SALESFORCE COM INC
Form 10-Q
November 25, 2008
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x **Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the quarterly period ended October 31, 2008

OR

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

salesforce.com, inc.

(Exact name of registrant as specified in its charter)

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

The Landmark @ One Market, Suite 300

San Francisco, California 94105

(Address of principal executive offices)

Telephone Number (415) 901-7000

(Registrant s telephone number, including area code)

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

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

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

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

As of October 31, 2008, there were approximately 122.0 million shares of the Registrant s Common Stock outstanding.

Table of Contents

salesforce.com, inc.

INDEX

		Page No.
	PART I. FINANCIAL INFORMATION	
Item 1.	**Condensed Consolidated Financial Statements:**	
	Condensed Consolidated Balance Sheets as of October 31, 2008 and January 31, 2008	3
	Condensed Consolidated Statements of Operations for the three and nine months ended October 31, 2008 and 2007	4
	Condensed Consolidated Statements of Cash Flows for the three and nine months ended October 31, 2008 and 2007	5
	Notes to Condensed Consolidated Financial Statements	6
Item 2.	**Management s Discussion and Analysis of Financial Condition and Results of Operations**	24
Item 3.	**Quantitative and Qualitative Disclosures About Market Risk**	42
Item 4.	**Controls and Procedures**	43
	PART II. OTHER INFORMATION	
Item 1.	**Legal Proceedings**	44
Item 1A.	**Risk Factors**	44
Item 2.	**Unregistered Sales of Equity Securities and Use of Proceeds**	58
Item 3.	**Defaults Upon Senior Securities**	58
Item 4.	**Submission of Matters to a Vote of Security Holders**	58
Item 5.	**Other Information**	58
Item 6.	**Exhibits**	58
	Signatures	59

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

salesforce.com, inc.

Condensed Consolidated Balance Sheets

(in thousands)

	October 31, 2008 (unaudited)	January 31, 2008
Assets		
Current assets:		
Cash and cash equivalents	$ 382,314	$ 279,095
Short-term marketable securities	219,144	171,748
Accounts receivable, net	157,680	220,061
Deferred commissions	35,355	35,679
Deferred income taxes	14,319	7,173
Prepaid expenses and other current assets	39,747	27,055
Total current assets	848,559	740,811
Marketable securities, noncurrent	203,148	218,957
Fixed assets, net	66,833	41,380
Deferred commissions, noncurrent	13,909	16,435
Deferred income taxes, noncurrent	36,258	26,512
Capitalized software, net	31,950	23,061
Goodwill	27,699	8,556
Other assets, net	47,375	13,881
Total assets	$ 1,275,731	$ 1,089,593
Liabilities and stockholders equity		
Current liabilities:		
Accounts payable	$ 20,875	$ 7,478
Accrued expenses and other current liabilities	134,600	125,996
Income taxes payable	1,923	3,622
Deferred revenue	458,044	468,821
Total current liabilities	615,442	605,917
Income taxes payable, noncurrent	10,834	8,465
Long-term lease abandonment liability and other	6,150	2,136
Deferred revenue, noncurrent	11,490	12,073
Minority interest	13,428	8,943
Total liabilities	657,344	637,534
Commitments and contingencies		
Stockholders equity:		
Common stock	122	119
Additional paid-in capital	613,768	471,802
Accumulated other comprehensive loss	(7,592)	(2,276)

Retained earnings (deficit)	12,089	(17,586)
Total stockholders equity	618,387	452,059
Total liabilities and stockholders equity	$ 1,275,731	$ 1,089,593

See accompanying Notes to Condensed Consolidated Financial Statements.

Table of Contents

salesforce.com, inc.

Condensed Consolidated Statements of Operations

(in thousands, except per share data)

(unaudited)

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2008	2007	2008	2007
Revenues:				
Subscription and support	$ 253,403	$ 176,376	$ 718,464	$ 484,064
Professional services and other	23,084	16,427	68,722	47,730
Total revenues	276,487	192,803	787,186	531,794
Cost of revenues (1):				
Subscription and support	32,424	23,887	91,802	66,446
Professional services and other	23,924	20,394	69,935	58,414
Total cost of revenues	56,348	44,281	161,737	124,860
Gross profit	220,139	148,522	625,449	406,934
Operating expenses (1):				
Research and development	26,270	16,892	70,070	46,109
Marketing and sales	136,452	96,216	389,930	270,357
General and administrative	41,284	29,296	117,797	80,889
Total operating expenses	204,006	142,404	577,797	397,355
Income from operations	16,133	6,118	47,652	9,579
Interest, net	3,840	6,556	17,270	17,178
Gain on sale of investment		1,272		1,272
Other income (expense)	534	285	(1,069)	734
Income before provision for income taxes and minority interest	20,507	14,231	63,853	28,763
Provision for income taxes	(8,824)	(6,594)	(29,693)	(15,089)
Income before minority interest	11,683	7,637	34,160	13,674
Minority interest in consolidated joint venture	(1,559)	(1,125)	(4,485)	(2,697)
Net income	$ 10,124	$ 6,512	$ 29,675	$ 10,977
Basic net income per share	$ 0.08	$ 0.06	$ 0.25	$ 0.09
Diluted net income per share	0.08	0.05	0.24	0.09
Weighted-average number of shares used in per share amounts:				
Basic	121,635	117,361	120,759	116,208
Diluted	125,133	122,169	125,173	121,429

(1) Amounts include stock-based expenses, as follows:

Cost of revenues	$ 2,817	$ 2,014	$ 8,149	$ 5,753
Research and development	2,494	1,685	6,852	4,472
Marketing and sales	9,235	6,313	26,105	18,197
General and administrative	4,730	4,166	15,119	11,199
	$ 19,276	$ 14,178	$ 56,225	$ 39,621

See accompanying Notes to Condensed Consolidated Financial Statements.

Table of Contents

salesforce.com, inc.

Condensed Consolidated Statements of Cash Flows

(in thousands)

(unaudited)

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2008	2007	2008	2007
Operating activities:				
Net income	$ 10,124	$ 6,512	$ 29,675	$ 10,977
Adjustments to reconcile net income to net cash provided by operating activities:				
Gain on sale of investment		(1,272)		(1,272)
Loss on securities	2,052		2,052	
Minority interest	1,559	1,125	4,485	2,697
Depreciation and amortization	7,910	6,758	24,938	17,651
Amortization of deferred commissions	14,784	11,044	43,414	29,727
Expenses related to stock-based awards	19,276	14,178	56,225	39,621
Excess tax benefits from employee stock plans	(17,706)	(9,298)	(42,247)	(24,504)
Changes in assets and liabilities	(20,878)	22,951	35,486	48,585
Net cash provided by operating activities	17,121	51,998	154,028	123,482
Investing activities:				
Purchase of subsidiary stock	(16,693)		(16,693)	
Business combination, net of cash acquired	(27,344)		(27,344)	
Changes in marketable securities	(30,263)	(35,140)	(38,841)	(83,087)
Capital expenditures	(11,614)	(9,122)	(48,827)	(35,183)
Proceeds from sale of investment		1,659		1,659
Net cash used in investing activities	(85,914)	(42,603)	(131,705)	(116,611)
Financing activities:				
Proceeds from the exercise of stock options	6,595	20,586	40,605	44,290
Excess tax benefits from employee stock plans	17,706	9,298	42,247	24,504
Principal payments on capital lease obligations	(286)	(6)	(291)	(169)
Net cash provided by financing activities	24,015	29,878	82,561	68,625
Effect of exchange rate changes	49	(1,461)	(1,665)	(1,343)
Net (decrease) increase in cash and cash equivalents	(44,729)	37,812	103,219	74,153
Cash and cash equivalents, beginning of period	427,043	122,949	279,095	86,608
Cash and cash equivalents, end of period	$ 382,314	$ 160,761	$ 382,314	$ 160,761
Supplemental cash flow disclosure:				
Cash paid during the period for:				
Income taxes, net of tax refunds	$ 1,894	$ 55	$ 7,309	$ 920

See accompanying Notes to Condensed Consolidated Financial Statements.

5

Table of Contents

salesforce.com, inc.

Notes to Condensed Consolidated Financial Statements

1. Summary of Business and Significant Accounting Policies

Description of Business

Salesforce.com, inc. (the Company) is the leading provider, based on revenue and market share, of software on demand, according to a July 2007 report by International Data Corporation (IDC). It provides a comprehensive customer relationship management (CRM) service to businesses of all sizes and industries worldwide. The Company began to offer its on-demand application service on a subscription basis in February 2000.

Fiscal Year

The Company s fiscal year ends on January 31. References to fiscal 2009, for example, refer to the fiscal year ending January 31, 2009.

Basis of Presentation

The accompanying condensed consolidated balance sheet as of October 31, 2008 and the condensed consolidated statements of operations and the condensed consolidated statements of cash flows for the three and nine months ended October 31, 2008 and 2007, respectively, are unaudited. The condensed consolidated balance sheet data as of January 31, 2008 was derived from the audited consolidated financial statements which are included in the Company s Form 10-K for the fiscal year ended January 31, 2008, which was filed with the Securities and Exchange Commission (the SEC) on February 29, 2008. The accompanying statements should be read in conjunction with the audited consolidated financial statements and related notes contained in the Company s fiscal 2008 Form 10-K.

The accompanying condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles, or GAAP, for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the financial information and footnotes required by GAAP for complete financial statements. In the opinion of the Company s management, the unaudited condensed consolidated financial statements have been prepared on the same basis as the audited consolidated financial statements in the Form 10-K, and include all adjustments necessary for the fair presentation of the Company s statement of financial position as of October 31, 2008, and its results of operations and its cash flows for the three and nine months ended October 31, 2008 and 2007. All adjustments are of a normal recurring nature. The results for the three and nine months ended October 31, 2008 are not necessarily indicative of the results to be expected for any subsequent quarter or for the fiscal year ending January 31, 2009.

Use of Estimates

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

Significant estimates and assumptions made by management include the determination of the provision for income taxes, whether an other-than-temporary decline has occurred in the fair value of certain investments in marketable securities, the fair value of stock awards issued and the allocation of the purchase price paid to acquire InStranet, Inc. Actual results could differ from those estimates.

Table of Contents

salesforce.com, inc.

Notes to Condensed Consolidated Financial Statements (Continued)

Principles of Consolidation

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

Additionally, the Company holds a majority interest in Kabushiki Kaishu salesforce.com (Salesforce Japan), a Japanese joint venture. In the third quarter, the Company acquired shares held by minority shareholders and increased its ownership to 72 percent (see note 7, Acquisitions).

Given the Company s majority ownership interest in the joint venture, the accounts of the joint venture have been consolidated with the accounts of the Company, and a minority interest has been recorded for the minority investors interests in the net assets and operations of the joint venture to the extent of the minority investors individual investments.

Segments

The Company operates in one segment.

Foreign Currency Translation

The functional currency of the Company s major foreign subsidiaries is generally the local currency. For example, the functional currency for the Company s subsidiaries in Europe is the Euro. Adjustments resulting from translating foreign functional currency financial statements into U.S. dollars are recorded as part of a separate component of stockholders equity. Foreign currency transaction gains and losses are included in net income for the period. All assets and liabilities denominated in a foreign currency are translated into U.S. dollars at the exchange rate on the balance sheet date. Revenues and expenses are translated at the average exchange rate during the period. Equity transactions are translated using historical exchange rates.

Concentrations of Credit Risk and Significant Customers

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

One customer accounted for more than 5 percent of accounts receivable at October 31, 2008 and none at January 31, 2008. No customer accounted for 5 percent or more of total revenue during the three and nine month periods ended October 31, 2008 and 2007.

Table of Contents

salesforce.com, inc.

Notes to Condensed Consolidated Financial Statements (Continued)

As of October 31, 2008 and January 31, 2008, assets located outside the Americas was 14 percent of total assets for both periods. Revenues by geographical region are as follows (in thousands):

	Three months ended October 31,		Nine months ended October 31,	
	2008	2007	2008	2007
Revenues by geography:				
Americas	$ 200,143	$ 141,682	$ 567,076	$ 399,477
Europe	48,076	33,880	142,597	88,614
Asia Pacific	28,268	17,241	77,513	43,703
	$ 276,487	$ 192,803	$ 787,186	$ 531,794

Cash and Cash Equivalents

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

Marketable Securities

Management determines the appropriate classification of investments in marketable securities at the time of purchase in accordance with Statement of Financial Accounting Standards No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, and reevaluates such determination at each balance sheet date. Securities, which are classified as available for sale, are carried at fair value, with the unrealized gains and losses, net of tax, reported as a separate component of stockholders equity. Fair value is determined based on quoted market rates when observable or utilizing data points that are observable such as quoted prices, interest rates and yield curves. Realized gains and losses on the sale of available for sale securities were less than 2 percent of interest, net for the three and nine months ended October 31, 2008. Declines in fair value judged to be other-than-temporary on securities available for sale are included as a component of interest, net. The cost of securities sold is based on the specific-identification method. Interest on securities classified as available for sale is also included as a component of interest, net.

Fair Value Measurement

Effective February 1, 2008, the Company implemented Statement of Financial Accounting Standards No. 157, *Fair Value Measurement*, or SFAS 157, for its financial assets and liabilities that are re-measured and reported at fair value at each reporting period, and non-financial assets and liabilities that are re-measured and reported at fair value at least annually. In accordance with the provisions of FASB Staff Position No. 157-2, *Effective Date of FASB Statement No. 157,* the Company has elected to defer implementation of SFAS 157 as it relates to its non-financial assets and non-financial liabilities until February 1, 2009. The Company is evaluating the impact, if any, this standard will have. In October 2008, the FASB issued FSB SFAS 157-3, *Determining the Fair Value of a Financial Asset when the Market for that Asset is Not Active* (FSB 157-3), to clarify how an entity would determine fair value in an inactive market. FSB 157-3 is effective immediately and applies to the Company s October 31, 2008 financial statements. The application of the provisions of FSB 157-3 did not materially impact the Company s consolidated financial position, results of operations and cash flows as of and for the period ended October 31, 2008.

In accordance with SFAS 157, the Company measures its cash equivalents, marketable securities and foreign currency derivative contracts at fair value. A majority of the Company s cash equivalents and its marketable securities are classified within Level 1 or Level 2, which are described below. This is because the Company s cash equivalents and marketable securities are valued using quoted market prices or alternative pricing sources and models utilizing market observable inputs.

Table of Contents

salesforce.com, inc.

Notes to Condensed Consolidated Financial Statements (Continued)

A portion of the Company s money market mutual funds are classified within Level 3, described below, because they are invested in The Reserve Primary Fund (The Reserve Fund). At October 31, 2008 the Company s investment portfolio included $45.1 million invested in The Reserve Fund with an estimated fair value of $43.9 million. During the three months ended October 31, 2008, the Company recorded a $1.2 million loss related to this decline in fair value that is considered other-than-temporary. This loss is included in interest, net on the condensed consolidated statements of operations. While the Company believes it has the right to the recovery of the entire $45.1 million investment, the Company cannot predict when The Reserve Fund will disperse the Company s funds, or the amounts that the Company will receive. Therefore, the Company has recorded the aforementioned other-than-temporary loss. Additionally, the Company reclassified its investment from cash and cash equivalents to short-term marketable securities on the Company s condensed consolidated balance sheet as of October 31, 2008.

The Company s foreign currency derivative contracts are classified within Level 2 as the valuation inputs are based on quoted prices and market observable data of similar instruments in inactive markets.

SFAS 157 establishes a three-tier value hierarchy, which prioritizes the inputs used in the valuation methodologies in measuring fair value:

Level 1. Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets.

