period, and accompanying sales of new maintenance and support contracts. All of our customers to date have purchased first-year annual maintenance and support services and substantially all of our customers renewed their maintenance and support agreements.

Gross Margin

Total gross margin was 65% and 67% for the three months ended July 31, 2010 and 2009, respectively and 65% and 66% for the six months ended July 31, 2010 and 2009, respectively. The decrease in gross margin was the result of a decrease in the services gross margin, but is not necessarily indicative of any future trends.

Product gross margin was 63% and 63% for the three months ended July 31, 2010 and 2009, respectively and 64% and 63% for the six months ended July 31, 2010 and 2009, respectively. This increase was due primarily to a reduction in the cost of our hardware components and increased efficiencies from improved relationships with our contract manufacturers.

Services gross margin was 68% and 76% for the three months ended July 31, 2010 and 2009, respectively and 70% and 74% for the six months ended July 31, 2010 and 2009, respectively. The decrease in the services gross margin for the three and six months ended July 31, 2010 was primarily due to a services headcount increase of 23% to 58 at July 31, 2010 from 47 at July 31, 2009 and increases in third party hardware service costs.

Sales and Marketing Expenses

Sales and marketing expenses increased $5.2 million, or 33%, to $20.9 million for the three months ended July 31, 2010 from $15.7 million for the three months ended July 31, 2009. The increase in sales and marketing expenses for the three months ended July 31, 2010 was primarily due to increases of $2.3 million in increases sales commissions due to increased revenues, $1.3 million in salaries and employee benefits due to additional headcount, $0.8 million in sales travel and expense, $0.4 million in stock-based compensation expense and $0.3 million in marketing programs primarily related to our TwinFin appliance.

Sales and marketing expenses increased $9.7 million, or 32%, to $40.1 million for the six months ended July 31, 2010 from $30.4 million for the six months ended July 31, 2009. The increase in sales and marketing expenses for the six months ended July 31, 2010 was primarily due to increases of $3.3 million in increases sales commissions due to increased revenues, $2.8 million in salaries and employee benefits due to additional headcount, $1.3 million in sales travel and expense, $1.0 million in marketing programs primarily related to our TwinFin appliance, $0.8 million in office costs and shared overhead and fringe costs and $0.6 million in stock-based compensation expense.

As a percentage of revenue, sales and marketing expenses were 33% and 36% for the three months ended July 31, 2010 and 2009, respectively and 33% and 34% for the six months ended July 31, 2010 and 2009, respectively.

The number of sales and marketing employees increased to 193 at July 31, 2010, from 147 at July 31, 2009, as we continue to expand our sales force to provide better geographic distribution and market penetration.

Research and Development Expenses

Research and development expenses increased $1.7 million, or 18%, to $11.0 million for the three months ended July 31, 2010 from $9.3 million for the three months ended July 31, 2009. The increase in research and development expenses for the three months ended July 31, 2010 was due primarily to increases of $0.4 million due to additional headcount, $0.4 million in consulting costs, $0.3 million in office costs, $0.2 million in shared overhead and fringe costs and $0.2 million in stock-based compensation expense.

Research and development expenses increased $0.9 million, or 4%, to $21.8 million for the six months ended July 31, 2010 from $20.9 million for the six months ended July 31, 2009. The increase in research and development expenses for the six months ended July 31, 2010 was due primarily to a increases of $1.2 million due to additional headcount, $0.8 million in shared overhead and fringe costs, $0.7 million in consulting costs, $0.4 million in office costs and $0.4 million in stock-based compensation expense, partially offset by a decrease of $2.5 million in prototype expense primarily due to expenditures in the six months ended July 30, 2009 related to product development of our TwinFin appliance.

As a percentage of revenue, research and development expenses were 17% and 21% for the three months ended July 31, 2010 and 2009, respectively and 18% and 23% for the six months ended July 31, 2010 and 2009, respectively.

The number of research and development employees increased to 172 at July 31, 2010 from 156 at July 31, 2009. The development team from our contract engineering firm in India also increased to 77 at July 31, 2010 from 72 at July 31, 2009, in order to take advantage of the cost efficiencies associated with offshore research and development resources.

General and Administrative Expenses

General and administrative expenses increased $0.4 million, or 11%, to $4.4 million for the three months ended July 31, 2010 from $4.0 million for the three months ended July 31, 2009. The increase in general and administrative expenses for the three months ended July 31, 2010 was due primarily to increases of $0.4 million in salaries and employee benefits and $0.3 million in stock-based compensation expense, partially offset by decreases of $0.2 million in shared overhead and fringe costs.

General and administrative expenses increased $1.0 million, or 13%, to $9.0 million for the six months ended July 31, 2010 from $8.0 million for the six months ended July 31, 2009. The increase in general and administrative expenses for the six months ended July 31, 2010 was due primarily to increases of $0.9 million in salaries and employee benefits, $0.5 million in office rent and office costs and $0.5 million in stock-based compensation expense, partially offset by decreases of $1.0 million in shared overhead and fringe costs.

As a percentage of revenue, general and administrative expenses were 7% and 9% for the three months ended July 31, 2010 and 2009, respectively and 7% and 9% for the six months ended July 31, 2010 and 2009, respectively.

The number of general and administrative employees was 34 at July 31, 2010 and 32 at July 31, 2009, and may change from time to time to ensure that we have appropriate infrastructure to support the growth of our organization and to support the demands of public company compliance.

Interest Income (Expense), Net

We recorded approximately $243,000 of interest income, net, for the three months ended July 31, 2010 as compared to $172,000 for the three months ended July 31, 2009. Interest income, net, for the three months ended July 31, 2010 was comprised of interest income of $243,000. Interest income, net, for the three months ended July 31, 2009 was comprised of interest income of $197,000 and interest expense of approximately $25,000.

We recorded approximately $529,000 of interest income, net, for the six months ended July 31, 2010 as compared to $457,000 for the six months ended July 31, 2009. Interest income, net, for the six months ended July 31, 2010 was comprised of interest income of $529,000. Interest income, net, for the six months ended July 31, 2009 was comprised of interest income of $507,000 and interest expense of approximately $50,000.

Other Income (Expense), Net

We incurred other expense, net, of approximately $87,000 for the three months ended July 31, 2010 as compared to other income, net, of approximately $247,000 for the three months ended July 31, 2009. The components of other expense, net, for the three months ended July 31, 2010 were a loss on the change in fair value of our auction rate security put right, gains on trading securities, transaction losses for activities in our foreign subsidiaries and losses associated with changes in the fair value of foreign currency forward contracts. The components of other income, net in the three months ended July 31, 2009 were a gain on bargain purchase resulting from an acquisition, a gain on the change in fair value of our auction rate security put right, losses on trading securities, transaction losses for activities in our foreign subsidiaries and losses associated with changes in the fair value of foreign currency forward contracts.

We incurred other expense, net, of approximately $133,000 for the six months ended July 31, 2010 as compared to other income, net, of approximately $378,000 for the six months ended July 31, 2009. The components of other expense, net, for the six months ended July 31, 2010 were a loss on the change in fair value of our auction rate security put right, gains on trading securities, transaction losses for activities in our foreign subsidiaries and losses associated with changes in the fair value of foreign currency forward contracts. The components of other income, net in the six months ended July 31, 2009 were a gain on bargain purchase resulting from an acquisition, gains on trading securities, transactions gains for activities in our foreign subsidiaries, gains associated with changes in the fair value of foreign currency forward contracts and a loss on the change in fair value of our auction rate security put right.

Provision for Income Taxes

We recorded an income tax expense of approximately $1.9 million and approximately $80,000 for the three months ended July 31, 2010 and 2009, respectively. We recorded an income tax expense of approximately $3.4 million and approximately $9,000 for the six months ended July 31, 2010 and 2009, respectively.

Our effective income tax rate was 38% and 10% for the three months ended July 31, 2010 and 2009, respectively. Our effective income tax rate is based upon the estimated income for the year, the estimated composition of the income in different jurisdictions and adjustments, if any, in the applicable quarterly periods for potential tax consequences, benefits, resolution of tax audits or other tax contingencies. For the three months ended July 31, 2010, the effective income tax rate was greater than the U.S. federal statutory tax rate of 35%, primarily due to the effects of accounting for stock-based compensation and state taxes, as well as the offsetting effects of the federal manufacturers deduction and the utilization of state tax credits. For the three months ended July 31, 2009, the effective income tax rate was less than the U.S. federal statutory tax rate of 35%, primarily due to the utilization of federal tax credits and the effects of purchase accounting from our acquisition of Tizor Systems, Inc., as well as the offsetting effects of accounting for stock-based compensation and state taxes.

Our effective income tax rate was 36% and 2% for the six months ended July 31, 2010 and 2009, respectively. Our effective income tax rate is based upon the estimated income for the year, the estimated composition of the income in different jurisdictions and adjustments, if any, in the applicable quarterly periods for potential tax consequences, benefits, resolution of tax audits or other tax contingencies. For the six months ended July 31, 2010, the effective income tax rate was greater than the U.S. federal statutory tax rate of 35%, primarily due to the effects of accounting for stock-based compensation and state taxes, as well as the offsetting effects of the federal manufacturers deduction and the utilization of state tax credits. For the six months ended July 31, 2009, the effective income tax rate was less than the U.S. federal statutory tax rate of 35%, primarily due to the utilization of federal tax credits and the effects of purchase accounting from our acquisition of Tizor Systems, Inc., as well as the offsetting effects of accounting for stock-based compensation and state taxes.