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

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

The following table presents information about the Company s assets that are measured at fair value on a recurring basis as of October 31, 2008 and indicates the fair value hierarchy of the valuation (in thousands):

Description	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balances as of October 31, 2008
Cash equivalents (1):				
Time deposits	$ 436	$	$	$ 436
Money market mutual funds	118,804			118,804
Corporate notes and obligations		86,775		86,775
U.S. treasury securities	16,997			16,997
U.S. agency obligations		45,698		45,698
Marketable securities:				
Corporate notes and obligations		179,503		179,503
U.S. agency obligations		198,867		198,867
Money market mutual funds			43,922	43,922
Foreign currency derivative contracts (2)		375		375
Total Assets	$ 136,237	$ 511,218	$ 43,922	$ 691,377
Liabilities				
Foreign currency derivative contracts (3)	$	$ 81	$	$ 81
Total Liabilities	$	$ 81	$	$ 81

9

Table of Contents

salesforce.com, inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(1) Included in cash and cash equivalents in the accompanying Condensed Consolidated Balance Sheet as of October 31, 2008, in addition to $113,604 of cash.
(2) Included in prepaid expenses and other current assets in the accompanying Condensed Consolidated Balance Sheet as of October 31, 2008.
(3) Included in accrued expenses and other current liabilities in the accompanying Condensed Consolidated Balance Sheet as of October 31, 2008.

The following table presents the Company s assets measured at fair value using significant unobservable inputs (Level 3) at October 31, 2008. These assets consist of the Company s investment in The Reserve Fund (in thousands):

Balance at February 1, 2008	$
Transfers to Level 3	45,126
Realized loss included in Interest, net	(1,204)
Balance at October 31, 2008	$ 43,922

Derivative Financial Instruments

The Company has operated a hedging program for the past three years to manage its short-term exposure to fluctuations in foreign currency exchange rates, which exist as part of ongoing business operations. The Company enters into foreign currency contracts with financial institutions to reduce the risk that its cash flows and earnings will be adversely affected by foreign currency exchange rate fluctuations. The Company uses forward contracts to hedge a majority of transaction exposures denominated in Euros, Swiss francs, Australian dollars, Singapore dollars, Japanese yen and British pounds. The Company s program is not designated for trading or speculative purposes. Prior to October 31, 2008 it had been the Company s practice to settle foreign currency contracts prior to each quarter end because the maturities of the foreign currency contracts were less than 3 months. The Company continues its practice of entering into foreign currency contracts with maturities less than three months. As of October 31, 2008 the contracts that were not settled are recorded at fair value on the condensed consolidated balance sheet.

The Company s foreign currency forward contracts , which are not designated as hedging instruments under FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*, or SFAS 133, are used to reduce the exchange rate risk associated primarily with intercompany receivables and payables. Forward contracts are marked-to-market at the end of each reporting period with gains and losses recognized as other income (expense) to offset the gains or losses resulting from the settlement of the underlying foreign currency denominated receivables and payables. While the contract or notional amount is often used to express the volume of foreign exchange contracts, the amounts potentially subject to credit risk are generally limited to the amounts, if any, by which the counterparties obligations under the agreements exceed the obligations of the Company to the counterparties.

Details on outstanding forward contracts related to intercompany receivables and payables are presented below (in thousands):

	October 31, 2008	January 31, 2008
Notional amount of foreign currency forward contracts	$ 61,708	$
Fair value of foreign currency forward contracts	294	

Table of Contents

salesforce.com, inc.

Notes to Condensed Consolidated Financial Statements (Continued)

Comprehensive Income

Comprehensive income consists of net income and other comprehensive income (loss), which includes certain changes in equity that is excluded from net income. Primarily, cumulative foreign currency translation adjustments and unrealized gains and losses on marketable securities, net of tax, are included in accumulated other comprehensive loss. Comprehensive income has been reflected in stockholders equity.

Comprehensive income consisted of the following (in thousands):

	Three months ended October 31,		Nine months ended October 31,	
	2008	2007	2008	2007
Net income	$ 10,124	$ 6,512	$ 29,675	$ 10,977
Translation adjustment and other adjustments	1,947	(1,859)	1,766	(2,157)
Unrealized (loss) gain on marketable securities	(5,351)	860	(7,082)	1,251
Total comprehensive income	$ 6,720	$ 5,513	$ 24,359	$ 10,071

The components of accumulated other comprehensive loss were as follows (in thousands):

	October 31, 2008	January 31, 2008
Foreign currency translation and other adjustments	$ (2,366)	$ (4,132)
Net unrealized (loss) gain on marketable securities	(5,226)	1,856
	$ (7,592)	$ (2,276)

Net Income Per Share

Basic net income per share is computed by dividing net income by the weighted-average number of common shares outstanding for the fiscal period. Diluted net income per share is computed giving effect to all potential dilutive common stock, including options and restricted stock units. The dilutive effect of outstanding awards is reflected in diluted earnings per share by application of the treasury stock method.

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

	Three months ended October 31,		Nine months ended October 31,	
	2008	2007	2008	2007
Numerator:				
Net income	$ 10,124	$ 6,512	$ 29,675	$ 10,977
Denominator:				
Weighted-average shares outstanding for basic earnings per share, net of weighted-average shares of common stock subject to repurchase	121,635	117,361	120,759	116,208
Effect of dilutive securities:				

Employee stock awards	3,498	4,808	4,414	5,221
Adjusted weighted-average shares outstanding and assumed conversions for diluted earnings per share	125,133	122,169	125,173	121,429

Table of Contents

salesforce.com, inc.

Notes to Condensed Consolidated Financial Statements (Continued)

The following were excluded from the computation of diluted shares outstanding as they would have had an anti-dilutive impact (in thousands). The dilutive securities are excluded when, for example, their exercise prices are greater than the average fair values of the Company s common stock.

	Three months ended October 31,		Nine months ended October 31,	
	2008	2007	2008	2007
Stock awards	4,440	2,859	3,328	3,181

Income Taxes

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

The Company recorded a provision for income taxes of $8.8 million and $29.7 million for the three and nine months ended October 31, 2008, compared to a provision of $6.6 million and $15.1 million during the same periods a year ago.

The total income tax benefit recognized in the accompanying condensed consolidated statements of operations related to Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment*, or SFAS 123R, was $20.1 million and $13.1 million for the nine months ended October 31, 2008 and 2007, respectively.

A reconciliation of income taxes at the statutory federal income tax rate to the provision for income taxes included in the accompanying condensed consolidated statements of operations is as follows (in thousands):

	Nine months ended October 31,	
	2008	2007
U.S. federal taxes at statutory rate	$ 22,349	$ 10,067
State, net of the federal benefit	3,564	1,801
Foreign losses providing no benefit	3,226	1,898
Foreign taxes in excess of the U.S. statutory rate	3,156	2,242
Tax credits	(3,780)	(1,776)
Non-deductible expenses	805	862
Other, net	373	(5)
	$ 29,693	$ 15,089

The Company records liabilities related to uncertain tax positions in accordance with the provisions of Financial Accounting Standards Board Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, an interpretation of SFAS No. 109, *Accounting for Income Taxes*. There were no material changes to the Company s unrecognized tax benefits for the three and nine months ended October 31, 2008.

Table of Contents

salesforce.com, inc.

Notes to Condensed Consolidated Financial Statements (Continued)

Tax positions for the Company and its subsidiaries are subject to income tax audits by many tax jurisdictions throughout the world. The Internal Revenue Service completed the examination of the Company s federal income tax return for the fiscal year ended January 31, 2006. No adjustment was made as a result of the audit. Management does not believe that it is reasonably possible that the estimates of unrecognized tax benefits will change significantly in the next twelve months. However, an adverse resolution of one or more uncertain tax positions in any period could have a material impact on the results of operations for that period.

Revenue Recognition

The Company derives its revenues from two sources: (1) subscription revenues, which are comprised of subscription fees from customers accessing its on-demand application service, and from customers purchasing additional support beyond the standard support that is included in the basic subscription fee; and (2) related professional services and other revenue. Other revenues consist primarily of training fees. Because the Company provides its application as a service, the Company follows the provisions of the SEC s Staff Accounting Bulletin No. 104, *Revenue Recognition*, and Emerging Issues Task Force Issue No. 00-21, *Revenue Arrangements with Multiple Deliverables*. The Company recognizes revenue when all of the following conditions are met:

There is persuasive evidence of an arrangement;

The service has been provided to the customer;

The collection of the fees is reasonably assured; and

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

The Company s arrangements do not contain general rights of return.

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

Professional services and other revenues, when sold with subscription and support offerings, are accounted for separately when these services have value to the customer on a standalone basis and there is objective and reliable evidence of fair value of each deliverable. When accounted for separately, revenues are recognized as the services are rendered for time and material contracts, and when the milestones are achieved and accepted by the customer for fixed price contracts. The majority of the Company s consulting contracts are on a time and material basis. Training revenues are recognized after the services are performed. For revenue arrangements with multiple deliverables, such as an arrangement that includes subscription, premier support, consulting or training services, the Company allocates the total amount the customer will pay to the separate units of accounting based on their relative fair values, as determined by the price of the undelivered items when sold separately.

In determining whether the consulting services can be accounted for separately from subscription and support revenues, the Company considers the following factors for each consulting agreement: availability of the consulting services from other vendors, whether objective and reliable evidence for fair value exists for the undelivered elements, the nature of the consulting services, the timing of when the consulting contract was signed in comparison to the subscription service start date, and the contractual dependence of the subscription service on the customer s satisfaction with the consulting work. If a consulting arrangement does not qualify for separate accounting, the Company recognizes the consulting revenue ratably over the remaining term of the subscription contract. Additionally, in these situations, the Company defers only the direct costs of the consulting arrangement and amortizes those costs over the same time period as the consulting revenue is recognized. As of

13

Table of Contents

salesforce.com, inc.

Notes to Condensed Consolidated Financial Statements (Continued)

October 31, 2008 and January 31, 2008, the deferred cost on the accompanying condensed consolidated balance sheet totaled $17.3 million and $13.9 million, respectively. These deferred costs are included in prepaid expenses and other current assets and other assets.

Deferred Revenue

Deferred revenue primarily consists of billings or payments received in advance of revenue recognition from the Company s subscription service and is recognized as the revenue recognition criteria are met. The Company generally invoices its customers in quarterly or annual installments. Accordingly, the deferred revenue balance does not represent the total contract value of annual or multi-year, noncancelable subscription agreements. Deferred revenue also includes certain deferred professional services fees which are recognized as revenue ratably over the subscription contract term. The Company defers the professional service fees in situations where the professional services and subscription contracts are accounted for as a single unit of accounting. Deferred revenue that will be recognized during the succeeding 12-month period is recorded as current deferred revenue and the remaining portion is recorded as noncurrent. Approximately 9 percent and 8 percent of total deferred revenue as of October 31, 2008 and January 31, 2008, respectively, related to deferred professional services revenue.

Deferred Commissions

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

Accounting for Stock-Based Compensation

The Company accounts for stock-based expenses pursuant to the provisions of SFAS 123R, which requires that all share-based payments, including grants of employee stock options, be recognized as an expense in the statement of operations based on their fair values over the vesting period, which is 4 years.

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

	Three months ended October 31,		Nine months ended October 31,	
	2008	2007	2008	2007
Volatility	47%	46%	47%	46%
Weighted-average estimated life	4 years	4 years	4 years	4 years
Weighted-average risk-free interest rate	2.65-3.00%	3.96-4.14%	2.24-3.08%	3.96-4.56%
Dividend yield				
Weighted-average fair value per share of grants	$20.34	$19.97	$22.26	$18.53

The expected life of options was based on the simplified calculation of expected life, described in the SEC s Staff Accounting Bulletins 107 and 110. Accordingly, the weighted-average estimated life assumption of 4 years

Table of Contents

salesforce.com, inc.

Notes to Condensed Consolidated Financial Statements (Continued)

was based on the average of the vesting term and the 5 year contractual lives of options awarded. The weighted-average risk free interest rate is based on the rate for a 4 year U.S. government security at the time of the option grant.

The Company estimated its future stock price volatility considering both observed option-implied volatilities and historical volatility calculations for both the Company and a group of peer comparable companies. Management believes this is the best estimate of the expected volatility over the 4 year weighted-average expected life of its option grants.

During the three months ended October 31, 2008 and 2007, the Company capitalized $369,000 and $431,000, respectively, of stock-based expenses related to capitalized internal-use software development and deferred professional services costs and $1.4 million and $1.6 million for the nine months ended October 31, 2008 and 2007, respectively.

During the nine months ended October 31, 2008, the Company recognized stock-based expense of $56.2 million. As of October 31, 2008, the aggregate stock compensation remaining to be amortized to costs and expenses was $219.6 million. The Company expects this stock compensation balance to be amortized as follows: $23.9 million during the remaining three months of fiscal 2009; $87.3 million during fiscal 2010; $65.3 million during fiscal 2011; $38.5 million during fiscal 2012; and $4.6 million during fiscal 2013. The expected amortization reflects only outstanding stock awards as of October 31, 2008 and assumes no forfeiture activity. The Company expects to continue to issue share-based awards to its employees in future periods.

The Company grants stock options and restricted stock units to employees throughout the world. In certain foreign jurisdictions, the Company incurs a payroll or social tax cost when its employees exercise their vested awards. Pursuant to SFAS 123R, the payroll and social tax costs are recognized as an operating expense at the time of the exercise. As of October 31, 2008, the Company would incur as an operating expense in excess of $2.6 million for these taxes if all vested awards held by employees in these foreign jurisdictions were exercised. This amount is based on the number of vested awards held and the market price of the Company s common stock. The timing of when employees in these foreign jurisdictions exercise their vested awards could materially affect the Company s future results of operations in a particular period.

Warranties and Indemnification

The Company s on-demand application service is typically warranted to perform in a manner consistent with general industry standards that are reasonably applicable and materially in accordance with the Company s online help documentation under normal use and circumstances.

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

The Company has entered into service level agreements with a small number of its customers warranting certain levels of uptime reliability and performance and permitting those customers to receive credits or terminate their agreements in the event that the Company fails to meet those levels. As of October 31, 2008 and January 31, 2008, the reserve balance was approximately $0.4 million, respectively.

The Company has also agreed to indemnify its directors and executive officers for costs associated with any fees, expenses, judgments, fines and settlement amounts incurred by any of these persons in any action or

Table of Contents

salesforce.com, inc.

Notes to Condensed Consolidated Financial Statements (Continued)

proceeding to which any of those persons is, or is threatened to be, made a party by reason of the person s service as a director or officer, including any action by the Company, arising out of that person s services as the Company s director or officer or that person s services provided to any other company or enterprise at the Company s request. The Company maintains director and officer insurance coverage that would generally enable the Company to recover a portion of any future amounts paid.

Recent Accounting Pronouncements

In December 2007, the FASB issued Statement No. 141 (revised), *Business Combinations*. This standard changes the accounting for business combinations including the measurement of acquirer shares issued in consideration for a business combination, the recognition of contingent consideration, the accounting for preacquisition gain and loss contingencies, the recognition of capitalized in-process research and development, the accounting for acquisition-related restructuring cost accruals, the treatment of acquisition related transaction costs and the recognition of changes in the acquirer s income tax valuation allowance. SFAS 141(R) is effective for fiscal years beginning after December 15, 2008.

In December 2007, the FASB issued Statement No. 160, *Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51 or* SFAS 160. The standard changes the accounting for noncontrolling (minority) interests in consolidated financial statements including the requirements to classify noncontrolling interests as a component of consolidated stockholders equity, and the elimination of minority interest accounting in results of operations with earnings attributable to noncontrolling interests reported as part of consolidated earnings. Additionally, SFAS 160 revises the accounting for both increases and decreases in a parent s controlling ownership interest. SFAS 160 is effective for fiscal years beginning after December 15, 2008, with early adoption prohibited. The Company is currently evaluating the impact of the pending adoption of SFAS 160 on its consolidated financial statements.

In March 2008, the FASB issued Statement No. 161, *Disclosures About Derivative Instruments and Hedging Activities*, or SFAS 161. This Standard enhances the disclosure requirements for derivative instruments and hedging activities. This Standard is effective January 1, 2009. Since SFAS 161 requires only additional disclosures concerning derivatives and hedging activities, adoption of SFAS 161 will not affect the Company s financial condition, results of operations or cash flows.

In April 2008, the FASB issued FSP SFAS 142-3, *Determination of the Useful Life of Intangible Assets* (FSP 142-3). This guidance is intended to improve the consistency between the useful life of a recognized intangible asset under SFAS No. 142, *Goodwill and Other Intangible Assets* (SFAS 142), and the period of expected cash flows used to measure the fair value of the asset under SFAS 141(R) when the underlying arrangement includes renewal or extension of terms that would require substantial costs or result in a material modification to the asset upon renewal or extension. Companies estimating the useful life of a recognized intangible asset must now consider their historical experience in renewing or extending similar arrangements or, in the absence of historical experience, must consider assumptions that market participants would use about renewal or extension as adjusted for SFAS 142 s entity-specific factors. FSP 142-3 is effective for the Company beginning February 1, 2009. The Company is currently evaluating the potential impact of the adoption of FSP 142-3 on its consolidated financial statements.

Table of Contents

salesforce.com, inc.

Notes to Condensed Consolidated Financial Statements (Continued)

2. Balance Sheet Accounts

Marketable Securities

At October 31, 2008, marketable securities consisted of the following (in thousands):

	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Corporate notes and obligations	$ 183,194	$ 164	$ (3,855)	$ 179,503
Money market mutual fund (see Note 1)	43,922			43,922
U.S. agency obligations	198,560	636	(329)	198,867
	$ 425,676	$ 800	$ (4,184)	$ 422,292

At January 31, 2008, marketable securities consisted of the following (in thousands):

	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Corporate notes and obligations	$ 276,866	$ 2,328	$ (414)	$ 278,780
U.S. treasury securities	9,483	53		9,536
U.S. agency obligations	101,094	1,296	(1)	102,389
	$ 387,443	$ 3,677	$ (415)	$ 390,705

	October 31, 2008	January 31, 2008
Recorded as follows (in thousands):		
Short-term (due in one year or less)	$ 219,144	$ 171,748
Long-term (due between one and 3 years)	203,148	218,957
	$ 422,292	$ 390,705

At October 31, 2008, the following investments were in an unrealized loss position (in thousands):

	Less than 12 Months		12 Months or Greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Corporate notes and obligations	$ 133,332	$ (2,993)	$ 14,827	$ (862)	$ 148,159	$ (3,855)
U.S. agency obligations	68,689	(329)			68,689	(329)

$ 202,021	$ (3,322)	$ 14,827	$ (862)	$ 216,848	$ (4,184)

The unrealized loss for each of these fixed rate investments ranged from less than $1,000 to $541,000. The Company does not believe any of the unrealized losses represent an other-than-temporary impairment based on its evaluation of available evidence as of October 31, 2008. The Company expects to receive the full principal and interest on these investment securities.

Table of Contents

salesforce.com, inc.

Notes to Condensed Consolidated Financial Statements (Continued)

Prepaid Expenses and Other Current Assets

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

	October 31, 2008	January 31, 2008
Deferred professional services costs	$ 12,847	$ 9,376
Prepaid expenses and other current assets	26,900	17,679
	$ 39,747	$ 27,055

Fixed Assets

Fixed assets consisted of the following (in thousands):

	October 31, 2008	January 31, 2008
Computers, equipment and software	$ 54,583	$ 34,197
Furniture and fixtures	12,626	8,354
Leasehold improvements	49,894	36,279
	117,103	78,830
Less accumulated depreciation and amortization	(50,270)	(37,450)
	$ 66,833	$ 41,380

Depreciation and amortization expense totaled $5.5 million and $4.5 million for the three months ended October 31, 2008 and 2007, respectively, and $15.0 million and $12.3 million for the nine months ended October 31, 2008 and 2007, respectively.

Fixed assets at October 31, 2008 and January 31, 2008 included $8.4 million and $3.6 million, respectively, acquired under capital lease agreements. Accumulated amortization relating to equipment and software under capital leases totaled $3.7 million and $3.6 million, respectively, at October 31, 2008 and January 31, 2008. Amortization of assets under capital leases is included in depreciation and amortization expense.

In February 2008, the Company expanded one of its existing software license agreements to provide additional capacity in its business operations at a cost of $8.0 million. These software licenses are being depreciated over their useful life of 5 years.

Capitalized Software

Capitalized software consisted of the following (in thousands):

	October 31, 2008	January 31, 2008
Capitalized internal-use software development costs, net of accumulated amortization of $9,567 and $4,898, respectively	$ 17,233	$ 13,932
Acquired developed technology, net of accumulated amortization of $11,344 and $6,542, respectively	14,717	9,129
	$ 31,950	$ 23,061

Table of Contents

salesforce.com, inc.

Notes to Condensed Consolidated Financial Statements (Continued)

Capitalized internal use software amortization expense totaled $1.8 million and $0.8 million for the three months ended October 31, 2008 and 2007, respectively. Acquired developed technology amortization expense for the three months ended October 31, 2008 and 2007, was $2.1 million and $1.3 million, respectively. Capitalized internal use software amortization expense totaled $4.7 million and $1.7 million for the nine months ended October 31, 2008 and 2007, respectively. Acquired developed technology amortization expense for the nine months ended October 31, 2008 and 2007, was $4.8 million and $3.6 million, respectively.

In August 2008, the Company acquired InStranet, Inc. Of the $31.6 million purchase price consideration, $8.6 million was allocated to acquired developed technology (see note 7, Acquisitions).

Other Assets

Other assets consisted of the following (in thousands):

	October 31, 2008	January 31, 2008
Deferred professional services costs, noncurrent portion	$ 4,493	$ 4,546
Long-term deposits	7,676	6,682
Purchased intangible assets, net of accumulated amortization of $1,553 and $678, respectively	6,583	1,509
Purchase of subsidiary stock (see note 7, Acquisitions)	21,586	
Other	7,037	1,144
	$ 47,375	$ 13,881

In August 2008, the Company acquired InStranet, Inc. Of the $31.6 million purchase price consideration, $6.0 million was allocated to customer relationships which is included in purchased intangible assets (see note 7, Acquisitions).

Accrued Expenses and Other Current Liabilities

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

	October 31, 2008	January 31, 2008
Accrued compensation	$ 55,595	$ 63,327
Accrued other liabilities	40,218	20,988
Accrued other taxes payable	17,077	19,564
Accrued professional costs	4,877	6,980
Accrued rent	15,021	15,137
Capital lease obligations	1,812	
	$ 134,600	$ 125,996

3. Stockholders Equity

Stock Options Issued to Employees

The 1999 Stock Option Plan (the 1999 Plan) provides for the issuance of incentive and nonstatutory options to employees and nonemployees of the Company. The 1999 Plan provides for grants of immediately exercisable options; however, the Company has the right to repurchase any unvested common stock upon the termination of employment at the original exercise price.

Table of Contents

salesforce.com, inc.

Notes to Condensed Consolidated Financial Statements (Continued)

In addition to the 1999 Plan, the Company maintains the 2004 Equity Incentive Plan, the 2004 Employee Stock Purchase Plan and the 2004 Outside Directors Stock Plan. These plans, other than the 2004 Outside Directors Stock Plan, provide for annual automatic increases on February 1 to the shares reserved for issuance based on the lesser of (i) a specific percentage of the total number of shares outstanding at year end; (ii) a fixed number of shares; or (iii) a lesser number of shares set by the Company s Board of Directors, all as specified in the respective plans. On February 1, 2008, 4.0 million additional shares were reserved under the 2004 Equity Incentive Plan pursuant to the automatic increase.

The 2004 Employee Stock Purchase Plan will not be implemented unless and until the Company s Board of Directors authorizes the commencement of one or more offerings under the plan. No offering periods have been authorized to date.

In April 2006, the Company s Board of Directors approved the 2006 Inducement Equity Incentive Plan (the Inducement Plan) that allows for stock option and other equity incentive grants to employees in connection with merger or acquisition activity. The total number of shares reserved for issuance under the Inducement Plan is 400,000 shares. As of October 31, 2008, there were 98,730 shares of common stock available for grant under the Inducement Plan.

Prior to February 1, 2006, options issued under the Company s stock option plans were generally for periods not to exceed 10 years and were issued at fair value of the shares of common stock on the date of grant as determined by the trading price of such stock on the New York Stock Exchange. After February 1, 2006, options issued to employees are for periods not to exceed 5 years which is the contractual life. Grants made pursuant to the 2004 Equity Incentive Plan and the Inducement Plan do not provide for the immediate exercise of options.

Stock plan activity for the nine months ended October 31, 2008 is as follows:

	Shares Available for Grant	Options Outstanding		
		Outstanding Stock Options	Weighted-Average Exercise Price	Aggregate Intrinsic Value (in thousands)
Balance as of January 31, 2008	6,029,787	13,409,345	$ 27.83	
Increase in options authorized:				
2004 Equity Incentive Plan	4,000,000			
Options granted under all plans	(1,454,270)	1,454,270	$ 56.53	
Restricted stock units granted	(609,746)			
Stock grants to board members for board services and advisory board members	(38,550)			
Exercised		(2,160,042)	$ 18.80	
Restricted stock units cancelled	127,387			
Options cancelled	429,439	(429,439)	$ 38.27	
Balance as of October 31, 2008	8,484,047	12,274,134	$ 32.46	$ 92,664
Vested or expected to vest		11,186,860	$ 31.35	$ 91,491
Exercisable at October 31, 2008		5,784,293	$ 17.64	$ 86,757

The total intrinsic value of the options exercised during the nine months ended October 31, 2008 and 2007 were $97.8 million and $109.4 million, respectively.

The weighted-average remaining contractual life of vested and expected to vest options is approximately 5 years.

20

Table of Contents

salesforce.com, inc.

Notes to Condensed Consolidated Financial Statements (Continued)

As of October 31, 2008, options to purchase 5,784,293 shares were vested at a weighted average exercise price of $17.64 per share and a remaining weighted-average remaining contractual life of approximately 5 years. The total intrinsic value of these vested options as of October 31, 2008 was $86.8 million.

The following table summarizes information about stock options outstanding as of October 31, 2008:

	Options Outstanding			Options Vested	
Range of Exercise Prices	Number Outstanding	Weighted-Average Remaining Contractual Life (Years)	Weighted-Average Exercise Price	Number of Shares	Weighted-Average Exercise Price
$0.40 to $8.00	2,377,581	4.77	$ 4.24	2,376,101	$ 4.24
$12.77 to $23.05	1,762,759	6.26	16.43	1,441,256	16.12
$23.57 to $34.85	1,921,971	4.11	29.88	963,909	29.81
$35.15 to $39.97	1,760,847	3.55	38.08	730,879	38.06
$40.50 to $52.48	3,014,026	3.97	50.23	249,123	43.86
$52.76 to $68.25	1,419,730	4.42	57.94	23,025	54.22
$70.86	17,220	4.65	70.86		
	12,274,134		$ 32.46	5,784,293	$ 17.64

Restricted stock unit activity for the nine months ended October 31, 2008 is as follows:

	Restricted Stock Units Outstanding		
	Outstanding	Weighted-Average Exercise Price	Aggregate Intrinsic Value (in thousands)
Balance as of January 31, 2008	1,717,290	$ 0.001	
Granted	609,746	0.001	
Issued	(312,123)	0.001	
Cancelled	(130,511)	0.001	
Balance as of October 31, 2008	1,884,402	$ 0.001	$ 58,341
Expected to vest	1,577,998		$ 48,855

The restricted stock units, which upon vesting entitles the holder to one share of common stock for each restricted stock unit, have an exercise price of $0.001 per share, which is equal to the par value of the Company s common stock, and vest over 4 years. The Company first awarded restricted stock units in May 2006.

Common Stock

The following shares of common stock are available for future issuance at October 31, 2008:

Options outstanding	12,274,134
Restricted stock units outstanding	1,884,402
Stock available for future grant:	
1999 Stock Option Plan	708,485
2004 Equity Incentive Plan	6,957,832
2006 Inducement Equity Incentive Plan	98,730
2004 Employee Stock Purchase Plan	1,000,000
2004 Outside Directors Stock Plan	719,000
	23,642,583

Table of Contents

salesforce.com, inc.

Notes to Condensed Consolidated Financial Statements (Continued)

4. Commitments and Contingencies

Letters of Credit

As of October 31, 2008, the Company had a total of $8.5 million in letters of credit and bank guarantees outstanding for office space in San Francisco, California, New York City, Singapore, Sweden, United Kingdom, Australia and Switzerland. The letters of credit renew annually and mature at various dates through December 2016.

Leases

The Company leases office space and equipment under noncancelable capital and operating leases with various expiration dates.

As of October 31, 2008, the future minimum lease payments are as follows (in thousands):

	Capital Leases	Operating Leases
Remaining three months in fiscal 2009	$ 487	$ 24,424
Fiscal 2010	1,949	75,881
Fiscal 2011	1,949	61,590
Fiscal 2012	1,137	43,284
Fiscal 2013		34,826
Thereafter		90,754
Total minimum lease payments	5,522	$ 330,759
Less: amount representing interest	(386)	
Present value of capital lease obligations	$ 5,136	

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

5. Legal Proceedings

The Company is involved in various legal proceedings arising from the normal course of business activities. In management s opinion, resolution of these matters is not expected to have a material adverse impact on the Company s consolidated results of operations, cash flows or its financial position. However, depending on the nature and timing of any such dispute, an unfavorable resolution of a matter could materially affect the Company s future results of operations, cash flows or financial position in a particular period.

6. Related-Party Transactions

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

Since the Foundation s inception, the Company has provided at no charge certain resources to Foundation employees such as office space. The value of these items totals approximately $35,000 per quarter.

Table of Contents

salesforce.com, inc.

Notes to Condensed Consolidated Financial Statements (Continued)

In addition to the resource sharing with the Foundation, the Company issued the Foundation warrants in August 2002 to purchase 500,000 shares of common stock. Through October 31, 2008, the Foundation exercised all of these warrants. As of October 31, 2008, the Foundation held 196,500 shares of salesforce.com common stock. Additionally, the Company has donated subscriptions to the Company s service to other qualified non-profit organizations. The fair value of these donated subscriptions is in excess of $2.0 million per month. The Company plans to continue providing free subscriptions to qualified non-profit organizations.

7. Acquisitions

In August 2008, the Company acquired 100 percent of the outstanding stock of InStranet, Inc. (InStranet), a privately-held company with operations in Paris, France, and Chicago, Illinois for $31.6 million in cash. InStranet offers a knowledge management application for business to consumer call centers. The Company acquired InStranet for its developed technology in order to expand its CRM customer service and support offerings in the customer service and support market. The Company accounted for this acquisition using Statement of Financial Accounting Standards No. 141, *Business Combinations*. Accordingly, the results of operations for the acquired business are included in the accompanying condensed consolidated statements of operations since the acquisition date, and the related assets and liabilities were recorded based upon their fair values as of the acquisition date. Pro forma results of operations have not been presented because the effects of the acquisition were not significant.