Non-GAAP Net Income and Non-GAAP Net Income per Share

Non-GAAP net income and non-GAAP net income per share are alternative views of our performance used by management that we are providing because management believes this information enhances investors understanding of our results and is used by us in public communications. We believe that these non-GAAP financial

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measures, when taken together with the corresponding GAAP financial measures, provide meaningful supplemental information regarding our performance by excluding certain non-cash items that may not be indicative of our core business or future outlook. The presentation of these non-GAAP measures is not intended to be considered in isolation from, as a substitute for, or superior to, the financial information prepared and presented in accordance with GAAP, and may be different from non-GAAP measures used by other companies. In addition, these non-GAAP measures have limitations in that they do not reflect all of the amounts associated with our results of operations as determined in accordance with GAAP.

The non-GAAP financial measures presented by us exclude non-cash stock-based compensation, amortization of acquired intangible assets, gain on bargain purchase and the related income tax effect of excluding these expenses. Because of the varying valuation methodologies and assumptions that companies use to measure stock-based compensation expense, we believe that excluding non-cash stock-based compensation allows investors to analyze our recurring business over multiple periods and provide more meaningful comparisons with other companies. Because the amount of amortization of acquired intangible assets varies in amount and frequency and is significantly affected by the timing and size of our acquisitions, we believe that excluding amortization of acquired intangible assets allows investors to analyze our recurring business over multiple periods. The gain on bargain purchase in the three months ended July 31, 2009 resulted from the value of identifiable net assets acquired exceeding the value of the purchase consideration transferred for our acquisition of Tizor Systems, Inc. Since we had no gain on bargain purchase in any other periods and due to the one-time nature of this charge, we are presenting our operating results without this gain to allow for a more meaningful comparison of current periods to prior year periods**.**

A reconciliation between GAAP financial measures and non-GAAP financial measures is as follows (in thousands except per share data):

	Three Months Ended July 31,		**Six Months Ended July 31,**	
	2010	**2009**	**2010**	**2009**
Net income as reported under GAAP	$ 3,184	$ 730	$ 5,856	$ 493
Adjustments to GAAP net income:				
Non-cash employee stock based compensation	3,429	2,447	6,408	4,682
Amortization of acquired intangible assets	235	269	495	500
Gain on bargain purchase (1)		(365)		(365)
Income tax effect (2)	(1,056)	(803)	(2,108)	(1,465)
Non-GAAP net income	$ 5,792	$ 2,278	$ 10,651	$ 3,845
Net income per share as reported under GAAP diluted	$ 0.05	$ 0.01	$ 0.09	$ 0.01
Net income per share impact of excluded items	0.04	0.03	0.07	0.05
Non-GAAP net income per share diluted	$ 0.09	$ 0.04	$ 0.16	$ 0.06

(1) Represents gain on bargain purchase resulting from the value of identifiable net assets acquired

exceeding the value of the purchase price for our acquisition of Tizor Systems, Inc.

(2) Income tax effect of excluding stock-based compensation and amortization of acquired intangible assets. The method used to determine this adjustment was to calculate the tax provision excluding these charges as compared to the tax provision including these charges. For the three and six months ended July 31, 2009, the total income tax effect is reported with the tax benefit adjustment (see footnote 1 above).

Liquidity and Capital Resources

As of July 31, 2010, our principal sources of liquidity were cash and cash equivalents of $66.6 million, short-term investments in U.S. treasury and government agency securities of $69.8 million and accounts receivable of $32.4 million.

Since our inception, we have funded our operations using a combination of issuances of convertible preferred stock, which provided us with aggregate net proceeds of $73.3 million, cash collections from customers and a term loan credit facility and a revolving credit facility with Silicon Valley Bank. In July 2007, we raised $113.0 million of proceeds, net of underwriting discounts and expenses, in our initial public offering. In the future, we anticipate that our primary sources of liquidity will be cash generated from our operating activities.

Our principal uses of cash historically have consisted of payroll and other operating expenses, repayments of borrowings, our acquisition of NuTech Solutions, Inc. in May 2008 and Tizor Systems, Inc. in February 2009, purchases of property and equipment primarily to support the development of new products, and purchases of inventory to support our sales and the volume of evaluation units located at customer locations that enable our customers and prospective customers to test our equipment prior to purchasing.

At July 31, 2010, we held auction rate securities, or ARS, with a par value totalling $30.1 million. These ARS, most of which are AAA-rated bonds collateralized by federally guaranteed student loans, are long-term variable rate bonds tied to short-term interest rates that are reset through a Dutch auction process that typically occurs every 7 to 35 days. Historically, the carrying value (par value) of the ARS approximated fair market value due to the resetting of variable interest rates. Beginning in late February 2008, however, the auctions for ARS then held by us were unsuccessful. As a result, the interest rates on the investments reset to the maximum rate per the applicable investment offering statements. On November 7, 2008, we accepted an offer from UBS AG (UBS), one of our brokers, which provided us with rights (the Put Right) to sell UBS $15.8 million of its ARS investments at par, which were purchased through UBS, at any time during a two-year period beginning June 30, 2010. During the three months ended July 31, 2010, we exercised the Put Right and liquidated our existing ARS positions with UBS at par. We will not be able to liquidate the remaining $30.1 million of ARS held with other brokers until a future auction on these investments is successful, a buyer is found outside the auction process, the securities are called or refinanced by the issuer, or the securities mature. In light of these liquidity issues, we performed a discounted cash flow analysis to determine the estimated fair value of these ARS investments. The discounted cash flow analysis we performed considered the timing of expected future successful auctions, the impact of extended periods of maximum interest rates, collateralization of underlying security investments and the creditworthiness of the issuer. The discounted cash flow analysis performed as of July 31, 2010 assumes a weighted average discount rate of 1.4% and an expected term of three years. The discount rate was determined using a proxy based upon the current market rates for similar debt offerings within the AAA-rated ARS market. The expected term was based on management s estimate of future liquidity. As a result, as of July 31, 2010, we have estimated an aggregate loss of $0.9 million, which was related to the impairment of ARS deemed to be temporary and included in accumulated other comprehensive loss within stockholders equity.

The following table shows our cash flows from operating activities, investing activities and financing activities for the stated periods:

	Six Months Ended July 31,	
	2010	2009
	(in thousands)	
Net cash provided by (used in) operating activities	$ 22,696	$ (943)
Net cash used in investing activities	(1,223)	(2,174)
Net cash provided by financing activities	4,577	784

Cash Provided by (Used in) Operating Activities

Net cash provided by operating activities was $22.7 million for the six months ended July 31, 2010 and primarily consisted of net income of $5.9 million, a decrease in accounts receivable of $21.1 million, primarily due to the timing and billing and collections of customer invoices, and an increase in accrued expenses of $4.3 million. These increases were partially offset by a decrease in accounts payable of $6.2 million, an increase in other assets of $5.2 million, an increase in inventory of $4.6 million, due to increased production of TwinFin inventory,

and a decrease in deferred revenue of $1.9 million. In addition, for the six months ended July 31, 2010, we had stock-based compensation expense of $6.4 million and depreciation and amortization expense of $3.1 million, each of which is a non-cash expense.

Net cash used in operating activities was $0.9 million for the six months ended July 31, 2009 and primarily consisted of a decrease in deferred revenues of $9.3 million, a decrease in accounts payable of $2.7 million, a decrease in accrued expenses of $1.3 million and a decrease in accrued compensation and benefits of $0.8 million. These uses of cash were partially offset by a decrease in accounts receivable of $3.1 million, primarily due to the timing of billing and collections of customer invoices, and a decrease in other assets of $1.6 million. In addition, for the six months ended July 31, 2009, we had stock-based compensation expense of $4.7 million and depreciation and amortization expense of $3.6 million, each of which is a non-cash expense.

Cash Used in Investing Activities

Net cash used in investing activities was $1.2 million for the six months ended July 31, 2010, comprised primarily of purchases of short-term and long-term U.S. treasury and government agency securities of $73.2 million and $3.9 million of capital expenditures related primarily to new product development. These uses of cash were partially offset by $75.7 million of sales and maturities of our investments.

Net cash used in investing activities was $2.2 million for the six months ended July 31, 2009, comprised primarily of $2.0 million, net of cash acquired, used to acquire Tizor, and $1.8 million of capital expenditures related primarily to new product development. These uses of cash were partially offset by $1.7 million of sales and maturities of our investments.

Cash Provided by Financing Activities

Net cash provided by financing activities was $4.6 million and $0.8 million for the six months ended July 31, 2010 and 2009, respectively, each of which consisted of proceeds received from the issuance of common stock upon the exercise of stock options.

Contractual Obligations

The following is a summary of our contractual obligations as of July 31, 2010:

Contractual obligations	Total	Less than 1 year	1 - 3 Years	3 - 5 Years	More Than 5 Years
			(in thousands)		
Operating lease obligations	$ 22,533	$ 2,149	$ 7,152	$ 5,105	$ 8,127
Purchase obligations (1)	13,879	13,879			

(1) Purchase obligations primarily represent the value of purchase orders issued to our contract manufacturers for the procurement of assembled appliance systems for the next three months.