The preliminary allocation of the purchase price below was based upon a preliminary valuation and the Company s estimates and assumptions are subject to change. The primary areas of those purchase price allocations that are not finalized relate to certain income and non-income based taxes and residual goodwill. The preliminary valuation of acquired assets and liabilities performed in part by an unrelated third-party appraiser, is as follows (in thousands):

Net tangible assets	$ 3,863
Developed product technology	8,610
Customer relationships	5,950
Goodwill	19,003
Deferred tax liability	(5,851)
Total purchase price consideration	$ 31,575

Customer relationships and developed technologies have a useful life of 3 years. The goodwill balance of $19.0 million is not deductible for tax purposes. This asset is attributed to the premium paid for an established knowledge management application.

In performing the preliminary purchase price allocation, the Company considered, among other factors, its intention for future use of the acquired assets, analysis of historical financial performance and estimates of future performance of InStranet s knowledge management application. The fair value of intangible assets was primarily based on the income approach.

Salesforce Japan

In the third quarter of fiscal 2009, the Company acquired shares held by minority shareholders and increased its ownership to 72 percent. The Company plans to account for this purchase as a step-acquisition. The preliminary allocation is not completed and will be completed in the fourth quarter.

Table of Contents

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

The following discussion in Management s Discussion and Analysis of Financial Condition and Results of Operations (MD&A) contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Forward-looking statements consist of, among other things, trend analyses, statements regarding future events, future financial performance, our business strategy and our plan to build our business, the expenses associated with our data center capacity, our anticipated growth, trends in our business, new application service features, our strategy of acquiring or making investments in complementary companies, services and technologies, the effect of general economic and market conditions including sudden declines in the fair value of our investments in cash equivalents and marketable securities, the effect of foreign currency exchange rate and interest rate fluctuations on our financial results, the potential availability of additional tax assets in the future and related matters, the impact of expensing stock options, the sufficiency of our capital resources, and our strategy to become a platform player for on-demand applications, all of which are based on current expectations, estimates, and forecasts, and the beliefs and assumptions of our management. Words such as expects, anticipates, projects, intends, plans, believes, estimates, variations of such words, and similar expressions are also intended to identify such forward-looking statements. These forward-looking statements are subject to risks, uncertainties and assumptions that are difficult to predict. Therefore, actual results may differ materially and adversely from those expressed in any forward-looking statements. Readers are directed to risks and uncertainties identified below, under Risk Factors and elsewhere in this report, for factors that may cause actual results to be different than those expressed in these forward-looking statements. Except as required by law, we undertake no obligation to revise or update publicly any forward-looking statements for any reason.

Overview

We are the leading provider, based on revenues and market share, of software on demand, according to a July 2007 report by IDC. We provide a comprehensive CRM service to businesses of all sizes and industries worldwide.

We were founded in February 1999 and began offering our on-demand CRM application service in February 2000.

Our objective is to be the leading provider of on-demand application services for businesses worldwide and to be the leading platform on which our customers and partners build on-demand applications. Key elements of our strategy include:

Strengthening our CRM applications and extending into new application areas;

Continuing to lead the industry transformation to software-as-a-service and platform-as-a service;

Pursuing new customers and new territories aggressively;

Deepening relationships within our existing customer base; and

Encouraging the development of third-party applications on our Force.com platform.

We believe the factors that would influence our ability to achieve our objective include our prospective customers willingness to migrate to an on-demand application service; the performance and security of our service; our ability to continue to release, and gain customer acceptance of, new and improved features; successful customer adoption and utilization of our service; acceptance of our service in markets where we have few customers; the emergence of additional competitors in our market and improved product offerings by existing and new competitors; the location of new data centers; third-party developers willingness to develop applications on our platform; and our ability to manage growth.

Table of Contents

To address these factors, we will need to, among other things, continue to add substantial numbers of paying subscriptions, upgrade our customers to versions such as our Unlimited Edition, provide high quality technical support to our customers and encourage the development of third-party applications on our Force.com platform. We also plan to invest for future growth by expanding our data center capacity both domestically and internationally, and we are opening a new data center in Singapore. We also plan to hire additional personnel, particularly in direct sales and other customer-related areas. During the three months ended October 31, 2008, we added 272 employees and our headcount as of October 31, 2008 was 3,318. We also plan to expand our domestic and international selling and marketing activities; add additional distribution channels; increase our research and development activities to upgrade and extend our service offerings and to develop new services and technologies; expand the number of locations around the world where we conduct business; add to our infrastructure to support our growth; and expand our operational systems to manage a growing business. Additionally, in our effort to further strengthen and extend our service offering, we may in the future acquire or make investments in complementary companies, services and technologies.

In August 2008, we acquired InStranet, Inc. which offers a knowledge management application for business to consumer call centers. We acquired InStranet, Inc. for its developed technology in order to expand our CRM customer service and support offerings in the customer service and support market.

We expect marketing and sales costs, which were 49 percent of our total revenues for the nine months ended October 31, 2008 and 51 percent for the same period a year ago, to continue to represent a substantial portion of total revenues in the future as we seek to add more paying subscribers, build brand awareness and increase the number of marketing events that we sponsor.

Fiscal Year

Our fiscal year ends on January 31. References to fiscal 2009, for example, refer to the fiscal year ended January 31, 2009.

Sources of Revenues

We derive our revenues from two sources: (1) subscription revenues, which are comprised of subscription fees from customers accessing our on-demand application service, and from customers purchasing additional support beyond the standard support that is included in the basic subscription fee; and (2) related professional services and other revenues. Other revenues consist primarily of training fees. Subscription and support revenues accounted for approximately 91 percent of our total revenues for the nine months ended October 31, 2008. Subscription revenues are driven primarily by the number of paying subscribers of our service and the subscription price of our service. None of our customers accounted for more than 5 percent of our revenues during the nine months ended October 31, 2008 and 2007, respectively.

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

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

Table of Contents

We recognize revenue in accordance with the provisions of SEC Staff Accounting Bulletin No. 104, *Revenue Recognition,* or SAB 104, and Emerging Issues Task Force, or EITF, Issue No. 00-21, *Revenue Arrangements with Multiple Deliverables,* or EITF 00-21. In determining whether professional services can be accounted for separately from subscription and support revenues, we consider a number of factors, which are described in Critical Accounting Policies and Estimates Revenue Recognition below. As we introduce new service offerings such as Unlimited Edition, Partner Edition and Salesforce Sandbox, we may not be able to establish objective and reliable evidence of fair value for these elements of our sales arrangements. As a result, when the professional services are sold together with subscription services that do not have objective and reliable evidence of fair value, the professional services fees cannot be accounted for separately, and the entire arrangement is accounted for as a single unit of accounting. In such situations, we recognize the entire arrangement fee ratably over the term of the subscription contract. Approximately 9 percent and 8 percent of our total deferred revenue as of October 31, 2008 and January 31, 2008, respectively, related to deferred professional services revenue.

Seasonal Nature of Deferred Revenue and Accounts Receivable

Deferred revenue primarily consists of billings to customers for our subscription service. Over 90 percent of the value of our billings to customers is for our subscription service. We generally invoice our customers in either quarterly or annual cycles, with a disproportionate weighting towards annual billings in the fourth quarter, primarily as a result of large enterprise account buying patterns. Additionally, our fourth quarter has historically been our strongest quarter for new business. The year on year compounding effect of this seasonality in both billing patterns and overall new business is causing the value of invoices that we generate in the fourth quarter for both new and existing customers to increase as a proportion of our total annual billings.

Accordingly, the sequential quarterly changes in accounts receivable and the related deferred revenue during the first three quarters of our fiscal year are not necessarily indicative of the billing activity that will occur in the fourth quarter.

The following table sets forth our accounts receivable and deferred revenue balances as of the end of each fiscal quarter:

(in thousands)	April 30, 2008	July 31, 2008	October 31, 2008	
Fiscal 2009				
Accounts receivable, net	$ 143,909	$ 146,982	$ 157,680	
Deferred revenue, current and noncurrent	470,297	479,546	469,534	

	April 30, 2007	July 31, 2007	October 31, 2007	January 31, 2008
Fiscal 2008				
Accounts receivable, net	$ 105,013	$ 114,046	$ 121,961	$ 220,061
Deferred revenue, current and noncurrent	295,672	321,852	340,808	480,894

	April 30, 2006	July 31, 2006	October 31, 2006	January 31, 2007
Fiscal 2007				
Accounts receivable, net	$ 72,337	$ 75,704	$ 82,808	$ 128,693
Deferred revenue, current and noncurrent	182,036	202,836	219,431	284,063

Cost of Revenues and Operating Expenses

Cost of Revenues. Cost of subscription and support revenues primarily consists of expenses related to hosting our service and providing support, the costs of additional data center capacity, depreciation or operating lease expense associated with computer equipment, costs associated with website development activities, allocated overhead and amortization expense associated with capitalized software related to our application service. We allocate overhead such as rent and occupancy charges based on headcount. Employee benefit costs and taxes are allocated based upon a percentage of total compensation expense. As such, general overhead

Table of Contents

expenses are reflected in each cost of revenue and operating expense category. Cost of professional services and other revenues consists primarily of employee-related costs associated with these services, including stock-based expenses, the cost of subcontractors and allocated overhead. The cost associated with providing professional services is significantly higher as a percentage of revenue than for our on-demand subscription service due to the labor costs associated with providing professional services.

We intend to continue to invest additional resources in our on-demand application service and in our consulting services. The timing of these additional expenses will affect our cost of revenues, both in terms of absolute dollars and as a percentage of revenues, in a particular quarterly period. For example, we have obtained additional data center capacity on the west and east coasts of the United States and we are opening a data center in Singapore. We expect the annual cost of these resources to be significant.

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

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

We plan to continue to invest heavily in marketing and sales by increasing the number of direct sales personnel in order to add new customers and increase penetration within our existing customer base, expanding our domestic and international selling and marketing activities, building brand awareness and sponsoring additional marketing events. We expect that in the future, marketing and sales expenses will increase in absolute dollars and continue to be our largest cost.

General and Administrative. General and administrative expenses consist of salaries and related expenses, including stock-based expenses, for finance and accounting, human resources and management information systems personnel, legal costs, professional fees, other corporate expenses and allocated overhead. We expect that in the future, general and administrative expenses will increase in absolute dollars as we add personnel and incur additional professional fees and insurance costs related to the growth of our business and international expansion.

Stock-Based Expenses. Our cost of revenues and operating expenses include stock-based expenses related to option and stock awards to employees and non-employee directors. We account for stock-based expenses pursuant to the provisions of Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment*, or SFAS 123R. SFAS 123R requires that share-based payments, including grants of employee stock options be recognized as an expense in the statement of operations based on their fair values and vesting periods. These charges are significant and we expect them to increase in absolute dollars in the future.

Joint Venture

In December 2000, we established a Japanese joint venture, Kabushiki Kaisha salesforce.com, with SunBridge, Inc., a Japanese corporation, to assist us with our sales efforts in Japan. In the third quarter we acquired shares held by minority shareholders and increased our ownership to 72 percent. As we continue to

Table of Contents

maintain a majority interest, we consolidate the venture s financial results, which are reflected in each revenue, cost of revenues and expense category in our consolidated statement of operations. We then record minority interest, which reflects the minority investors interest in the venture s results, exclusive of intercompany charges. Through October 31, 2008, the operating performance and liquidity requirements of the Japanese joint venture have not been significant. While we plan to expand our selling and marketing activities in Japan in order to add new customers, we believe the future operating performance and liquidity requirements of the Japanese joint venture will not be significant.

Critical Accounting Policies and Estimates

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

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

Revenue Recognition. We recognize revenue in accordance with the provisions of SAB 104 and EITF 00-21.

We recognize revenue when all of the following conditions are satisfied: (1) there is persuasive evidence of an arrangement; (2) the service has been provided to the customer; (3) the collection of our fees is reasonably assured; and (4) the amount of fees to be paid by the customer is fixed or determinable. Our arrangements do not contain general rights of return.

We recognize subscription revenues ratably over the contract terms beginning on the commencement dates of each contract. Support revenues from customers who purchase our premium support offerings are recognized similarly over the term of the support contract. As part of their subscription agreements, customers generally benefit from new features and functionality with each release at no additional cost. In situations where we have contractually committed to an individual customer specific technology, we defer all of the revenue for that customer until the technology is delivered and accepted. Once delivery occurs, we then recognize the revenue over the remaining contract term.

Consulting services and training revenues are accounted for separately from subscription and support revenues when these services have value to the customer on a standalone basis and there is objective and reliable evidence of fair value of each deliverable. When accounted for separately, revenues are recognized as the services are rendered for time and material contracts, and when the milestones are achieved and accepted by the customer for fixed price contracts. The majority of our consulting service contracts are on a time and material basis. Training revenues are recognized after the services are performed. For revenue arrangements with multiple deliverables, such as an arrangement that includes subscription, premium support, consulting or training services, we allocate the total amount the customer will pay to the separate units of accounting based on their relative fair values, as determined by the price of the undelivered items when sold separately.

In determining whether the consulting services can be accounted for separately from subscription and support revenues, we consider the following factors for each consulting agreement: availability of the consulting services from other vendors, whether objective and reliable evidence for fair value exists for the undelivered elements, the nature of the consulting services, the timing of when the consulting contract was signed in comparison to the subscription service start date, and the contractual dependence of the subscription service on the customer s satisfaction with the consulting work. If a consulting arrangement does not qualify for separate

Table of Contents

accounting, we recognize the consulting revenue ratably over the remaining term of the subscription contract. Additionally, in these situations we defer the direct costs of the consulting arrangement and amortize those costs over the same time period as the consulting revenue is recognized. The deferred cost on our condensed consolidated balance sheet totaled $17.3 million at October 31, 2008 and $13.9 million at January 31, 2008. Such amounts are included in prepaid expenses and other current assets and other assets.

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

During the nine months ended October 31, 2008, we deferred $40.6 million of commission expenditures and we amortized $43.4 million to sales expense. During the same period a year ago, we deferred $33.0 million of commission expenditures and we amortized $29.7 million to sales expense. Deferred commissions on our condensed consolidated balance sheets totaled $49.3 million at October 31, 2008 and $52.1 million at January 31, 2008.

Accounting for Stock-Based Awards. We account for share-based compensation under SFAS 123R. We recognize the fair value of our stock awards on a straight-line basis over the requisite service period of the award, which is the vesting term of four years.

We recognized stock-based expense of $56.2 million, or 7 percent of revenue, during the nine months ended October 31, 2008. The requirement to expense stock-based awards will continue to materially reduce our reported results of operations. As of October 31, 2008, we had an aggregate of $219.6 million of stock compensation remaining to be amortized to expense over the remaining requisite service period of the underlying awards. We currently expect this stock compensation balance to be amortized as follows: $23.9 million during the remaining three months of fiscal 2009; $87.3 million during fiscal 2010; $65.3 million during fiscal 2011, $38.5 million during fiscal 2012 and $4.6 million during fiscal 2013. These amounts reflect only outstanding stock awards as of October 31, 2008 and assume no forfeiture activity. We expect to continue to issue share-based awards to our employees in future periods.

We grant stock options and restricted stock units to employees throughout the world. In certain foreign jurisdictions, we are obligated for the payroll or social tax costs when employees exercise their vested awards. Pursuant to SFAS 123R, we recognize as an operating expense the payroll and social tax costs at the time of the exercise. As of October 31, 2008, we would incur as an operating expense in excess of $2.6 million for these taxes if all vested awards outstanding by employees in these foreign jurisdictions were exercised. This amount is based on the number of vested awards held and the market price of our common stock as of October 31, 2008. The timing of when employees in these foreign jurisdictions exercise their vested awards could materially affect our future results of operations in a particular period.