The table above does not reflect unrecognized tax benefits of $4.6 million, the timing of which is uncertain.

We believe that our cash and cash equivalents of $66.6 million and our short-term marketable securities of $69.8 million, both as of July 31, 2010, will be sufficient to fund our projected operating requirements for at least the next twelve months. Our future operating requirements will depend on many factors, including the rate of revenue growth and the expansion of our sales and marketing and product development activities. However, to the extent that our cash and cash equivalents and our cash flow from operating activities are insufficient to fund our future activities, we may need to raise additional funds through bank credit arrangements or a secondary public offering.

Off-Balance Sheet Arrangements

We did not have during the periods presented, and we do not currently have, any off-balance sheet arrangements, as defined under SEC rules. Examples of off-balance sheet arrangements include relationships with unconsolidated

entities or financial partnerships, which are often referred to as structured finance or special purpose entities, established for the purpose of facilitating financing transactions that do not have to be reflected on our balance sheet.

Recent Accounting Pronouncements

In January 2010, the FASB issued an update requiring reporting entities to provide new disclosures, and clarifications of currently required disclosures related to fair value measurements. The new disclosures require reporting entities to disclose separately the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurements and describe the reasons for the transfers. Additionally, in the Level 3 reconciliations, a reporting entity should present separately information about purchases, sales, issuances and settlements. The update also clarifies that a reporting entity needs to use judgment in determining the appropriate classes of assets and liabilities, and should provide disclosures about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements in Level 2 and Level 3. The new disclosures and clarifications of existing disclosures are effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances, and settlements in the rollforward of activity in Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. This new guidance only requires additional disclosures and will not have a material impact on our consolidated financial statements.

In October 2009, the FASB issued an accounting standard for multiple-deliverable revenue arrangements, which amends previously issued guidance to require that an entity use an estimated selling price when VSOE or acceptable third-party evidence does not exist for any products or services included in a multiple element arrangement. The arrangement consideration should be allocated among the products and services based upon their relative selling prices, thus eliminating the use of the residual method of allocation. This standard also requires expanded qualitative and quantitative disclosures regarding significant judgments made and changes made to revenue recognition policies in applying this guidance. This standard is effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. Early adoption and retrospective application are also permitted. We adopted the guidance beginning February 1, 2010, as described in *Revenue Recognition* above.

In October 2009, the FASB issued an accounting standard for certain revenue arrangements that include software elements. This standard amends previously issued guidance to exclude tangible products containing software components and non-software components that function together to deliver the product s essential functionality. Entities that sell joint hardware and software products that meet this exception will be required to follow the guidance for multiple-deliverable revenue arrangements. This standard is effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. Early adoption and retrospective application are also permitted. We adopted the guidance beginning February 1, 2010, as described in *Revenue Recognition* above.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Foreign Currency Risk

Our international sales and marketing operations incur expenses that are denominated in foreign currencies. These expenses could be materially affected by currency fluctuations. Our exposures are to fluctuations in exchange rates for the U.S. dollar versus the British pound, Australian dollar, the euro, the Canadian dollar, the Polish zloty, the Korean won and the Japanese yen. Changes in currency exchange rates could adversely affect our consolidated results of operations or financial position. Additionally, our international sales and marketing operations maintain cash balances denominated in foreign currencies. In order to decrease the inherent risk associated with translation of foreign cash balances into our reporting currency, we have not maintained excess cash balances in foreign currencies. As of July 31, 2010, we had $11.3 million of cash in foreign accounts. We enter into derivative transactions, specifically foreign currency forward contracts, to manage our exposure to fluctuations in foreign exchange rates that arise, primarily from our foreign currency-denominated receivables and payables. The contracts

are in British pounds, Australian dollars, Japanese yen and euros, typically have maturities of one month and require an exchange of foreign currencies for U.S. dollars at maturity of the contracts at rates agreed to at inception of the contracts. We do not enter into or hold derivatives for trading or speculative purposes. Generally, we do not designate foreign currency forward contracts as hedges for accounting purposes, and changes in the fair value of these instruments are recognized immediately in current earnings. Because we enter into forward contracts only as an economic hedge, any gain or loss on the underlying foreign-denominated balance would be offset by the loss or gain on the forward contract. Gains and losses on forward contracts and foreign denominated receivables and payables are included in other income (expense), net.

At July 31, 2010, we had outstanding foreign currency forward contracts with an aggregate notional value of $19.2 million, denominated in British pounds, Australian dollars, euros and Japanese yen. The mark-to-market effect associated with these contracts was a net unrealized loss of approximately $241,000 at July 31, 2010. Net realized gains and losses associated with exchange rate fluctuations on forward contracts and the underlying foreign currency exposure being hedged were immaterial for all periods presented.

Interest Rate Risk

We had an unrestricted cash and cash equivalents balance of $66.6 million at July 31, 2010, which was held for working capital purposes. We do not enter into investments for trading or speculative purposes. We do not believe that we have any material exposure to changes in the fair value of these investments as a result of changes in interest rates. Declines in interest rates, however, will reduce future investment income and an increase in rates will increase investment income.

Our exposure to market risk for changes in interest rates relates primarily to our investment portfolio. We place our investments with high quality issuers and, by policy, limit the amount of risk by investing primarily in money market funds, high-quality corporate obligations and certificates of deposit.

At July 31, 2010, we held ARS with a par value of $30.1 million that had experienced failed auctions, which has prevented us from liquidating those investments. As a result, we have classified these investments as long-term assets in our consolidated balance sheet as of July 31, 2010. We have recorded a gross unrealized loss of $0.9 million related to impairment of our entire ARS position. See Note 3 to the accompanying financial statements for a description of how we value these ARS. Our valuation of the ARS is sensitive to market conditions and management s judgment and could change significantly based on the assumptions used. If we had used an expected term of one year or five years and a discount rate of 1.2% and 2.3% respectively, the gross unrealized loss would have been $0.3 million or $2.3 million, respectively. If we had used an expected term of three years and a discount rate of 1.2% or 2.3%, the gross unrealized loss would have been $0.8 million or $1.6 million, respectively. If we had used an expected term of three years and illiquidity discounts of 1.0% or 2.0%, the gross unrealized loss would have been $0.5 million or $1.3 million, respectively. Based on our ability to access our cash and short-term investments and our expected cash flows, we do not anticipate the current lack of liquidity on these ARS to have a material impact on our ability to operate our business

Item 4. Controls and Procedures

Our management, with the participation of our chief executive officer and chief financial officer, evaluated the effectiveness of our disclosure controls and procedures as of July 31, 2010. The term disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, or the Exchange Act, means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company s management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on the evaluation of our disclosure

controls and procedures as of July 31, 2010, our chief executive officer and chief financial officer

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concluded that, as of such date, our disclosure controls and procedures were effective at the reasonable assurance level.

No change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) occurred during the three months ended July 31, 2010 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1A. Risk Factors

There are risks and uncertainties that could cause our actual results to differ materially from the results contemplated by the forward-looking statements contained in this Quarterly Report on Form 10-Q. Because of the these factors, as well as other variables affecting our operating results, past financial performance should not be considered as a reliable indicator of future performance and investors should not use historical trends to anticipate results or trends in future periods. These risks are not the only ones facing us. Please also see Cautionary Statement in Part I, Item 2 of this Quarterly Report on Form 10-Q. The following discussion highlights certain risks which may affect future operating results. These are the risks and uncertainties we believe are most important for our existing and potential stockholders to consider. These risk factors have been updated from those in our Annual Report on Form 10-K, to, among other things, update the risk factor related to our future interpretations of existing accounting standards. Additional risks and uncertainties not presently known to us, which we currently deem immaterial or which are similar to those faced by other companies in our industry or business in general, may also impair our business operations. If any of the following risks or uncertainties actually occurs, our business, financial condition and operating results would likely suffer.

Risks Related to Our Business and Industry

Adverse changes in economic conditions and reduced information technology spending may continue to negatively impact our business.

Our business depends on the overall demand for information technology and on the economic health of our current and prospective customers and the geographic regions in which we operate. In addition, the purchase of our products is often discretionary and may involve a significant commitment of capital and other resources. Over the past two fiscal years, there was a significant deterioration in economic conditions in many of the countries and regions in which we do business. Although there has recently been improvement in these economic conditions, they have caused some of our current or prospective customers to reduce their information technology spending, causing them to modify, delay or cancel plans to purchase our products. If our customers continue to reduce their information technology spending, or otherwise modify, delay or cancel plans to purchase our products, our operating results will be adversely affected.

Our operating results may fluctuate significantly from quarter to quarter and may fall below expectations in any particular fiscal quarter, which could adversely affect the market price of our common stock.

Our operating results are difficult to predict and may fluctuate from quarter to quarter due to a variety of factors, many of which are outside of our control. As a result, comparing our operating results on a period-to-period basis may not be meaningful, and you should not rely on our past results as an indication of our future performance. If our revenue or operating results fall below the expectations of investors or any securities analysts that follow our company in any period, the price of our common stock would likely decline.

In addition to other risk factors listed in this Risk Factors section, factors that may cause our operating results to fluctuate include:

- the impact of the recent economic downturn on customer purchases;
- the impact of new competitors or new competitive offerings;
- the typical recording of a significant portion of our quarterly sales in the final month of the quarter, whereby small delays in completion of sales transactions could have a significant impact on our operating results for that quarter;

the relatively high average selling price of our products and our dependence on a limited number of customers for a substantial portion of our revenue in any quarterly period, whereby the loss of or delay in a customer order could significantly reduce our revenue for that quarter;

the possibility of seasonality in demand for our products;

the addition of new customers or the loss of existing customers;

the rates at which customers purchase additional products or additional capacity for existing products from us;

changes in the mix of products and services sold;

the rates at which customers renew their maintenance and support contracts with us;

our ability to develop and introduce new products and to enhance our existing products with new and better functionality that meet customer requirements;

the timing of recognizing revenue as a result of revenue recognition rules, including due to the timing of delivery and receipt of our products;

the length of our product sales cycle;

the productivity and growth of our sales force;

service interruptions with any of our single source suppliers or manufacturing partners;

changes in pricing by us or our competitors, or the decision to provide discounts to win business;

the timing of our product releases or upgrades or similar announcements by us or our competitors;

the timing of investments in research and development related to new product releases or upgrades;

our ability to control costs, including operating expenses and the costs of the components used in our products;

volatility in our stock price, which may lead to higher stock compensation expenses;

future accounting pronouncements and changes in accounting policies;

costs related to the acquisition and integration of companies, assets or technologies;

technology and intellectual property issues associated with our products; and

general economic trends, including changes in information technology spending or geopolitical events such as war or incidents of terrorism.

Most of our operating expenses do not vary directly with revenue and are difficult to adjust in the short term. As a result, if revenue for a particular quarter is below our expectations, we could not proportionately reduce operating expenses for that quarter, and therefore this revenue shortfall would have a disproportionate effect on our expected operating results for that quarter.

Our limited operating history and the rapid development of the data warehouse market make it difficult to evaluate our current business and future prospects, and may increase the risk of your investment.

Our company has only been in existence since August 2000. We first began shipping products in February 2003 and much of our growth has occurred in the past several fiscal years. Our limited operating history and the rapid development of the data warehouse market in which we operate makes it difficult to evaluate our current business and our future prospects. As a result, we cannot be certain that we will sustain our growth or maintain profitability. We will encounter risks and difficulties frequently experienced by early-stage companies in rapidly-evolving industries. These risks include the need to:

- attract new customers and maintain current customer relationships;
- continue to develop and upgrade our data warehouse solutions;
- respond quickly and effectively to competitive pressures;
- offer competitive pricing or provide discounts to customers in order to win business;
- manage our expanding operations, including internationally;
- maintain adequate control over our expenses;
- maintain adequate internal controls and procedures;
- maintain our reputation, build trust with our customers and further establish our brand; and
- identify, attract, retain and motivate qualified personnel.

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If we fail to successfully address these needs, our business, operating results and financial condition may be adversely affected.

We have a limited history of profitability and we may not maintain profitability in the future.

We have been profitable for the last three fiscal years, generating net income of $4.2 million in fiscal 2010, $31.5 million in fiscal 2009 and $2.0 million in fiscal 2008, but we had not been profitable in any prior fiscal period. As of July 31, 2010, our accumulated deficit was $37.6 million. We expect to make significant additional expenditures to facilitate the expansion of our business, including expenditures in the areas of sales, research and development, and customer service and support. Furthermore, we may encounter unforeseen issues that require us to incur additional costs. As a result of these increased expenditures, we will have to generate and sustain increased revenue to maintain profitability. Accordingly, we may not be able to maintain profitability and we may incur significant losses in the future.

We depend on a single product family, our data warehouse appliance family, for nearly all of our revenue, so we are particularly vulnerable to any factors adversely affecting the sale of that product family.

Nearly all of our revenue is derived from sales and service of our data warehouse appliance product family, and we expect that this product family will account for substantially all of our revenue for the foreseeable future. If the data warehouse market declines or our data warehouse appliance products fail to maintain or achieve greater market acceptance, we will not be able to grow our revenues sufficiently to maintain profitability.

If our new data warehouse appliance, the TwinFin appliance, does not achieve widespread market acceptance, our operating results will suffer.

In August 2009, we announced the general availability of our next generation TwinFin appliance, which is the first in a family of new blade server-based appliances. We expect that sales of our new family of blade server-based data warehouse appliances, of which the TwinFin appliance is the first member, will generate the substantial majority of our anticipated product revenues in fiscal 2011. Our future sales and operating results will depend, to a significant extent, on the successful deployment and marketing of the TwinFin appliance. In order to achieve market penetration for the TwinFin appliance, we may be required to incur additional expenses in marketing and sales in advance of the realization of expected sales. There can be no assurance that the TwinFin appliance will achieve widespread acceptance in the market. If we incur delays in the manufacture and shipment of the TwinFin appliance or customer testing and verification takes longer than anticipated, or the TwinFin appliance does not achieve our planned levels of sales or the TwinFin appliance does not achieve performance specifications, our operating results will suffer and our competitive position could be impaired.

If we lose key personnel, or if we are unable to attract and retain highly-qualified personnel on a cost-effective basis, it will be more difficult for us to manage our business and to identify and pursue growth opportunities.

Our success depends substantially on the performance of our key senior management, technical, and sales and marketing personnel. Each of our employees may terminate his or her relationship with us at any time and the loss of the services of such persons could have an adverse effect on our business.

There may be departures of our key management personnel from time to time and our continued success will depend on our ability to attract or develop highly qualified managerial personnel and fully integrate them into our business, which may be time-consuming and may result in additional disruptions to our operations. In addition, our success depends in significant part on our ability to develop and enhance our products, which requires talented hardware and software engineers with specialized skills, and on our ability to maintain and grow an effective sales force. We experience intense competition for highly qualified managerial, technical, and sales and marketing personnel and we cannot ensure that we will be able to successfully attract, assimilate, or retain such personnel in the future.

If we are unable to develop and introduce new products and enhancements to existing products, if our new products and enhancements to existing products do not achieve market acceptance, or if we fail to manage product transitions, we may fail to increase, or may lose, market share.

The market for our products is characterized by rapid technological change, frequent new product introductions and evolving industry standards. Our future growth depends on our successful development and introduction of new products, such as our TwinFin appliance, and enhancements to existing products that achieve acceptance in the market. Due to the complexity of our products, which include integrated hardware and software components, any new products and product enhancements would be subject to significant technical risks that could impact our ability to introduce those products and enhancements in a timely manner. In addition, such new products or product enhancements may not achieve market acceptance despite our expending significant resources to develop them. If we are unable, for technological or other reasons, to develop, introduce and enhance our products in a timely manner in response to changing market conditions or evolving customer requirements, or if these new products and product enhancements do not achieve market acceptance due to competitive or other factors, our operating results and financial condition could be adversely affected.

Product introductions and certain enhancements of existing products by us in future periods may also reduce demand for our existing products or could delay purchases by customers awaiting arrival of our new products. As new or enhanced products are introduced, we must successfully manage the transition from older products in order to minimize disruption in customers ordering patterns, avoid excessive levels of older product inventories and ensure that sufficient supplies of new products can be delivered in a timely manner to meet customer demand.

We face intense and growing competition from leading technology companies as well as from emerging companies. Our inability to compete effectively with any or all of these competitors could impact our ability to achieve our anticipated market penetration and achieve or sustain profitability.

The data warehouse market is highly competitive and we expect competition to intensify in the future. This competition may make it more difficult for us to sell our products, and may result in increased pricing pressure, reduced profit margins, increased sales and marketing expenses and failure to increase, or the loss of, market share, any of which would likely seriously harm our business, operating results and financial condition.

Currently, our most significant competition includes companies which typically sell several if not all elements of a data warehouse environment as individual products, including database software, servers, storage and professional services. These competitors are often leaders in many of these segments including EMC, Hewlett-Packard, IBM, Oracle, Sun Microsystems (which was acquired by Oracle in January 2010), Sybase and Teradata. In addition, a large number of fast growing companies have recently entered the market, many of them selling integrated appliance offerings similar to our products. Additionally, as the benefits of an appliance solution have become evident in the marketplace, many of our competitors have also begun to bundle their products into appliance-like offerings that more directly compete with our products. We also expect additional competition in the future from new and existing companies with whom we do not currently compete directly. As our industry evolves, our current and potential competitors may establish cooperative relationships among themselves or with third parties, including software and hardware companies with whom we have partnerships and whose products interoperate with our own, that could acquire significant market share, which could adversely affect our business. We also face competition from internally developed systems. Any of these competitive threats, alone or in combination with others, could seriously harm our business, operating results and financial condition.

Many of our competitors have greater market presence, longer operating histories, stronger name recognition, larger customer bases and significantly greater financial, technical, sales and marketing, manufacturing, distribution and other resources than we have. In addition, many of our competitors have broader product and service offerings than we do. These companies may attempt to use their greater resources to better position themselves in the data warehouse market including by pricing their products at a discount or bundling them with other products and services in an attempt to rapidly gain market share. Moreover, many of our competitors have more extensive customer and partner relationships than we do, and may therefore be in a better position to identify and respond to market developments or changes in customer demands. Potential customers may also prefer to purchase from their existing suppliers rather than a new supplier regardless of product performance or features. We cannot assure you that we will be able to compete successfully against existing or new competitors.