The impact of SFAS 123R in the future is dependent upon, among other things, the timing of when we hire additional employees, the effect of long-term incentive strategies involving stock awards in order to continue to attract and retain employees, the total number of stock awards granted and the timing of when those awards are granted, the fair value of the stock awards at the time of grant, changes in estimated forfeiture assumption rates and the tax benefit that we may or may not receive from stock-based expenses. Additionally, the application of SFAS 123R requires the use of an option-pricing model to determine the fair value of stock option awards. This determination of fair value is affected by our stock price as well as assumptions regarding a number of highly

Table of Contents

complex and subjective variables. These variables include, but are not limited to, our expected stock price volatility over the term of the awards.

As of October 31, 2008, there were 1,884,402 restricted stock units outstanding. We plan to continue awarding restricted stock units to our employees in the future. The restricted stock units, which upon vesting entitles the holder to one share of common stock for each restricted stock unit, have an exercise price of $0.001 per share, which is equal to the par value of our common stock, and vest over 4 years. The fair value of the restricted stock units is based on our closing stock price on the date of grant, and compensation expense, net of estimated forfeitures, is recognized on a straight-line basis over the vesting period.

Accounting for Income Taxes. We account for income taxes using the liability method, which requires the recognition of deferred tax assets or liabilities for the tax-effected temporary differences between the financial reporting and tax bases of our assets and liabilities and for net operating loss and tax credit carryforwards. The tax expense or benefit for unusual items, or certain adjustments to the valuation allowance are treated as discrete items in the interim period in which the events occur.

Our effective tax rate could be adversely affected by changes in the mix of earnings and losses in countries with differing statutory tax rates, certain non-deductible expenses arising from SFAS 123R and the valuation of deferred tax assets and liabilities.

Table of Contents

Results of Operations

The following tables set forth selected data for each of the periods indicated and are in thousands, except for per share data. All data is unaudited.

	Three months ended October 31,		Nine months ended October 31,	
	2008	2007	2008	2007
Revenues:				
Subscription and support	$ 253,403	$ 176,376	$ 718,464	$ 484,064
Professional services and other	23,084	16,427	68,722	47,730
Total revenues	276,487	192,803	787,186	531,794
Cost of revenues :				
Subscription and support	32,424	23,887	91,802	66,446
Professional services and other	23,924	20,394	69,935	58,414
Total cost of revenues	56,348	44,281	161,737	124,860
Gross profit	220,139	148,522	625,449	406,934
Operating expenses:				
Research and development	26,270	16,892	70,070	46,109
Marketing and sales	136,452	96,216	389,930	270,357
General and administrative	41,284	29,296	117,797	80,889
Total operating expenses	204,006	142,404	577,797	397,355
Income from operations	16,133	6,118	47,652	9,579
Interest, net	3,840	6,556	17,270	17,178
Gain on sale of investment		1,272		1,272
Other income (expense)	534	285	(1,069)	734
Income before provision for income taxes and minority interest	20,507	14,231	63,853	28,763
Provision for income taxes	(8,824)	(6,594)	(29,693)	(15,089)
Income before minority interest	11,683	7,637	34,160	13,674
Minority interest in consolidated joint venture	(1,559)	(1,125)	(4,485)	(2,697)
Net income	$ 10,124	$ 6,512	$ 29,675	$ 10,977
Basic net income per share	$ 0.08	$ 0.06	$ 0.25	$ 0.09
Diluted net income per share	0.08	0.05	0.24	0.09
Weighted-average number of shares used in per share amounts:				
Basic	121,635	117,361	120,759	116,208
Diluted	125,133	122,169	125,173	121,429
In addition to the statement of operations data above:				
Cash flow provided by operating activities	$ 17,121	$ 51,998	$ 154,028	$ 123,482

	October 31, 2008	As of January 31, 2008	October 31, 2007
Balance sheet data:			

Cash, cash equivalents and marketable securities	$ 804,606	$ 669,800	$ 571,003
Deferred revenue	469,534	480,894	340,808

Table of Contents

	Three months ended October 31,		Nine months ended October 31,	
	2008	2007	2008	2007
Revenues by geography:				
Americas	$ 200,143	$ 141,682	$ 567,076	$ 399,477
Europe	48,076	33,880	142,597	88,614
Asia Pacific	28,268	17,241	77,513	43,703
	$ 276,487	$ 192,803	$ 787,186	$ 531,794

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

	Three months ended October 31,		Nine months ended October 31,	
	2008	2007	2008	2007
Cost of revenues	$ 2,817	$ 2,014	$ 8,149	$ 5,753
Research and development	2,494	1,685	6,852	4,472
Marketing and sales	9,235	6,313	26,105	18,197
General and administrative	4,730	4,166	15,119	11,199
	$ 19,276	$ 14,178	$ 56,225	$ 39,621

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

	Three months ended October 31,		Nine months ended October 31,	
	2008	2007	2008	2007
Revenues:				
Subscription and support	92%	91%	91%	91%
Professional services and other	8	9	9	9
Total revenues	100	100	100	100
Cost of revenues:				
Subscription and support	12	12	12	12
Professional services and other	8	11	9	11
Total cost of revenues	20	23	21	23
Gross profit	80	77	79	77
Operating expenses:				
Research and development	10	9	9	9
Marketing and sales	49	50	49	51
General and administrative	15	15	15	15
Total operating expenses	74	74	73	75
Income from operations	6	3	6	2
Interest, net	1	3	2	3
Gain on sale of investment		1		
Other income (expense)				

Income before provision for income taxes and minority interest	7	7	8	5
Provision for income taxes	(3)	(3)	(4)	(3)
Income before minority interest	4	4	4	2
Minority interest in consolidated joint venture		(1)		
Net income	4%	3%	4%	2%

Table of Contents

	Three months ended October 31,		Nine months ended October 31,	
	2008	2007	2008	2007
Revenues by geography:				
Americas	72%	73%	72%	75%
Europe	17	18	18	17
Asia Pacific	11	9	10	8
	100%	100%	100%	100%

	Three months ended October 31,		Nine months ended October 31,	
	2008	2007	2008	2007
Stock-based expenses:				
Cost of revenues	1%	1%	1%	1%
Research and development	1	1	1	1
Marketing and sales	3	3	3	3
General and administrative	2	2	2	2
	7%	7%	7%	7%

Overview of the Three Months Ended October 31, 2008

During the three months ended October 31, 2008, net income was $10.1 million. Included in net income was $19.3 million of stock-based expenses and a $2.0 million loss for investments in a money market mutual fund and corporate note where the decline in their fair values were determined to be other-than-temporary. Net income during the same period a year ago was $6.5 million and included $14.2 million of stock-based expenses.

In August 2008, we acquired InStranet, Inc. for $31.6 million in cash, InStranet offers a knowledge management application for business to consumer call centers and websites. The results of operations of InStranet are included in the accompanying condensed consolidated statements of operations since the acquisition date. During the quarter we acquired shares held by minority shareholders in Salesforce Japan. These purchases increased our ownership to 72 percent.

Revenues during the three months ended October 31, 2008 were $276.5 million, an increase of 43 percent over the same period a year ago.

Our business has grown rapidly since we began offering our on-demand application service in February 2000, resulting in significant revenue growth since that time. We expect that our total revenue will continue to grow as we add more customers, add more paying subscriptions, sell advanced modules for an additional subscription fee to customers who require additional capabilities, upgrade our customers to versions such as our Unlimited Edition, and add additional distribution channels. However, our revenue growth rate as a percentage may decline over time because of the difficulty in maintaining growth rates as our revenue in absolute dollars increases to higher levels and because of unfavorable changes in foreign exchange rates.

Our gross profit during the three months ended October 31, 2008 was $220.1 million, or 80 percent of revenues. Our operating income was $16.1 million or 6 percent of revenues and included stock-based expenses of $19.3 million or 7 percent of revenues. During the same period a year ago, we generated a gross profit of $148.5 million or 77 percent of revenues. For the three months ended October 31, 2007 we had $6.1 million of operating income, which included $14.2 million of stock-based expenses or 7 percent of revenues.

Table of Contents

During the three months ended October 31, 2008, we invested for future growth in an effort to expand our business. We added sales personnel to focus on adding new customers and increasing subscriptions sales to existing customers, and we added developers to broaden and enhance our on-demand service. We also invested in our infrastructure to meet the demands of an expanding business.

During the three months ended October 31, 2008, we generated $17.1 million of cash from operating activities, as compared to $52.0 million during the same period a year ago. At October 31, 2008, we had cash, cash equivalents and marketable securities of $804.6 million, as compared to $571.0 million at October 31, 2007, accounts receivable of $157.7 million at October 31, 2008, as compared to $122.0 million at October 31, 2007, and deferred revenue, current and noncurrent of $469.5 million at October 31, 2008, as compared to $340.8 million at October 31, 2007.

Three Months Ended October 31, 2008 and 2007

Revenues.

	Three months ended October 31,		Variance	
(In thousands)	**2008**	**2007**	**Dollars**	**Percent**
Subscription and support	$ 253,403	$ 176,376	$ 77,027	44%
Professional services and other	23,084	16,427	6,657	41%
Total revenues	$ 276,487	$ 192,803	$ 83,684	43%

The growth in total revenues for the three months ended October 31, 2008 compared to the same period of fiscal 2008 was primarily attributed to 44 percent increase in subscription and support revenue as a result of an increased number of paying subscriptions and customers. The increase of 41 percent in professional services and other revenue compared to the same period a year ago was attributed to the higher demand for services from an increased number of paying subscriptions and customers.

Revenues in Europe and Asia Pacific accounted for $76.3 million, or 28 percent of total revenues, for the three months ended October 31, 2008, compared to $51.1 million, or 27 percent of total revenues, for the same period a year ago. The increase in revenues outside of the Americas was the result of our efforts to expand internationally. Additionally, the value of the U.S. dollar relative to foreign currencies contributed to the increase in total revenues in the three months ended October 31, 2008 as compared to the same period a year ago. The foreign currency impact compared to the same period a year ago was an increase of $2.5 million. As part of our overall growth, we expect the percentage of our revenue generated in Europe and Asia Pacific to continue to increase as a percentage of our total revenues world wide.

Cost of Revenues.

	Three months ended October 31,		Variance
(In thousands)	**2008**	**2007**	**Dollars**
Subscription and support	$ 32,424	$ 23,887	$ 8,537
Professional services and other	23,924	20,394	3,530
Total cost of revenues	$ 56,348	$ 44,281	$ 12,067
Percent of total revenues	20%	23%	

The increase in absolute dollars was primarily due to $2.5 million in employee-related costs, $0.8 million in stock-based expenses, $1.6 million in service delivery costs, primarily due to incremental data center capacity, $2.0 million in depreciation and amortization expenses, $3.3 million in outside subcontractor and other service

Table of Contents

costs, and $0.7 million in allocated overhead. The cost of professional services and other that was in excess of the related revenue was $840,000 during the three months ended October 31, 2008, as compared to $4.0 million during the same period of fiscal 2008. This reduction was the result of increasing the utilization of existing professional services staff, utilizing more outside subcontractors and not increasing professional services headcount. Professional services headcount did not increase significantly when compared to October 31, 2007, but headcount to support subscription and support services increased by 40 percent when compared to the same period a year ago.

We intend to continue to invest additional resources in our on-demand application service and in our capacity to deliver professional services. The timing of these additional expenses, as well as the costs of our new data center in Asia, will affect our cost of revenues, both in terms of absolute dollars and as a percentage of revenues. Additionally, we expect the cost of professional services and other revenue to continue to approximate the related revenue during the remainder of fiscal 2009.

Research and Development.

	Three months ended October 31,		Variance
(In thousands)	**2008**	**2007**	**Dollars**
Research and development	$ 26,270	$ 16,892	$ 9,378
Percent of total revenues	10%	9%	

This increase in absolute dollars was primarily due to $8.0 million in employee-related costs and $0.8 million in stock-based expenses. We increased our research and development headcount by 52 percent since October 31, 2007 in order to upgrade and extend our service offerings and develop new services and technologies.

Marketing and Sales.

	Three months ended October 31,		Variance
(In thousands)	**2008**	**2007**	**Dollars**
Marketing and sales	$ 136,452	$ 96,216	$ 40,236
Percent of total revenues	49%	50%	

The increase in absolute dollars was primarily due to $27.5 million in employee-related costs, $2.9 million in stock-based expenses, $2.6 million in advertising, marketing and event costs, $1.1 million in professional services and outside service costs and $5.4 million in allocated overhead. Our marketing and sales headcount increased by 37 percent since October 31, 2007 as we hired additional sales personnel to focus on adding new customers and increasing penetration within our existing customer base.

General and Administrative.

	Three months ended October 31,		Variance
(In thousands)	**2008**	**2007**	**Dollars**
General and administrative	$ 41,284	$ 29,296	$ 11,988
Percent of total revenues	15%	15%	

The increase in absolute dollars was primarily due to the increases in employee-related costs. Our general and administrative head count increased by 35 percent since October 31, 2007 as we added personnel to support our growth.

Table of Contents

Operating Income.

(In thousands)	Three months ended October 31, 2008	2007	Variance Dollars
Operating income	$ 16,133	$ 6,118	$ 10,015
Percent of total revenues	6%	3%	

We generated operating income of $16.1 million during the three months ended October 31, 2008, compared to operating income of $6.1 million during the same period a year ago. Operating income for the three months ended October 31, 2008 included $19.3 million of stock-based expenses compared to $14.2 million for the same period a year ago.

Interest, Net.

(In thousands)	Three months ended October 31, 2008	2007	Variance Dollars
Interest, net	$ 3,840	$ 6,556	$ (2,716)
Percent of total revenues	1%	3%	

Interest, net consists of investment income on cash and marketable securities balances. Interest, net decreased by $2.7 million for the three months ended October 31, 2008 compared to the same period a year ago. During the three months ended October 31, 2008, we recorded a $2.0 million loss for our investment in marketable securities as discussed under Liquidity and Capital Resources . Due to the current decline in market interest rates since last year and our focus on capital preservation, we expect that in the future interest, net will continue to decline when compared to the same periods in the previous year.

Other Income.

(In thousands)	Three months ended October 31, 2008	2007	Variance Dollars
Other income	$ 534	$ 285	$ 249

Other income primarily consists of foreign currency translation adjustments. Other income increased due to realized and unrealized losses on foreign currency translations for the three months ended October 31, 2008 compared to the same period a year ago.

Provision for Income Taxes.

(In thousands)	Three months ended October 31, 2008	2007	Variance Dollars
Provision for income taxes	$ (8,824)	$ (6,594)	$ (2,230)
Effective tax rate	43%	46%	

We recorded a provision for income taxes of $8.8 million during the three months ended October 31, 2008, compared to $6.6 million during the same period a year ago.

Our effective tax rate for the three months ended October 31, 2008 was 43 percent compared to 46 percent for the same period a year ago. The decrease in our effective tax rate was attributed to a reduced proportion of foreign losses for which no tax benefit can be realized. In addition, during the quarter, we recorded tax credits as a result of the enactment of the Emergency Economic Stabilization Act of 2008 which extended the federal

36

Table of Contents

research tax credit. This research tax credit previously expired on December 31, 2007. See Note 1 Summary of Business and Significant Accounting Policies for our reconciliation of income taxes at the statutory federal rate to the provision for income taxes for the nine months ended October 31, 2008.

Nine Months Ended October 31, 2008 and 2007

Revenues.