In addition, some of our traditional competitors have introduced their own integrated data warehousing solutions which may cause our sales cycles to be delayed and may have an adverse impact on our business, operating results

and financial condition.

Our success depends on the continued recognition of the need for business intelligence in the marketplace and on the adoption by our customers of data warehouse appliances, often as replacements for existing systems, to enable business intelligence. If we fail to improve our products to further drive this market migration as well as to successfully compete with alternative approaches and products, our business would suffer.

Due to the innovative nature of our products and the new approaches to business intelligence that our products enable, purchases of our products often involve the adoption of new methods of database access and utilization on the part of our customers. This may entail the acknowledgement of the benefits conferred by business intelligence and the customer-wide adoption of business intelligence analysis that makes the benefits of our system particularly relevant. Business intelligence solutions are still in their early stages of growth and their continued adoption and growth in the marketplace remain uncertain. Additionally, our appliance approach requires our customers to run their data warehouses in new and innovative ways and often requires our customers to replace their existing equipment and supplier relationships, which they may be unwilling to do, especially in light of the often critical nature of the components and systems involved and the significant capital and other resources they may have previously invested. Furthermore, purchases of our products involve material changes to established purchasing patterns and policies. Even if prospective customers recognize the need for our products, they may not select our data warehouse appliance solutions because they choose to wait for the introduction of products and technologies that serve as a replacement or substitute for, or represent an improvement over, our data warehouse appliance solutions. Therefore, our future success also depends on our ability to maintain our leadership position in the data warehouse market and to proactively address the needs of the market and our customers to further drive the adoption of business intelligence and to sustain our competitive advantage versus competing approaches to business intelligence and alternate product offerings.

Claims that we infringe or otherwise misuse the intellectual property of others could subject us to significant liability and disrupt our business, which could have a material adverse effect on our business and operating results.

Our competitors protect their intellectual property rights by means such as trade secrets, patents, copyrights and trademarks. We have not conducted an independent review of patents issued to third parties. Third parties have asserted, and may assert in the future, claims that our products infringe patents or patent applications to which we do not hold licenses or other rights. Third parties may own or control these patents and patent applications in the United States and abroad. These third parties have brought, and could in the future bring, claims against us that would cause us to incur substantial expenses and, if successfully asserted against us, could cause us to pay substantial damages. Further, if a patent infringement suit were brought against us, we could be forced to stop or delay manufacturing or sales of the product that is the subject of the suit. In addition, we could be forced to redesign the product that uses any allegedly infringing technology.

On November 20, 2009, we filed a complaint against Intelligent Integration Systems, Inc., a former solutions provider to Netezza that we refer to as IISi, in Superior Court in Suffolk County, Massachusetts. The complaint alleges that IISi breached an agreement with us, as well as breach of implied covenant of good faith and fair dealing, intentional interference with contractual relations and beneficial business relations and violations of the Massachusetts fair business practices act. Our complaint against IISi seeks unspecified monetary damages, a declaration that our termination of our agreement with IISi was in accordance with the terms of that agreement and the return of our property and proprietary information from IISi, costs and attorneys fees. On January 22, 2010, IISi filed an answer and counterclaim in response to our complaint, in which IISi alleges that we breached our contract with IISi, breach of the covenant of good faith and fair dealing, misappropriation of trade secrets, unjust enrichment, business defamation, intentional interference with contractual relations and violations of the Massachusetts fair business practices act. In its counterclaim, IISi seeks unspecified monetary damages, an injunction requiring us to return its trade secrets and proprietary information, costs and attorneys fees. On August 18, 2010, the court issued a partial summary judgment ruling that we had breached our agreement with IISi by terminating the agreement without good cause, but did not rule on damages for such breach or on IISi s remaining counterclaims, such as its allegation that we misappropriated IISi s trade secrets. On September 7, 2010, IISi filed a motion for preliminary injunction seeking, among other things, to prohibit us from marketing, distributing or using products allegedly containing IISi s trade secrets, including our geospatial product and IISi s extended SQL toolkit, or any versions or portions of those products. IISi s motion further

seeks to prohibit us from marketing, distributing or using any products that perform the functions of those products for a period of three years. The parties have not conducted full discovery with respect to IISi s counterclaims and damages for our termination of the agreement have not been determined. We deny that we used trade secrets or proprietary information of IISi and intend to vigorously contest ISSi s motion for preliminary injunction and to vigorously defend ourselves against IISi s remaining counterclaims, to which we continue to believe we have meritorious defenses. However, the continued prosecution of the remaining claims in our lawsuit against IISi, and the defense against IISi s counterclaims, may require significant investment of time and financial resources.

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We may in the future be sued for violations of other parties intellectual property rights, and the risk of such a lawsuit will likely increase as our size and the number and scope of our products increase, as our geographic presence and market share expand and as the number of competitors in our market increases. Any such claims or litigation could:

- be time-consuming and expensive to defend, whether meritorious or not;
- cause shipment delays;
- divert the attention of our technical and managerial resources;
- require us to enter into royalty or licensing agreements with third parties, which may not be available on terms that we deem acceptable, if at all;
- prevent us from operating all or a portion of our business or force us to redesign our products, which could be difficult and expensive and may degrade the performance of our products;
- subject us to significant liability for damages or result in significant settlement payments; and/or
- require us to indemnify our customers, distribution partners or suppliers.

Any of the foregoing could disrupt our business and have a material adverse effect on our operating results and financial condition.

Our products must interoperate with our customers information technology infrastructure, including customers software applications, networks, servers and data-access protocols, and if our products do not do so successfully, we may experience a weakening demand for our products.

To be competitive in the market, our products must interoperate with our customers information technology infrastructure, including software applications, network infrastructure and servers supplied by a variety of other vendors, many of whom are competitors of ours. Our products currently interoperate with a number of business intelligence and data-integration applications provided by vendors including IBM and Oracle, among others. When new or updated versions of these software applications are introduced, we must sometimes develop updated versions of our software that may require assistance from these vendors to ensure that our products effectively interoperate with these applications. If these vendors do not provide us with assistance on a timely basis, or decide not to work with us for competitive or other reasons, including due to consolidation with our competitors, we may be unable to ensure such interoperability. Additionally, our products interoperate with servers, network infrastructure and software applications predominantly through the use of data-access protocols. While many of these protocols are created and maintained by independent standards organizations, some of these protocols that exist today or that may be created in the future are, or could be, proprietary technology and therefore require licensing the proprietary protocol s specifications from a third party or implementing the protocol without specifications. Our development efforts to provide interoperability with our customers information technology infrastructures require substantial capital investment and the devotion of substantial employee resources. We may not accomplish these development efforts quickly, cost-effectively or at all. If we fail for any reason to maintain interoperability, we may experience a weakening in demand for our products, which would adversely affect our business, operating results and financial condition.

If we fail to enhance our brand, our ability to expand our customer base will be impaired and our operating results may suffer.

We believe that developing and maintaining awareness of the Netezza brand is critical to achieving widespread acceptance of our products and is an important element in attracting new customers and shortening our sales cycle. We expect the importance of brand recognition to increase as competition further develops in our market. Successful promotion of our brand will depend largely on the effectiveness of our marketing efforts and our ability to provide customers with reliable and technically sophisticated products at competitive prices. If customers do not perceive our

products and services to be of high value, our brand and reputation could be harmed, which could adversely impact our financial results. Despite our best efforts, our brand promotion efforts may not yield increased revenue sufficient to offset the additional expenses incurred in our brand-building efforts.

We may not receive significant revenues from our current research and development efforts for several years, if at all.

Investment in product development often involves a long payback cycle. We have made and expect to continue making significant investments in research and development and related product opportunities. Accelerated product introductions and short product life cycles require high levels of expenditures for research and development that could adversely affect our operating results if not offset by revenue increases. We believe that we must continue to dedicate a significant amount of resources to our research and development efforts to maintain our competitive position. However, we do not expect to receive significant revenues from these investments for several years, if at all.

Our sales cycles can be long and unpredictable, and our sales efforts require considerable time and expense, which contribute to the unpredictability and variability of our financial performance and may adversely affect our profitability.

The timing of our revenue is difficult to predict as we experience extended sales cycles, due in part to our need to educate our customers about our products and participate in extended product evaluations and the high purchase price of our products. In addition, product purchases are often subject to a variety of customer considerations that may extend the length of our sales cycle, including customers acceptance of our approach to data warehouse management and their willingness to replace their existing solutions and supplier relationships, timing of their budget cycles and approval processes, budget constraints, extended negotiations, and administrative, processing and other delays, including those due to general economic factors. As a result, our sales cycle extends to more than nine months in some cases and it is difficult to predict when or if a sale to a potential customer will occur. Furthermore, the introduction of new products, such as the recent introduction of our TwinFin appliance, may further extend the length of our sales cycle because of additional customer testing, verification and acceptance criteria for the new product. All of these factors can contribute to fluctuations in our quarterly financial performance and increase the likelihood that our operating results in a particular quarter will fall below investor expectations. In addition, the provision of evaluation units to customers may require significant investment in inventory in advance of sales of these units, which sales may not ultimately transpire. If we are unsuccessful in closing sales after expending significant resources, or if we experience delays for any of the reasons discussed above, our future revenues and operating expenses may be materially adversely affected.

Our company has grown rapidly and we may be unable to manage our growth effectively.

Between January 31, 2005 and July 31, 2010, the number of our employees increased from 140 to 469 and our installed base of customers grew from 15 to 373. In addition, during that time period our number of office locations has increased from 3 to 19. We anticipate that further expansion of our organization and operations will be required to achieve our growth targets. Our rapid growth has placed, and is expected to continue to place, a significant strain on our management and operational infrastructure. Our failure to continue to enhance our management personnel and policies and our operational and financial systems and controls in response to our growth could result in operating inefficiencies that could impair our competitive position and would increase our costs more than we had planned. If we are unable to manage our growth effectively, our business, our reputation and our operating results and financial condition will be adversely affected.

Our ability to sell to U.S. federal government agencies is subject to evolving laws and policies that could have a material adverse effect on our growth prospects and operating results, and our contracts with the U.S. federal government may impose requirements that are unfavorable to us.

In the six months ended July 31, 2010 and the fiscal years ended January 31, 2010 and 2009, we derived approximately 3%, 11% and 3%, respectively, of our revenue from sales made by resellers and various integrators to U.S. federal government agencies, and this amount may increase substantially in future periods. The demand for data warehouse products and services by federal government agencies may be affected by laws and policies that might restrict agencies collection, processing, and sharing of certain categories of information. Our ability to profitably sell products to government agencies is also subject to changes in agency funding priorities and contracting procedures and our ability to comply with applicable government regulations and other requirements.

The restrictions on federal government data management include, for example, the Privacy Act, which requires agencies to publicize their collection and use of personal data and implement procedures to provide individuals with

access to that information; the Federal Information Security Management Act, which requires agencies to develop comprehensive data privacy and security measures that may increase the cost of maintaining certain data; and the E-government Act, which requires agencies to conduct privacy assessments before acquiring certain information technology products or services and before initiating the collection of personal information or the aggregation of existing databases of personal information. These restrictions, any future restrictions, and public or political pressure to constrain the government s collection and processing of personal information may adversely affect the government s demand for our products and services and could have a material adverse effect on our growth prospects and operating results.

Federal agency funding for information technology programs is subject to annual appropriations established by Congress and spending plans adopted by individual agencies. Accordingly, government purchasing commitments normally last no longer than one year. The amounts of available funding in any year may be reduced to reflect budgetary constraints, economic conditions, or competing priorities for federal funding. Constraints on federal funding for information technology could harm our ability to sell products to government agencies, causing fluctuations in our revenues from this segment from period to period and resulting in a weakening of our growth prospects, operating results and financial condition.

Our contracts with government agencies may subject us to certain risks and give the government rights and remedies not typically found in commercial contracts, including rights that allow the government to, for example:

- terminate contracts for convenience at any time without cause;
- obtain detailed cost or pricing information;
- receive most favored customer pricing;
- perform routine audits;
- impose equal employment and hiring standards;
- require products to be manufactured in specified countries;
- restrict non-U.S. ownership or investment in our company; and
- pursue administrative, civil or criminal remedies for contractual violations.

Moreover, some of our contracts allow the government to use, or permit others to use, patented inventions that we developed under those contracts, and to place conditions on our right to retain title to such inventions. Likewise, some of our government contracts allow the government to use or disclose software or technical data that we develop or deliver under the contract without constraining subsequent uses of those data. Third parties authorized by the government to use our patents, software and technical data may emerge as alternative sources for the products and services we offer to the government and may enable the government to negotiate lower prices for our products and services. If we fail to assert available protections for our patents, software, and technical data, our ability to control the use of our intellectual property may be compromised, which may benefit our competitors, reduce the prices we can obtain for our products and services, and harm our financial condition.

Our international operations are subject to additional risks that we do not face in the United States, which could have an adverse effect on our operating results.

In the six months ended July 31, 2010 and the fiscal years ended January 31, 2010 and 2009, we derived approximately 22%, 20% and 26%, respectively, of our revenue from customers based outside the United States, and we currently have sales personnel in ten different foreign countries. We expect our revenue and operations outside the United States will expand in the future. Our international operations are subject to a variety of risks that we do not face in the United States, including:

difficulties in staffing and managing our foreign offices and the increased travel, infrastructure and legal and compliance costs associated with multiple international locations;

general economic conditions in the countries in which we operate, including seasonal reductions in business activity in the summer months in Europe, during Lunar New Year in parts of Asia and in other periods in various individual countries;

longer payment cycles for sales in foreign countries and difficulties in enforcing contracts and collecting accounts receivable;

additional withholding taxes or other taxes on our foreign income, and tariffs or other restrictions on foreign trade or investment;

- imposition of, or unexpected adverse changes in, foreign laws or regulatory requirements, many of which differ from those in the United States;
- increased length of time for shipping and acceptance of our products;
- difficulties in repatriating overseas earnings;
- increased exposure to foreign currency exchange rate risk;
- tariffs and trade barriers, import/export controls, and other regulatory or contractual limitations on our ability to sell or develop our products in certain foreign markets;
- reduced protection for intellectual property rights in some countries;
- costs and delays associated with developing products in multiple languages; and
- political unrest, war, incidents of terrorism, or responses to such events.

Our overall success in international markets depends, in part, on our ability to succeed in differing legal, regulatory, economic, social and political conditions. We may not be successful in developing and implementing policies and strategies that will be effective in managing these risks in each country where we do business. Our failure to manage these risks successfully could harm our international operations, reduce our international sales and increase our costs, thus adversely affecting our business, operating results and financial condition.

Our future revenue growth will depend in part on our ability to further develop our indirect sales channel, and our inability to effectively do so will impair our ability to grow our revenues.

Our future revenue growth will depend in part on the continued development of our indirect sales channel to complement our direct sales force. Our indirect sales channel includes resellers, systems integration firms and analytic service providers. In the six months ended July 31, 2010 and the fiscal years ended January 31, 2010 and 2009, we derived approximately 12%, 14% and 21%, respectively, of our revenue from our indirect sales channel. We plan to continue to invest in our indirect sales channel by expanding upon and developing new relationships with resellers, systems integration firms and analytic service providers. While the development of our indirect sales channel is a priority for us, we cannot predict the extent to which we will be able to attract and retain financially stable, motivated indirect channel partners. Additionally, due in part to the complexity and innovative nature of our products, our channel partners may not be successful in marketing and selling our products. Our indirect sales channel may be adversely affected by disruptions in relationships between our channel partners and their customers, as well as by competition between our channel partners or between our channel partners and our direct sales force. In addition our reputation could suffer as a result of the conduct and manner of marketing and sales by our channel partners. Our agreements with our channel partners are generally not exclusive and may be terminated without cause. If we fail to effectively develop and manage our indirect channel for any of these reasons, we may have difficulty attaining our growth targets.

Our ability to sell our products and retain customers is highly dependent on the quality of our maintenance and support services offerings, and our failure to offer high-quality maintenance and support could have a material adverse effect on our operating results.

Most of our customers purchase maintenance and support services from us, which represents a significant portion of our revenue (approximately 26% of our revenue in the six months ended July 31, 2010, 30% of our revenue in the fiscal year ended January 31, 2010 and 24% of our revenue in the fiscal year ended January 31, 2009). Customer satisfaction with our maintenance and support services is critical for the successful marketing and sale of our products and the success of our business. In addition to our support staff and installation and technical account management teams, we have developed service relationships with third parties to provide on-site hardware service to our customers. Although we believe these third parties and any other third-party service provider we utilize in the future will offer a high level of service consistent with our internal customer support services, we cannot assure you that they

will continue to devote the resources necessary to provide our customers with effective technical support. In addition, if we are unable to renew our service agreements with these third parties we utilize in the future or such agreements are terminated, we may be unable to establish alternative relationships on a timely basis or on terms acceptable to us, if at all. If we or our service partners are unable to provide effective maintenance and support services, it could adversely affect our ability to sell our products and harm our reputation with current and potential customers.

Our products are highly technical and may contain undetected software or hardware defects, which could cause data unavailability, loss or corruption that might result in liability to our customers and harm to our reputation and business.

Our products are highly technical and complex and are often used to store and manage data critical to our customers business operations. Our products may contain undetected errors, defects or security vulnerabilities that could result in data unavailability, loss or corruption or other harm to our customers. Some errors in our products may only be discovered after the products have been installed and used by customers. Any errors, defects or security vulnerabilities discovered in our products after commercial release or that are caused by another vendor s products with which we interoperate but are nevertheless attributed to us by our customers, as well as any computer virus or human error on the part of our customer support or other personnel, that result in a customer s data being misappropriated, unavailable, lost or corrupted could have significant adverse consequences, including:

- loss of customers;
- negative publicity and damage to our reputation;
- diversion of our engineering, customer service and other resources;
- increased service and warranty costs; and
- loss or delay in revenue or market acceptance of our products.

Any of these events could adversely affect our business, operating results and financial condition. In addition, there is a possibility that we could face claims for product liability, tort or breach of warranty, including claims from both our customers and our distribution partners. The cost of defending such a lawsuit, regardless of its merit, could be substantial and could divert management s attention from ongoing operations of the company. In addition, if our business liability insurance coverage proves inadequate with respect to a claim or future coverage is unavailable on acceptable terms or at all we may be liable for payment of substantial damages. Any or all of these potential consequences could have an adverse impact on our operating results and financial condition.