	Nine months ended October 31,		Variance	
(In thousands)	**2008**	**2007**	**Dollars**	**Percent**
Subscription and support	$ 718,464	$ 484,064	$ 234,400	48%
Professional services and other	68,722	47,730	20,992	44%
Total revenues	$ 787,186	$ 531,794	$ 255,392	48%

Total revenues were $787.2 million for the nine months ended October 31, 2008, compared to $531.8 million during the same period a year ago, an increase of $255.4 million, or 48 percent. Subscription and support revenues were $718.5 million, or 91 percent of total revenues, for the nine months ended October 31, 2008, compared to $484.1 million, or 91 percent of total revenues, during the same period a year ago. The increase in subscription and support revenues was due primarily to the increase in the number of paying subscriptions. Professional services and other revenues were $68.7 million, or 9 percent of total revenues, for the nine months ended October 31, 2008, compared to $47.7 million, or 9 percent of total revenues, for the same period a year ago. The increase in professional services and other revenues was due primarily to the higher demand for services from an increased number of paying subscriptions and customers.

Revenues in Europe and Asia Pacific accounted for $220.1 million, or 28 percent of total revenues, during the nine months ended October 31, 2008, compared to $132.3 million, or 25 percent of total revenues, during the same period a year ago, an increase of $87.8 million, or 66 percent. The increase in revenues outside of the Americas was the result of our efforts to expand the number of locations around the world where we conduct business and our international selling and marketing activities.

Cost of Revenues.

	Nine months ended October 31,		Variance
(In thousands)	**2008**	**2007**	**Dollars**
Subscription and support	$ 91,802	$ 66,446	$ 25,356
Professional services and other	69,935	58,414	11,521
Total cost of revenues	$ 161,737	$ 124,860	$ 36,877
Percent of total revenues	21%	23%	

Cost of revenues was $161.7 million, or 21 percent of total revenues, during the nine months ended October 31, 2008, compared to $124.9 million, or 23 percent of total revenues, during the same period a year ago, an increase of $36.9 million. The increase in absolute dollars was primarily due to $7.6 million in employee-related costs, primarily all of which was related to our professional services organization, $2.4 million in stock-based expenses, $7.0 million in service delivery costs, primarily due to an increase in data center capacity, $8.8 million in outside subcontractor and other service costs, $4.6 million in depreciation and amortization expenses and $3.1 million in allocated costs. The impact of increasing the utilization of existing professional service staff, utilizing more outside subcontractors and not increasing professional services headcount resulted in the cost of professional services and other revenues approximately equalling the related revenue for the nine months ended October 31, 2008.

Table of Contents

Research and Development.

(In thousands)	Nine months ended October 31, 2008	2007	Variance Dollars
Research and development	$ 70,070	$ 46,109	$ 23,961
Percent of total revenues	9%	9%	

Research and development expenses were $70.1 million, or 9 percent of total revenues, during the nine months ended October 31, 2008, compared to $46.1 million, or 9 percent of total revenues, during the same period a year ago, an increase of $24.0 million. The increase in absolute dollars was primarily due to $18.2 million in employee-related costs, $1.0 million in infrastructure costs and $2.4 million in stock-based expenses. We increased our research and development headcount by 42 percent since January 31, 2008 in order to upgrade and extend our service offerings and develop new services and technologies.

Marketing and Sales.

(In thousands)	Nine months ended October 31, 2008	2007	Variance Dollars
Marketing and sales	$ 389,930	$ 270,357	$ 119,573
Percent of total revenues	49%	51%	

Marketing and sales expenses were $389.9 million, or 49 percent of total revenues, during the nine months ended October 31, 2008, compared to $270.4 million, or 51 percent of total revenues, during the same period a year ago, an increase of $119.6 million. The increase in absolute dollars was primarily due to $75.3 million in employee-related costs, $7.9 million in stock-based expenses, $2.2 million in outside subcontractor and other service costs, $1.5 million in partner referral costs, $15.5 million in marketing, advertising and event costs and $16.0 million in allocated overhead. Our marketing and sales headcount increased by 31 percent since January 31, 2008 as we hired additional sales personnel to focus on adding new customers and increasing penetration within our existing customer base.

General and Administrative.

(In thousands)	Nine months ended October 31, 2008	2007	Variance Dollars
General and administrative	$ 117,797	$ 80,889	$ 36,908
Percent of total revenues	15%	15%	

General and administrative expenses were $117.8 million, or 15 percent of total revenues, during the nine months ended October 31, 2008, compared to $80.9 million, or 15 percent of total revenues, during the same period a year ago, an increase of $36.9 million. The increase was primarily due to employee-related costs. Our general and administrative headcount increased by 22 percent since January 31, 2008 as we added personnel to support our growth.

Operating Income.

(In thousands)	Nine months ended October 31, 2008	2007	Variance Dollars
Operating income	$ 47,652	$ 9,579	$ 38,073
Percent of total revenues	6%	2%	

38

Table of Contents

Operating income during the nine months ended October 31, 2008 was $47.7 million and included $56.2 million of stock-based expenses related to SFAS 123R. During the same period a year ago, the operating income was $9.6 million. The increase in our revenues were re-invested in an effort to expand our business.

Interest, Net.

(In thousands)	Nine months ended October 31, 2008	2007	Variance Dollars
Interest, net	$ 17,270	$ 17,178	$ 92
Percent of total revenues	2%	3%	

Interest, net consists of investment income on cash and marketable securities balances. Interest, net was $17.3 million during the nine months ended October 31, 2008 and was $17.2 million during the same period a year ago. The increase is net of the $2.0 million in losses in marketable securities that we recorded during the three months ended October 31, 2008 as discussed under Liquidity and Capital Resources . Due to the current decline in market interest rates since last year and our focus on capital preservation we expect that in the future interest, net will decline when compared to the same periods in the previous year.

Other Income (expense).

(In thousands)	Nine months ended October 31, 2008	2007	Variance Dollars
Other income (expense)	$ (1,069)	$ 734	$ (1,803)

Other income (expense) primarily consists of foreign currency translation adjustments. Other income decreased due to realized and unrealized losses on foreign currency translations for the nine months ended October 31, 2008 compared to the same period a year ago.

Provision for Income Taxes.

(In thousands)	Nine months ended October 31, 2008	2007	Variance Dollars
Provision for income taxes	$ (29,693)	$ (15,089)	$ (14,604)
Effective tax rate	47%	52%	

We recorded a provision for income taxes of $29.7 million during the nine months ended October 31, 2008, compared to $15.1 million during the same period a year ago.

Our effective tax rate decreased to 47 percent for the nine months ended October 31, 2008 compared to 52 percent for the same period a year ago. The decrease in our effective tax rate was attributed to a reduced proportion of foreign losses for which no tax benefit can be realized. See Note 1 Summary of Business and Significant Accounting Policies Income Taxes to the Notes to the Condensed Consolidated Financial Statements for our reconciliation of income taxes at the statutory federal rate to the provision for income taxes.

Recent Accounting Pronouncements

In December 2007, the FASB issued Statement No. 141 (revised), *Business Combinations*. The standard changes the accounting for business combinations including the measurement of acquirer shares issued in consideration for a business combination, the recognition of contingent consideration, the accounting for

Table of Contents

preacquisition gain and loss contingencies, the recognition of capitalized in-process research and development, the accounting for acquisition-related restructuring cost accruals, the treatment of acquisition related transaction costs and the recognition of changes in the acquirer s income tax valuation allowance. SFAS 141(R) is effective for fiscal years beginning after December 15, 2008.

In December 2007, the FASB issued Statement No. 160, *Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51* or SFAS 160. The standard changes the accounting for noncontrolling (minority) interests in consolidated financial statements including the requirements to classify noncontrolling interests as a component of consolidated stockholders equity, and the elimination of minority interest accounting in results of operations with earnings attributable to noncontrolling interests reported as part of consolidated earnings. Additionally, SFAS 160 revises the accounting for both increases and decreases in a parent s controlling ownership interest. SFAS 160 is effective for fiscal years beginning after December 15, 2008, with early adoption prohibited. We are currently evaluating the impact of the pending adoption of SFAS 160 on our consolidated financial statements.

In March 2008, the FASB issued Statement No. 161, *Disclosures About Derivative Instruments and Hedging Activities*, or SFAS 161. This Standard enhances the disclosure requirements for derivative instruments and hedging activities. This Standard is effective January 1, 2009. Since SFAS 161 requires only additional disclosures concerning derivatives and hedging activities, adoption of SFAS 161 will not affect our financial condition, results of operations or cash flows.

In April 2008, the FASB issued FSP SFAS 142-3, *Determination of the Useful Life of Intangible Assets* (FSP 142-3). This guidance is intended to improve the consistency between the useful life of a recognized intangible asset under SFAS No. 142, *Goodwill and Other Intangible Assets* (SFAS 142), and the period of expected cash flows used to measure the fair value of the asset under SFAS 141(R) when the underlying arrangement includes renewal or extension of terms that would require substantial costs or result in a material modification to the asset upon renewal or extension. Companies estimating the useful life of a recognized intangible asset must now consider their historical experience in renewing or extending similar arrangements or, in the absence of historical experience, must consider assumptions that market participants would use about renewal or extension as adjusted for SFAS 142 s entity-specific factors. FSP 142-3 is effective for us beginning February 1, 2009. We are currently evaluating the potential impact of the adoption of FSP 142-3 on our consolidated financial statements.

Liquidity and Capital Resources

As of October 31, 2008, our principal sources of liquidity were cash, cash equivalents and marketable securities totaling $804.6 million and accounts receivable of $157.7 million.

Net cash provided by operating activities was $154.0 million during the nine months ended October 31, 2008 and $123.5 million during the same period a year ago. The improvement in cash flow was due primarily to the growth in our customer base and the associated increase in billings and collections. Cash provided by operating activities has historically been affected by the amount of net income, sales of subscriptions and support and professional services, changes in working capital accounts, particularly increases and the seasonality in accounts receivable and deferred revenue as described above, and the timing of commission and bonus payments, collections from large enterprise customers, and add-backs of non-cash expense items such as depreciation and amortization and the expense associated with stock-based awards.

Net cash used in investing activities was $131.7 million during the nine months ended October 31, 2008 and was $116.6 million during the same period a year ago. The net cash used in investing activities during the nine months ended October 31, 2008 primarily related to the acquisition of InStranet, Inc. and the purchase of shares of Salesforce Japan from the minority shareholders. In an addition, our investing activities included capital expenditures associated with leasehold improvements and the purchase of software licenses, computer equipment and furniture and fixtures as we have expanded our infrastructure, number of offices around the world and work

Table of Contents

force. In February 2008, we expanded one of our existing software license agreements to provide additional capacity in our business operations at a cost of $8.0 million.

Net cash provided by financing activities was $82.6 million during the nine months ended October 31, 2008 and $68.6 million during the same period a year ago. During the nine months ended October 31, 2008, net cash provided by financing activities consisted of $40.6 million of proceeds from the exercise of employee stock options and $42.2 million of excess tax benefits from employee stock plans.

Our cash, cash equivalents and marketable securities are comprised of corporate notes and obligations, U.S. treasury securities, U.S. agency obligations, time deposits, money market mutual funds and an investment in The Reserve Primary Fund (The Reserve Fund), a money market mutual fund that suspended redemptions and is in the process of being liquidated.

As of October 31, 2008 our investment portfolio included $45.1 million invested in The Reserve Fund with an estimated fair value of $43.9 million. During the three months ended October 31, 2008, we recorded a $1.2 million loss related to this decline in fair value that is considered other-than-temporary. While we believe we have the rights to the recovery of the entire $45.1 million investment, we cannot predict when The Reserve Fund will disperse our funds, or the amounts that we will receive. Therefore, we have recorded the aforementioned other-than-temporary loss.

As of October 31, 2008, we had a total of $8.5 million in letters of credit outstanding and bank guarantees for office space in San Francisco, California, New York City, Singapore, United Kingdom, Australia, Sweden and Switzerland. To date, no amounts have been drawn against the letters of credit, which renew annually and mature at various dates through December 2016.

We do not have any special purpose entities, and other than operating leases, we do not engage in off-balance sheet financing arrangements. Additionally, we currently do not have a bank line of credit. Our principal commitments consist of obligations under leases for office space, co-location facilities for data center capacity, the development and test data center, computer equipment and furniture and fixtures.

As of October 31, 2008, our future minimum lease payments are as follows (in thousands):

	Capital Leases	Operating Leases
Remaining three months in fiscal 2009	$ 487	$ 24,424
Fiscal 2010	1,949	75,881
Fiscal 2011	1,949	61,590
Fiscal 2012	1,137	43,284
Fiscal 2013		34,826
Thereafter		90,754
Total minimum lease payments	5,522	$ 330,759
Less: amount representing interest	(386)	
Present value of capital lease obligations	$ 5,136	

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

Table of Contents

We believe our existing cash, cash equivalents and short-term marketable securities and cash provided by operating activities will be sufficient to meet our working capital and capital expenditure needs over the next 12 months. Our future capital requirements will depend on many factors, including our rate of revenue growth, the expansion of our marketing and sales activities, the timing and extent of spending to support product development efforts and expansion into new territories, the timing of introductions of new services and enhancements to existing services, the timing of capital expenditures and expenses associated with Web hosting and the continuing market acceptance of our services. To the extent that available funds are insufficient to fund our future activities, we may need to raise additional funds through public or private equity or debt financing.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Foreign currency exchange risk

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

Prior to October 31, 2008, our practice was to settle foreign currency contracts prior to each quarter end because the maturities of the foreign currency contracts were less than 3 months. We have continued our practice of entering into foreign currency contracts with maturities less than three months. As of October 31, 2008 the contracts that were not settled are recorded at fair value on the condensed consolidated balance sheet.

Interest rate sensitivity

We had cash, cash equivalents and marketable securities totaling $804.6 million at October 31, 2008. These amounts were invested primarily in money market funds and instruments, corporate notes and bonds, government securities and other debt securities with credit ratings of at least single A or better. The cash, cash equivalents and short-term marketable securities are held for working capital purposes with capital preservation as the primary objective. We do not enter into investments for trading or speculative purposes.

We account for our investment instruments in accordance with SFAS No. 115, *Accounting for Investments in Debt and Equity Securities*. All of our cash and cash equivalents and marketable securities are treated as available for sale under SFAS No. 115. Our marketable securities include corporate notes and obligations, U.S. treasuries, U.S. agency obligations, time deposits, and money market mutual funds.

Our cash equivalents and our portfolio of marketable securities are subject to market risk due to changes in interest rates. Fixed rate interest securities may have their market value adversely impacted due to a rise in interest rates, while floating rate securities may produce less income than expected if interest rates fall. Due in part to these factors, our future investment income may fall short of expectation due to changes in interest rates or we may suffer losses in principal if we are forced to sell securities that decline in the market value due to changes in interest rates. However because we classify our debt securities as available for sale , no gains or losses are recognized due to changes in interest rates unless such securities are sold prior to maturity or declines in fair value are determined to be other-than-temporary. Our fixed-income portfolio is subject to interest rate risk. An immediate increase or decrease in interest rates of 100-basis points at October 31, 2008 could result in a $3.7 million market value reduction or increase of the same amount. This estimate is based on a sensitivity model that measures market value changes when changes in interest rates occur. Fluctuations in the value of our investment securities caused by a change in interest rates (gains or losses on the carrying value) are recorded in other comprehensive income, and are realized only if we sell the underlying securities.

Table of Contents

As previously discussed in the Liquidity and Capital Resources section, we have an investment in The Reserve Fund, a money market mutual fund. While we believe we have the rights to the recovery of our entire investment, we cannot predict when The Reserve Fund will disperse our funds, or the amounts that we will receive.