It is difficult to predict our future capital needs and we may be unable to obtain additional financing that we may need, which could have a material adverse effect on our business, operating results and financial condition.

We believe that our current balance of cash, cash equivalents and investments, together with cash expected to be generated from operations, will be sufficient to fund our projected operating requirements, including anticipated capital expenditures, for at least the next twelve months. However, we may need to raise additional funds if we are presented with unforeseen circumstances or opportunities in order to, among other things:

- develop or enhance our products;
- support additional capital expenditures;
- respond to competitive pressures;
- fund operating losses in future periods; or
- take advantage of acquisition or expansion opportunities.

Any required additional financing may not be available on terms acceptable to us, or at all. If we raise additional funds by issuing equity securities, you may experience significant dilution of your ownership interest, and the newly issued securities may have rights senior to those of the holders of our common stock. If we raise additional funds by obtaining loans from third parties, the terms of those financing arrangements may include negative covenants or other restrictions on our business that could impair our operational flexibility and would also require us to fund additional interest expense, which would harm our profitability. Holders of debt would also have rights, preferences or privileges senior to those of holders of our common stock.

A substantial portion of our marketable securities is invested in highly rated auction rate securities. Failures in these auctions may affect our liquidity.

A substantial percentage of our marketable securities portfolio is invested in highly rated auction rate securities collateralized by student loans with the majority of such collateral being guaranteed by the United States government. Auction rate securities are securities that are structured to allow for short-term interest rate resets but with contractual maturities that can be well in excess of ten years. At the end of each reset period, which typically occurs every 7 to 35 days, investors can sell or continue to hold the securities at par. Beginning in late February

2008, due to market conditions, the auction process for our auction rate securities failed. Such failures resulted in the interest rate on these investments resetting to predetermined rates in accordance with their underlying loan agreements which are, in some instances, lower than the current market rate of interest. In the event we need to liquidate our investments in these types of securities, we will not be able to do so until a future auction on these investments is successful, the issuer redeems the outstanding securities, a buyer is found outside the auction process, the securities mature, or there is a default requiring immediate repayment from the issuer. In the future, should the auction rate securities we hold be subject to additional auction failures and/or we determine that the decline in value of auction rate securities are other than temporary, we would recognize a loss in our consolidated statement of operations, which could be material. In addition, any future failed auctions may adversely impact the liquidity of our investments. Furthermore, if one or more issuers of the auction rate securities held in our portfolio are unable to successfully close future auctions and their credit ratings deteriorate, we may be required to adjust the carrying value of these investments through an impairment charge, which could be material.

If we are unable to protect our intellectual property rights, our competitive position could be harmed or we could be required to incur significant expenses to enforce our rights.

Our success is dependent in part on obtaining, maintaining and enforcing our intellectual property and other proprietary rights. We rely on a combination of trade secret, patent, copyright and trademark laws and contractual provisions with employees and third parties, all of which offer only limited protection. Despite our efforts to protect our intellectual property and proprietary information, we may not be successful in doing so, for several reasons. We cannot be certain that our pending patent applications will result in the issuance of patents or whether the examination process will require us to narrow our claims. Even if patents are issued to us, they may be contested, or our competitors may be able to develop similar or superior technologies without infringing our patents.

Although we enter into confidentiality, assignments of proprietary rights and license agreements, as appropriate, with our employees and third parties, including our contract engineering firm, and generally control access to and distribution of our technologies, documentation and other proprietary information, we cannot be certain that the steps we take to prevent unauthorized use of our intellectual property rights are sufficient to prevent their misappropriation, particularly in foreign countries where laws or law enforcement practices may not protect our intellectual property rights as fully as in the United States.

Even in those instances where we have determined that another party is breaching our intellectual property and other proprietary rights, enforcing our legal rights with respect to such breach may be expensive and difficult. We may need to engage in litigation to enforce or defend our intellectual property and other proprietary rights, which could result in substantial costs and diversion of management resources. Further, many of our current and potential competitors are substantially larger than we are and have the ability to dedicate substantially greater resources to defending any claims by us that they have breached our intellectual property rights.

Our products may be subject to open source licenses, which may restrict how we use or distribute our solutions or require that we release the source code of certain technologies subject to those licenses.

Some of our proprietary technologies incorporate open source software. For example, the open source database drivers that we use may be subject to an open source license. The GNU General Public License and other open source licenses typically require that source code subject to the license be released or made available to the public. Such open source licenses typically mandate that proprietary software, when combined in specific ways with open source software, become subject to the open source license. We take steps to ensure that our proprietary software is not combined with, or does not incorporate, open source software in ways that would require our proprietary software to be subject to an open source license. However, few courts have interpreted the open source licenses, and the manner in which these licenses may be interpreted and enforced is therefore subject to uncertainty. If these licenses were to be interpreted in a manner different than we interpret them, we may find ourselves in violation of such licenses. While our customer contracts prohibit the use of our technology in any way that would cause it to violate an open source license, our customers could, in violation of our agreement, use our technology in a manner prohibited by an open source license.

In addition, we rely on multiple software engineers to design our proprietary products and technologies. Although we take steps to ensure that our engineers do not include open source software in the products and technologies they

design, we may not exercise complete control over the development efforts of our engineers and we cannot be certain that they have not incorporated open source software into our proprietary technologies. In the

event that portions of our proprietary technology are determined to be subject to an open source license, we might be required to publicly release the affected portions of our source code, which could reduce or eliminate our ability to commercialize our products.

As part of our business strategy, we engage in acquisitions, which could disrupt our business, cause dilution to our stockholders, reduce our financial resources and result in increased expenses.

We acquired NuTech Solutions, Inc. in May 2008 and Tizor Systems, Inc. in February 2009. In the future, we may acquire additional companies, assets or technologies in an effort to complement our existing offerings or enhance our market position. Any acquisitions we make could subject us to a number of risks, including:

- the purchase price we pay could significantly deplete our cash reserves, impair our future operating flexibility or result in dilution to our existing stockholders;
- we may find that the acquired company, assets or technology do not further improve our financial and strategic position as planned;
- we may find that we overpaid for the company, asset or technology, or that the economic conditions underlying our acquisition have changed;
- we may have difficulty integrating the operations and personnel of the acquired company;
- we may have difficulty retaining the employees with the technical skills needed to enhance and provide services with respect to the acquired assets or technologies;
- the acquisition may be viewed negatively by customers, financial markets or investors;
- we may have difficulty incorporating the acquired technologies or products with our existing product lines;
- we may encounter difficulty entering and competing in new product or geographic markets;
- we may encounter a competitive response, including price competition or intellectual property litigation;
- we may have product liability, customer liability or intellectual property liability associated with the sale of the acquired company s products;
- we may be subject to litigation by terminated employees or third parties;
- we may incur debt, one-time write-offs, such as acquired in-process research and development costs, and restructuring charges;
- we may acquire goodwill and other intangible assets that are subject to impairment tests, which could result in future impairment charges;
- our ongoing business and management s attention may be disrupted or diverted by transition or integration issues and the complexity of managing geographically or culturally diverse enterprises; and
- our due diligence process may fail to identify significant existing issues with the target company s product quality, product architecture, financial disclosures, accounting practices, internal controls, legal contingencies, intellectual property and other matters.

These factors could have a material adverse effect on our business, operating results and financial condition.

In addition, from time to time we may enter into negotiations for acquisitions or investments that are not ultimately consummated. Such negotiations could result in significant diversion of management time, as well as substantial out-of-pocket costs, any of which could have a material adverse effect on our business, operating results and financial condition.

We are subject to governmental export controls that could impair our ability to compete in international markets.

Our products are subject to U.S. export control laws and regulations and their distribution outside the United States may be subject to export licensing or the conditions of a regulatory exception to an export licensing requirement. In addition, various countries regulate the import of certain encryption technology and have enacted laws that could limit our ability to distribute our products or could limit our customers ability to deploy our products in those countries. The introduction of new products, such as our new TwinFin appliance, changes in our products or changes in export regulations may create delays in the introduction of our products in international markets, prevent our customers with international operations from deploying our products throughout their global systems or, in some cases, prevent the export of our products to certain countries altogether. Any change in export regulations or related legislation, shift in approach to the enforcement or scope of existing regulations or change in the countries, persons or technologies targeted by these regulations could result in decreased use of our products by,

or in our decreased ability to export or sell our products to, existing or potential customers with international operations. It may be costly to implement systems and procedures to comply with these restrictions, and we may incur penalties, including limits on foreign distribution, for any transactions that we conduct in violation of these regulations. Any decreased use of our products or limitation on our ability to export or sell our products would likely adversely affect our business, operating results and financial condition.

We rely on a single contract manufacturer to assemble our products, and our failure to manage our relationship with our contract manufacturer successfully could negatively impact our ability to sell our products.