At January 31, 2008, we had cash, cash equivalents and marketable securities totaling $669.8 million. The fixed-income portfolio was also subject to interest rate risk. Changes in interest rates of 100-basis points would have resulted in market value changes of $3.2 million.

ITEM 4. CONTROLS AND PROCEDURES

Disclosure controls and procedures

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

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

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

Internal control over financial reporting

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

Table of Contents

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

We are involved in various legal proceedings arising from the normal course of business activities. In our opinion, resolution of these matters is not expected to have a material adverse impact on our consolidated results of operations, cash flows or our financial position. However, depending on the nature and timing of any such dispute, an unfavorable resolution of a matter could materially affect our future results of operations, cash flows or financial position in a particular period.

ITEM 1A. RISK FACTORS

A restated description of the risk factors associated with our business is set forth below. This description includes any material changes to and supersedes the description of the risk factors included in our Annual Report on Form 10-K for the fiscal year ended January 31, 2008. The risks and uncertainties described below are not the only ones facing us. Other events that we do not currently anticipate or that we currently deem immaterial also may affect our results of operations and financial condition.

Risks Related to Our Business and Industry

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

Because our service is complex and we have incorporated a variety of new computer hardware and software, both developed in-house and acquired from third party vendors, our service may have errors or defects that users identify after they begin using it that could result in unanticipated downtime for our subscribers and harm our reputation and our business. Internet-based services frequently contain undetected errors when first introduced or when new versions or enhancements are released. We have from time to time found defects in our service and new errors in our existing service may be detected in the future. In addition, our customers may use our service in unanticipated ways that may cause a disruption in service for other customers attempting to access their data. Since our customers use our service for important aspects of their business, any errors, defects, disruptions in service or other performance problems with our service could hurt our reputation and may damage our customers businesses. If that occurs, customers could elect not to renew, or delay or withhold payment to us, we could lose future sales or customers may make warranty claims against us, which could result in an increase in our provision for doubtful accounts, an increase in collection cycles for accounts receivable or the expense and risk of litigation.

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

We currently serve our customers from a third-party datacenter hosting facility located on the west coast of the United States and we plan to begin to serve some customers from a third-party datacenter hosting facility located on the east coast of the United States. Additionally, we plan to begin serving customers from a new data center hosting facility we will be opening in Singapore during the coming months. Any damage to, or failure of, our systems generally could result in interruptions in our service. As we continue to add capacity in our existing and future data centers, we may move or transfer data. Despite precautions taken during this process, any unsuccessful data transfers may impair the delivery of our service. Further, any damage to, or failure of, our systems generally could result in interruptions in our service. Interruptions in our service may reduce our revenue, cause us to issue credits or pay penalties, cause customers to terminate their subscriptions and adversely affect our renewal rates and our ability to attract new customers. Our business will also be harmed if our customers and potential customers believe our service is unreliable.

As part of our current disaster recovery arrangements, our production environment and all of our customers data is currently replicated in near real-time in a separate standby facility located on the east coast. Features

Table of Contents

added through acquisition are temporarily served through alternate facilities. We do not control the operation of any of these facilities, and they are vulnerable to damage or interruption from earthquakes, floods, fires, power loss, telecommunications failures and similar events. They are also subject to break-ins, sabotage, intentional acts of vandalism and similar misconduct. Despite precautions taken at these facilities, the occurrence of a natural disaster or an act of terrorism, a decision to close the facilities without adequate notice or other unanticipated problems at these facilities could result in lengthy interruptions in our service. Even with the disaster recovery arrangements, our service could be interrupted.

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

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

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

Our service involves the storage and transmission of customers proprietary information, and security breaches could expose us to a risk of loss of this information, litigation and possible liability. If our security measures are breached as a result of third-party action, employee error, malfeasance or otherwise, during transfer of data to additional data centers or at any time, and, as a result, someone obtains unauthorized access to our data or our customers data, our reputation could be damaged, our business may suffer and we could incur significant liability. Additionally, third parties may attempt to fraudulently induce employees or customers into disclosing sensitive information such as user names, passwords or other information in order to gain access to our data or our customers data, which could result in significant legal and financial exposure and a loss of confidence in the security of our service that would harm our future business prospects. Because the techniques used to obtain unauthorized access, or to sabotage systems, change frequently and generally are not recognized until launched against a target, we may be unable to anticipate these techniques or to implement adequate preventative measures. If an actual or perceived breach of our security occurs, the market perception of the effectiveness of our security measures could be harmed and we could lose sales and customers. In addition, our customers may authorize third party technology providers, whose applications are available through our AppExchange directory, to access their customer data. Because we do not control the transmissions between our customers and third-party AppExchange technology providers, or the processing of such data by third-party AppExchange technology providers, we cannot ensure the complete integrity or security of such transmissions or processing.

If our on-demand application service is not widely accepted in markets where we have few customers, our future growth and success will be limited.

We derive substantially all of our revenue from subscriptions to our on-demand application service, and we expect this will continue for the foreseeable future. As a result, widespread acceptance of our service by companies located outside the United States or in industries where we currently have few customers is critical to our future growth and success. Factors that may affect market acceptance of our service include:

- reluctance by enterprises to migrate to an on-demand application service;
- a limited number of service offerings and risks associated with developing new service offerings;
- the price and performance of our service;

Table of Contents

- the level of customization we can offer;
- the location of our data centers;
- the availability, performance and price of competing products and services;
- reluctance by enterprises to trust third parties to store and manage their internal data; and
- adverse publicity about us, our service or the viability, reliability or security of on-demand application services generally from third party reviews, industry analyst reports and our competitors.

Many of these factors are beyond our control. The inability of our on-demand application service to achieve widespread market acceptance would harm our business.

Efforts we are making to expand our service beyond the CRM market may not succeed and may reduce our revenue growth rate and cause us to incur additional liabilities.

In fiscal 2006 we introduced the AppExchange directory, an on-line marketplace for on-demand applications that run on our Force.com on-demand application service platform. The market for third-party on-demand applications and our platform is new and unproven, and it is uncertain whether the initiative will ever result in significant revenue for us. Among other things, the success of the AppExchange will depend to a substantial extent on the willingness of third-party technology providers to write on-demand applications that run on our platform and the willingness of enterprises, large and small, to purchase and deploy these applications. If third-party technology providers or enterprises do not perceive the benefits of our on-line application marketplace, then the market for this initiative may not develop at all, or it may develop more slowly than we expect, either of which would affect our ability to grow our revenue. Given this new and unproven market, we have limited insight into trends that may develop and affect this initiative. In addition, our customers may not authorize such third-party technology providers to access their customer data. If our customers do authorize such access, we do not warrant the functionality, security and integrity of the data transmission or processing. Further, despite contract provisions designed to protect us, customers may look to us to support and warrant the third-party applications, which may expose us to potential claims, liabilities and obligations for applications we did not develop or sell. Moreover, the AppExchange directory, and other efforts to expand our service beyond the CRM market, may divert management resources from existing operations and require us to commit significant financial resources to an unproven business, which may harm our business.

Our quarterly results can fluctuate and if we fail to meet the expectations of analysts or investors, our stock price and the value of your investment could decline substantially.

Our quarterly operating results are likely to fluctuate, and if we fail to meet or exceed the expectations of securities analysts or investors, the trading price of our common stock could decline. Moreover, our stock price may be based on expectations of our future performance that may be unrealistic or that may not be met. Some of the important factors that could cause our revenues and operating results to fluctuate from quarter to quarter include:

- the amount and timing of operating costs and capital expenditures related to the operations and expansion of our business;
- our ability to retain and increase sales to existing customers, attract new customers and satisfy our customers requirements;
- the renewal rates for our service;
- changes in our pricing policies whether initiated by us or as a result of intense competition;

the cost, timing and management effort for the introduction of new features to our service;

the rate of expansion and productivity of our sales force;

the length of the sales cycle for our service;

Table of Contents

new product and service introductions by our competitors;

our success in selling our service to large enterprises;

variations in the revenue mix of editions of our service;

technical difficulties or interruptions in our service;

expenses related to increasing our data center capacity and expanding our data centers domestically and internationally;

changes in foreign currency exchange rates (as an example, recently the value of the U.S. dollar has increased against the Euro by approximately 13 percent from a year ago, and as such, our revenue results outside the Americas in fiscal 2009 have been negatively impacted);

changes in interest rates, which would impact our return on our investments in cash and marketable securities (as an example the yield on the 2 year U.S. treasury has declined approximately 60 percent from a year ago to 1.5614 percent);

conditions, particularly sudden changes, in the financial markets have and may continue to impact the value of and the access to our investment portfolio. During the three months ended October 31, 2008, we recorded a $1.2 million loss in our investment in the Reserve Primary money market mutual fund;

changes in the effective tax rates;

general economic conditions could adversely affect either our customers ability or willingness to purchase our application service or delay the customers purchasing decision or affect renewal rates, all of which could adversely affect our operating results;

the timing of additional investments in our on-demand application service and in our consulting service;

regulatory compliance costs;

the timing of customer payments and payment defaults by customers;

costs associated with acquisitions of companies and technologies, such as our August 2008 acquisition of InStranet, Inc.;

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

the impact of new accounting pronouncements;

the timing of stock awards to employees and the related adverse financial statement impact of having to expense those stock awards ratably over their 4 year vesting schedules; and

the timing of payroll and social tax expense which is triggered when employees in foreign jurisdictions exercise their vested stock options.

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

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

The market for CRM, enterprise business applications, and development platforms is highly competitive, rapidly evolving and fragmented, and subject to changing technology, shifting customer needs and frequent introductions of new products and services. We compete primarily with vendors of packaged CRM software, whose software is installed by the customer directly and companies offering on-demand CRM applications. We

Table of Contents

also compete with internally developed applications and face, or expect to face, competition from enterprise software vendors and online service providers who may develop toolsets and products that allow customers to build new applications that run on the customers current infrastructure or as hosted services. Our current principal competitors include:

- enterprise software application vendors including Amdocs Limited, Epicor Software Corporation, IBM Corporation, Infor Global Solutions, Microsoft Corporation, Oracle Corporation, and SAP AG;
- packaged CRM software vendors, some of which offer hosted services, such as CDC Software Corporation, a subsidiary of chinadotcom corporation, Consona Corporation (formerly Made2Manage Systems Inc.), FrontRange Solutions, Inc., Pivotal Corporation, which is owned by, Sage Group plc, and SugarCRM;
- on-demand CRM application service providers such as Oracle Corporation, NetSuite, Inc., RightNow Technologies, Inc., and SAP AG;
- platform and development environment companies, including established vendors, such as IBM Corporation, Oracle Corporation, and Microsoft Corporation; and an array of emerging vendors that have gained traction with the press and analyst communities.

In addition, we face competition from businesses that develop their own CRM applications internally, as well as from enterprise software vendors and online service providers who may develop and/or bundle CRM products with their products in the future. For small business customers, we also face competition from companies whose offering is based on Microsoft Outlook and Excel for limited contact management functionality. We also face competition from some of our larger and more established competitors who historically have been packaged CRM software vendors, but who also have directly competitive on-demand CRM application services offerings.

Our professional services organization competes with a broad range of large systems integrators, including Accenture Ltd., BearingPoint, Inc., Deloitte Consulting and IBM Corporation as well as smaller independent consulting firms specializing in CRM implementations. We have close relationships with many of these consulting companies and frequently work cooperatively on projects with them, even as we compete for business in other customer engagements.

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

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

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

We generally recognize revenue from customers ratably over the terms of their subscription agreements, which are typically 12 to 24 months, although terms can range from one to 60 months. As a result, most of the revenue we report in each quarter results from the recognition of deferred revenue relating to subscription agreements entered into during previous quarters. Consequently, a decline in new or renewed subscriptions in any one quarter will not necessarily be fully reflected in the deferred revenue balance on our consolidated

Table of Contents

balance sheet and the revenue in that quarter but will negatively affect our revenue in future quarters. In addition, we may be unable to adjust our cost structure to reflect the changes in revenues. Accordingly, the effect of significant downturns in sales and market acceptance of our service and potential changes in our rate of renewals may not be fully reflected in our results of operations until future periods. Our subscription model also makes it difficult for us to rapidly increase our revenue through additional sales in any period, as revenue from new customers must be recognized over the applicable subscription term.

If we experience significant fluctuations in our rate of growth and fail to balance our expenses with our revenue forecasts, our results could be harmed and our stock price may decline without advance notice.

Due to our evolving business model, the unpredictability of our emerging industry and deteriorating general economic and financial market conditions, we may not be able to accurately forecast our rate of growth. We base our current and future expense levels and our investment plans on estimates of future revenue and future rate of growth. We may not be able to adjust our spending quickly enough if the rate of new or renewed subscriptions falls short of our expectations.

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

The market for our technology delivery model and on-demand application services is immature and volatile, and if it develops more slowly than we expect, our business could be harmed.

The market for on-demand application services is not as mature as the market for packaged enterprise software, and it is uncertain whether these services will achieve and sustain high levels of demand and market acceptance. Our success will depend to a substantial extent on the willingness of enterprises, large and small, to increase their use of on-demand application services in general, and for CRM in particular. Many enterprises have invested substantial personnel and financial resources to integrate traditional enterprise software into their businesses, and therefore may be reluctant or unwilling to migrate to an on-demand application service. Furthermore, some enterprises may be reluctant or unwilling to use on-demand application services because they have concerns regarding the risks associated with security capabilities, among other things, of the technology delivery model associated with these services. If enterprises do not perceive the benefits of on-demand application services, then the market for these services may not develop at all, or it may develop more slowly than we expect, either of which would significantly adversely affect our operating results. In addition, we may make errors in predicting and reacting to relevant business trends, which could harm our business.

Our success also depends on the willingness of third-party developers to build applications that are complementary to our service. Without the development of these applications, both current and potential customers may not find our service sufficiently attractive. In fiscal 2006, we introduced the AppExchange directory, a central online marketplace for on-demand applications that we host for our customers, developers and partners to exchange custom on-demand applications that are built on, or can integrate with, our service. These custom applications, some of which are not CRM-related, include applications ranging from expense management to purchasing to recruiting. It is uncertain whether this service will be accepted and adopted by our customers, developers and partners or will increase the demand for subscriptions to our service.

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

Our customers have no obligation to renew their subscriptions for our service after the expiration of their initial subscription period, which is typically 12 to 24 months, and in fact, some customers have elected not to renew. In addition, our customers may renew for fewer subscriptions or renew for shorter contract lengths. We

Table of Contents

cannot accurately predict customer renewal rates, particularly for our enterprise customers who purchase a large number of subscriptions under multi-year contracts. Our customers renewal rates may decline or fluctuate as a result of a number of factors, including their dissatisfaction with our service, their ability to continue their operations and spending levels and deteriorating general economic and financial market conditions. If our customers do not renew their subscriptions for our service or reduce the number of paying subscriptions at the time of renewal, our revenue will decline and our business will suffer.

Our future success also depends in part on our ability to sell additional features and services, more subscriptions or enhanced editions of our service to our current customers. This may require increasingly sophisticated and costly sales efforts that are targeted at senior management. If these efforts are not successful, our business may suffer.

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

We continue to experience a period of increasing headcount and growth in our operations to support a growing customer base, which has placed, and will continue to place, to the extent that we are able to sustain such growth, a significant strain on our management, administrative, operational and financial infrastructure. We anticipate that further growth will be required to address increases in our customer base, further development of our service, as well as our expansion into new geographic areas.

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

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

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

Periodic restructurings of our sales organization can be disruptive and may negatively impact our revenues.