We currently rely on a single contract manufacturer to assemble our appliances, manage our appliance supply chain and participate in negotiations regarding appliance costs. While we believe that our use of this contract manufacturer provides benefits to our business, our reliance on it reduces our control over the assembly process, exposing us to risks, including reduced control over quality assurance, production costs and product supply. These risks could become more acute if we are successful in our efforts to increase revenue. If we fail to manage our relationships with this contract manufacturer effectively, or if the contract manufacturer experience delays, disruptions, capacity constraints or quality control problems in its operations, our ability to ship products to our customers could be impaired and our competitive position and reputation could be harmed. In addition, we are required to provide forecasts to the contract manufacturer regarding product demand and production levels. If we inaccurately forecast demand for our products, we may have excess or inadequate inventory or incur cancellation charges or penalties, which could adversely impact our operating results and financial condition.

Additionally, the contract manufacturer can terminate our agreement for any reason upon 60 days notice. If we are required to change contract manufacturers or assume internal manufacturing operations due to any termination of the agreements with our contract manufacturer, we may lose revenue, experience manufacturing delays, incur increased costs or otherwise damage our customer relationships. We cannot guarantee that we will be able to establish alternative manufacturing relationships on acceptable terms or at all.

We depend on a continued supply of components for our products from third-party suppliers, and if shortages of these components arise, we may not be able to secure enough components to build new products to meet customer demand or we may be forced to pay higher prices for these components.

We rely on a limited number of suppliers for several key components utilized in the assembly of our products, including disk drives and microprocessors. Although in many cases we use standard components for our products, some of these components may only be purchased or may only be available from a single supplier. In addition, we maintain relatively low inventory and acquire components only as needed, and neither we nor our contract manufacturer enter into long-term supply contracts for these components and none of our third-party suppliers is obligated to supply products to us for any specific period or in any specific quantities, except as may be provided in a particular purchase order. Our industry has experienced component shortages and delivery delays in the past, and we may experience shortages or delays of critical components in the future as a result of strong demand in the industry or other factors. If shortages or delays arise, we may be unable to ship our products to our customers on time, or at all, and increased costs for these components that we could not pass on to our customers would negatively impact our operating margins. For example, new generations of disk drives are often in short supply, which may limit our ability to procure these disk drives. In addition, disk drives represent a significant portion of our cost of revenue, and the price of various kinds of disk drives is subject to substantial volatility in the market. Many of the other components required to build our systems are also occasionally in short supply. Therefore, we may not be able to secure enough components at reasonable prices or of acceptable quality to build new products, resulting in an inability to meet customer demand or our own operating goals, which could adversely affect our customer relationships, business, operating results and financial condition.

We currently rely on a contract engineering firm for quality assurance and product integration engineering.

In addition to our internal research and development staff, we have contracted with Persistent Systems Ltd. located in Pune, India, to employ a dedicated team of engineers focused on certain aspects of our product development. Persistent Systems can terminate our agreement for any reason upon 15 days notice. If we were required to change our contract engineering firm, including due to a termination of the agreement with Persistent Systems, we may experience delays, incur increased costs or otherwise damage our customer relationships. We

cannot assure you that we will be able to establish an alternative contract engineering firm relationship on acceptable terms or at all.

Future interpretations of existing accounting standards could adversely affect our operating results.

Generally Accepted Accounting Principles in the United States, or GAAP, are subject to interpretation by the Financial Accounting Standards Board, or FASB, the American Institute of Certified Public Accountants, or AICPA, the SEC and various other bodies formed to promulgate and interpret appropriate accounting principles. A change in these principles or interpretations could have a significant effect on our reported operating results, and they could affect the reporting of transactions completed before the announcement of a change. For example, the AICPA and the Emerging Issues Task Force continue to issue interpretations and guidance for applying the relevant accounting standards to a wide range of sales contract terms and business arrangements that are prevalent in software licensing arrangements and arrangements for the sale of hardware products that contain more than an insignificant amount of software. Future interpretations of existing accounting standards or changes in our business practices could result in delays in our recognition of revenue that may have a material adverse effect on our operating results.

If we fail to maintain an effective system of internal controls, we might not be able to report our financial results accurately or prevent fraud; in that case, our stockholders could lose confidence in our financial reporting, which could negatively impact the price of our stock.

Effective internal controls are necessary for us to provide reliable financial reports and prevent fraud. SEC rules require that we maintain effective internal control over financial reporting and disclosure controls and procedures. In particular, for the fiscal year ended January 31, 2010, we performed system and process evaluation and testing of our internal controls over financial reporting to allow management and our independent registered public accounting firm to report on the effectiveness of our internal control over financial reporting, as required by Section 404 of the Sarbanes-Oxley Act and SEC rules. Our compliance with these rules will continue to require that we incur substantial expense and expend significant management time on compliance-related issues. Even if we conclude, and our independent registered public accounting firm concurs, that our internal control over financial reporting provides reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP, because of its inherent limitations, internal control over financial reporting may not prevent or detect fraud or misstatements. Failure to implement required new or improved controls, or difficulties encountered in their implementation, could harm our operating results or cause us to fail to meet our reporting obligations. If we or our independent registered public accounting firm discover a material weakness in our internal control, the disclosure of that fact, even if quickly remedied, could reduce the market s confidence in our financial statements and harm our stock price. In addition, a delay in compliance with these rules could subject us to a variety of administrative sanctions, including ineligibility for short form registration, action by the SEC, the suspension or delisting of our common stock from the NYSE and the inability of registered broker-dealers to make a market in our common stock, which would further reduce our stock price and could harm our business.

Risks Related to our Common Stock

The trading price of our common stock has been and is likely to continue to be volatile.

The trading price of our common stock will be susceptible to fluctuations in the market due to numerous factors, many of which may be beyond our control, including:

changes in operating performance and stock market valuations of other technology companies generally or those that sell data warehouse solutions in particular;

actual or anticipated fluctuations in our operating results;

the financial guidance that we may provide to the public, any changes in such guidance, or our failure to meet such guidance;

changes in financial estimates by securities analysts, our failure to meet such estimates, or failure of analysts to initiate or maintain coverage of our stock;

the public s response to our press releases or other public announcements by us, including our filings with the SEC;

- announcements by us or our competitors of significant technical innovations, customer wins or losses, acquisitions, strategic partnerships, joint ventures or capital commitments;
- introduction of technologies or product enhancements that reduce the need for our products;
- the loss of key personnel;
- the development and sustainability of an active trading market for our common stock;
- lawsuits threatened or filed against us;
- future sales of our common stock by our officers or directors; and
- other events or factors affecting the economy generally, including those resulting from political unrest, war, incidents of terrorism or responses to such events.

The trading price of our common stock might also decline in reaction to events that affect other companies in our industry even if these events do not directly affect us.

Some companies that have had volatile market prices for their securities have had securities class actions filed against them. If a suit were filed against us, regardless of its merits or outcome, it would likely result in substantial costs and divert management s attention and resources. This could have a material adverse effect on our business, operating results and financial condition.

Provisions in our certificate of incorporation and by-laws and Delaware law might discourage, delay or prevent a change in control of our company or changes in our management and, therefore, may negatively impact the trading price of our common stock.

Provisions of our certificate of incorporation and our by-laws may discourage, delay or prevent a merger, acquisition or other change in control that stockholders may consider favorable, including transactions in which you might otherwise receive a premium for your shares of our common stock. These provisions may also prevent or frustrate attempts by our stockholders to replace or remove our management. These provisions:

- establish a classified board of directors so that not all members of our board are elected at one time;
- provide that directors may only be removed for cause;
- authorize the issuance of blank check preferred stock that our board of directors could issue to increase the number of outstanding shares and to discourage a takeover attempt;
- eliminate the ability of our stockholders to call special meetings of stockholders;
- prohibit stockholder action by written consent, which has the effect of requiring all stockholder actions to be taken at a meeting of stockholders;
- provide that the board of directors is expressly authorized to make, alter or repeal our by-laws; and
- establish advance notice requirements for nominations for election to our board of directors or for proposing matters that can be acted upon by stockholders at stockholder meetings.

In addition, Section 203 of the Delaware General Corporation Law may discourage, delay or prevent a change in control of our company by prohibiting stockholders owning in excess of 15% of our outstanding voting stock from merging or combining with us during a specified period unless certain approvals are obtained.

Insiders own a significant portion of our outstanding common stock and will therefore have substantial control over us and will be able to influence corporate matters.

Our executive officers, directors and their affiliates beneficially own, in the aggregate, approximately 20% of our outstanding common stock. As a result, our executive officers, directors and their affiliates are able to exercise significant influence over all matters requiring stockholder approval, including the election of directors and approval of significant corporate transactions, such as a merger or other sale of our company or its assets. This concentration of ownership could limit your ability to influence corporate matters and may have the effect of delaying or preventing another party from acquiring control over us.

Item 6. Exhibits

See the Exhibit Index attached hereto which is herein incorporated by reference.

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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.

Netezza Corporation
(Registrant)

Date: September 9, 2010

By: /s/ Patrick J. Scannell, Jr.
Patrick J. Scannell, Jr.
Senior Vice President and Chief Financial Officer
(Principal Financial and Accounting Officer)

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EXHIBIT INDEX

Exhibit No.	Description
10.1	Second Amendment dated as of June 14, 2010, to the Lease, dated January 2, 2008, by and between the Company and NE Williams II, LLC
31.1	Certification of Chief Executive Officer, pursuant to Securities Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer, pursuant to Securities Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer and Chief Financial Officer pursuant to Securities Exchange Act Rules 13a-14(b) and 15d-14(b), as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.