We periodically restructure or make other adjustments to our sales organization in response to market opportunities, competitive threats, management changes, product introductions or enhancements, sales performance,

Table of Contents

increases in sales headcount and other internal and external considerations. In the past, these restructurings sometimes resulted in a temporary lack of focus and reduced productivity; these effects could recur in connection with any future sales restructurings we might undertake and our rate of revenue growth could be negatively affected.

If we are not able to develop enhancements and new features to our existing service or acceptable new services that keep pace with technological developments, our business will be harmed.

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

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

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

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

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

The software and Internet industries are characterized by the existence of a large number of patents, trademarks and copyrights and by frequent litigation based on allegations of infringement or other violations of intellectual property rights. We have received in the past, and may receive in the future, communications from third parties claiming that we have infringed on the intellectual property rights of others. In addition, we have been, and may in the future be, sued by third parties for alleged infringement of their proprietary rights. Our technologies may not be able to withstand any third-party claims or rights against their use. Any intellectual property claims, with or without merit, could be time-consuming and expensive to resolve, could

Table of Contents

divert management attention from executing our business plan and could require us to pay monetary damages or enter into royalty or licensing agreements. In addition, many of our subscription agreements require us to indemnify our customers for third-party intellectual property infringement claims, which would increase the cost to us of an adverse ruling on such a claim. An adverse determination could also prevent us from offering our service to others.

If we fail to develop our brands cost-effectively, our business may suffer.

We believe that developing and maintaining awareness of the salesforce.com brand and our other brands in a cost-effective manner is critical to achieving widespread acceptance of our existing and future services and is an important element in attracting new customers. Furthermore, we believe that the importance of brand recognition will increase as competition in our market develops. Successful promotion of our brands will depend largely on the effectiveness of our marketing efforts and on our ability to provide reliable secure and useful services at competitive prices. In the past, our efforts to build our brands have involved significant expense. Brand promotion activities may not yield increased revenue, and even if they do, any increased revenue may not offset the expenses we incurred in building our brands. If we fail to successfully promote and maintain our brands, or incur substantial expenses in an unsuccessful attempt to promote and maintain our brands, we may fail to attract enough new customers or retain our existing customers to the extent necessary to realize a sufficient return on our brand-building efforts, and our business could suffer.

Failure to adequately expand our direct sales force and develop and expand our indirect sales channel will impede our growth.

We continue to be substantially dependent on our direct sales force to obtain new customers, particularly large enterprise customers, and to manage our customer base. We believe that there is significant competition for direct sales personnel with the advanced sales skills and technical knowledge we need. Our ability to achieve significant growth in revenue in the future will depend, in large part, on our success in recruiting, training and retaining sufficient numbers of direct sales personnel. New hires require significant training and may, in some cases, take more than a year before they achieve full productivity. Our recent hires and planned hires may not become as productive as we would like, and we may be unable to hire sufficient numbers of qualified individuals in the future in the markets where we do business. If we are unable to hire and develop sufficient numbers of productive direct sales personnel, sales of our service will suffer and our growth will be impeded. In addition, we plan to develop and expand our indirect sales channel by engaging third-party resellers. Because of our on-demand service model, the structuring of such relationships is complex and requires the investment of significant business, financial and other resources. If we are unable to structure successful third-party channel relationships that enable us to enter markets we otherwise would have greater difficulty entering, our growth will be inhibited.

Our business could be adversely affected if our customers are not satisfied with implementation and customization services provided by us or our partners.

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

Table of Contents

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

Because we sell our service throughout the world, we are subject to risks and challenges that we would otherwise not face if we conducted our business only in the United States. For example, sales in Europe and Asia Pacific together represent over 25 percent of our total revenues, and we intend to continue to expand our international sales efforts. The risks and challenges associated with sales to customers outside the United States include:

- localization of our service, including translation into foreign languages and associated expenses;
- laws and business practices favoring local competitors;
- compliance with multiple, conflicting and changing governmental laws and regulations, including employment, tax, privacy and data protection laws and regulations;
- regional data privacy laws that apply to the transmission of our customers data across international borders;
- foreign currency fluctuations;
- different pricing environments;
- difficulties in staffing and managing foreign operations;
- different or lesser protection of our intellectual property;
- longer accounts receivable payment cycles and other collection difficulties; and
- regional economic conditions, including the affect of general economic and financial market conditions in the markets in which we operate outside the United States; and
- regional political conditions.

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

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

Evolving regulation of the Internet may affect us adversely.

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

solutions and restricting our ability to store, process and share data with our customers. In addition, taxation of services provided over the Internet or other charges imposed by government agencies or by private organizations for accessing the Internet may also be imposed. Any regulation imposing greater fees for Internet use or restricting information exchange over the Internet could result in a decline in the use of the Internet and the viability of Internet-based services, which could harm our business.

Privacy concerns and laws or other domestic or foreign regulations may reduce the effectiveness of our solution and adversely affect our business.

Our customers can use our service to store contact and other personal or identifying information regarding their customers and contacts. Federal, state and foreign government bodies and agencies, however, have adopted or are considering adopting laws and regulations regarding the collection, use and disclosure of personal information obtained from consumers and individuals. The costs of compliance with, and other burdens imposed by, such laws and regulations that are applicable to the businesses of our customers may limit the use and

Table of Contents

adoption of our service and reduce overall demand for it. Furthermore, privacy concerns may cause our customers customers to resist providing the personal data necessary to allow our customers to use our service effectively. Even the perception of privacy concerns, whether or not valid, may inhibit market adoption of our service in certain industries.

For example, in the United States regulations such as the Gramm-Leach-Bliley Act, which protects and restricts the use of consumer credit and financial information, and the Health Insurance Portability and Accountability Act of 1996, which regulates the use and disclosure of personal health information, impose significant requirements and obligations on businesses that may affect the use and adoption of our service.

The European Union has also adopted a data privacy directive that requires member states to impose restrictions on the collection and use of personal data that, in some respects, are far more stringent, and impose more significant burdens on subject businesses, than current privacy standards in the United States. All of these domestic and international legislative and regulatory initiatives may adversely affect our customers ability to collect and/or use demographic and personal information from their customers, which could reduce demand for our service. Many if not most other jurisdictions, including Asia countries, have similar stringent privacy laws and regulations.

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

Our business is subject to changing regulations regarding corporate governance and public disclosure that have increased both our costs and the risk of non-compliance.

We are subject to rules and regulations by various governing bodies, including, for example, the Securities and Exchange Commission, which are charged with the protection of investors and the oversight of companies whose securities are publicly traded. Our efforts to comply with new and changing regulations have resulted in, and are likely to continue to result in, increased general and administrative expenses and a diversion of management time and attention from revenue-generating activities to compliance activities.

We are required to comply on an on-going basis with the Sarbanes-Oxley Act, or SOX, requirements involving the assessment of our internal controls over financial reporting. Our efforts to comply with the SOX requirements have required, and will continue to require the commitment of significant financial and personnel resources.

Moreover, because these laws, regulations and standards are subject to varying interpretations, their application in practice may evolve over time as new guidance becomes available. This evolution may result in continuing uncertainty regarding compliance matters and additional costs necessitated by ongoing revisions to our disclosure and governance practices. If we fail to address and comply with these regulations and any subsequent changes, our business may be harmed.

We are dependent on our management team and development and operations personnel, and the loss of one or more key employees or groups could harm our business and prevent us from implementing our business plan in a timely manner.

Our success depends substantially upon the continued services of our executive officers and other key members of management. From time to time, there may be changes in our executive management team resulting from the hiring or departure of executives. Such changes in our executive management team may be disruptive to our business.

We are also substantially dependent on the continued service of our existing development and operations personnel because of the complexity of our service and technologies.

Table of Contents

We do not have employment agreements with any of our executive officers, key management, development or operations personnel and, therefore, they could terminate their employment with us at any time. We do not maintain key person life insurance policies on any of our employees. The loss of one or more of our key employees or groups could seriously harm our business.

Because competition for our target employees is intense, we may not be able to attract and retain the highly skilled employees we need to support our planned growth.

To continue to execute on our growth plan, we must attract and retain highly qualified personnel. Competition for these personnel is intense, especially for engineers with high levels of experience in designing and developing software and Internet-related services and senior sales executives. We may not be successful in attracting and retaining qualified personnel. We have from time to time in the past experienced, and we expect to continue to experience in the future, difficulty in hiring and retaining highly skilled employees with appropriate qualifications. Many of the companies with which we compete for experienced personnel have greater resources than we have. In addition, job candidates and existing employees often consider the value of the stock awards they are to receive in connection with their employment. Volatility in the price of our stock and the cost to expense stock options may discourage us from granting the size or type of stock awards that job candidates require to join our company. If we fail to attract new personnel or fail to retain and motivate our current personnel, our business and future growth prospects could be severely harmed.

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

As part of our business strategy, we may acquire, enter into joint ventures with or make investments in complementary companies, services and technologies in the future. In August 2008, we acquired InStranet, Inc., for $31.6 million in cash as discussed elsewhere in this report. Acquisitions and investments involve numerous risks, including:

- the potential failure to achieve the expected benefits of the combination or acquisition;
- difficulties in and the cost of integrating operations, technologies, services and personnel;
- diversion of financial and managerial resources from existing operations;
- risk of entering new markets in which we have little or no experience;
- potential write-offs of acquired assets or investments;
- potential loss of key employees;
- inability to generate sufficient revenue to offset acquisition or investment costs;
- the inability to maintain relationships with customers and partners of the acquired business;
- the difficulty of incorporating acquired technology and rights into our products and services and of maintaining quality standards consistent with our brand;

potential unknown liabilities associated with the acquired businesses;

unanticipated expenses related to acquired technology and its integration into existing technology;

negative impact to our results of operations because of the depreciation and amortization of amounts related to acquired intangible assets, fixed assets and deferred compensation, and the loss of acquired deferred revenue;

delays in customer purchases due to uncertainty and the inability to maintain relationships with customers of the acquired businesses;

the need to implement controls, procedures and policies appropriate for a public company at companies that prior to the acquisition lacked such controls, procedures and policies; and

challenges caused by distance, language and cultural differences.

Table of Contents

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

Unanticipated changes in our effective tax rate could adversely affect our future results.

We are subject to income taxes in the United States and various foreign jurisdictions, and our domestic and international tax liabilities are subject to the allocation of expenses in differing jurisdictions.

Our effective tax rate has experienced significant fluctuations over the past fiscal year in comparison to previous years. The tax rate is affected by changes in the mix of earnings and losses in countries with differing statutory tax rates, certain non-deductible expenses arising from the requirement to expense stock options and the valuation of deferred tax assets and liabilities. Increases in our effective tax rate could materially affect our net results.

Risks Related to Ownership of Our Common Stock

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

The trading prices of the securities of technology companies have been highly volatile. Accordingly, the trading price of our common stock has been and is likely to continue to be subject to wide fluctuations. For example, during the nine months ended October 31, 2008, the trading price of our common stock has ranged from a closing price of $25.31 to $74.43 per share. Factors affecting the trading price of our common stock include:

- variations in our operating results, earnings per share, cash flows from operating activities, deferred revenue, and other financial metrics and non-financial metrics, and how those results compare to analyst expectations;
- forward looking guidance to industry and financial analysts related to future revenue and earnings per share;
- the net increases in the number of customers and paying subscriptions, either independently or as compared with published expectations of industry, financial or other analysts that cover our company;
- changes in the estimates of our operating results or changes in recommendations by securities analysts that elect to follow our common stock;
- announcements of technological innovations, new services or service enhancements, strategic alliances or significant agreements by us or by our competitors;
- announcements by us or by our competitors of mergers or other strategic acquisitions, or rumors of such transactions involving us or our competitors;
- announcements of customer additions and customer cancellations or delays in customer purchases;
- recruitment or departure of key personnel;

disruptions in our service due to computer hardware, software or network problems;

market conditions in our industry, the industries of our customers and the economy as a whole; and

trading activity by a limited number of stockholders who together beneficially own a majority of our outstanding common stock.

In addition, if the market for technology stocks or the stock market in general experiences uneven investor confidence, the trading price of our common stock could decline for reasons unrelated to our business, operating results or financial condition. The trading price of our common stock might also decline in reaction to events that affect other companies within, or outside, our industry even if these events do not directly affect us.

Table of Contents

If securities analysts stop publishing research or reports about us or our business or if they downgrade our stock, the price of our stock could decline.

The trading market for our common stock relies in part on the research and reports that industry or financial analysts publish about us or our business. We do not control these analysts. If one or more of the analysts who do cover us downgrade our stock or lower their future stock price targets or estimates of our operating results, our stock price could decline rapidly. Furthermore, if one or more of these analysts cease coverage of our company, we could lose visibility in the market, which in turn could cause our stock price to decline.

The concentration of our capital stock ownership with insiders will likely limit your ability to influence corporate matters.

Our executive officers, directors, and several stockholders and their affiliated entities together beneficially own a majority of our outstanding common stock.

As a result, these stockholders, if they act together or in a block, could have significant influence over most matters that require approval by our stockholders, including the election of directors and approval of significant corporate transactions, even if other stockholders oppose them. This concentration of ownership might also have the effect of delaying or preventing a change of control of our company that other stockholders may view as beneficial.

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

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

- establish a classified board of directors so that not all members of our board are elected at one time;
- permit the board of directors to establish the number of directors;
- provide that directors may only be removed for cause and only with the approval of 66⅔ percent of our stockholders;
- require super-majority voting to amend some provisions in our amended and restated certificate of incorporation and bylaws;
- authorize the issuance of blank check preferred stock that our board could use to implement stockholder rights (also known as a poison pill);
- eliminate the ability of our stockholders to call special meetings of stockholders;
- prohibit stockholder action by written consent, which requires all stockholder actions to be taken at a meeting of our stockholders;
- provide that the board of directors is expressly authorized to make, alter or repeal our bylaws; and

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

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

Table of Contents

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS
Not applicable.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES
Not applicable.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS
Not applicable.

ITEM 5. OTHER INFORMATION
The Company plans to hold its 2009 Annual Meeting of Stockholders (the 2009 Annual Meeting) on June 11, 2009 in San Francisco, California. The 2009 Annual Meeting date constitutes a change of more than 30 days from the anniversary of our 2008 Annual Meeting of Stockholders. As previously disclosed in the Proxy Statement for 2008 Annual Meeting of Stockholders, stockholder proposals to be presented at the 2009 Annual Meeting must be received by the Secretary of the Company at the Company s principal executive offices not later than January 27, 2009, and any stockholder proposal intended to be included in the Company s proxy statement for the 2009 Annual Meeting must also be received by the Company not later than January 27, 2009. Please refer to the Proxy Statement for 2008 Annual Meeting of Stockholders for the procedures for submitting stockholder proposals.

ITEM 6. EXHIBITS
Exhibits

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

Exhibit 3.1(1)	Amended and Restated Certificate of Incorporation of salesforce.com, inc.
Exhibit 3.1(2)	Amended and Restated Bylaws of salesforce.com, inc.
Exhibit 31.1	Certification of Chief Executive Officer pursuant to Exchange Act Rule 13a-14(a) and 15(d)-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
Exhibit 31.2	Certification of Chief Financial Officer pursuant to Exchange Act Rule 13a-14(a) and 15(d)-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
Exhibit 32.1	Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

(1) Incorporated by reference from the Company s registration statement on Form S-1 (No. 333-111289) Amendment No. 3 as filed with the Securities and Exchange Commission on April 20, 2004.
(2) Incorporated by reference from the Company s Form 8-K filed with the Securities and Exchange Commission on December 7, 2007.

Table of Contents

SIGNATURES

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

Dated: November 25, 2008

salesforce.com, inc.

/s/ Graham Smith
Graham Smith

Chief Financial Officer

(Principal Financial Officer and Duly Authorized Officer)