DemandTec, Inc.
Form 10-K
April 24, 2009

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-K

þ	**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
	For the fiscal year ended February 28, 2009
o	**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

Commission file number 001-33634
DemandTec, Inc.
(Exact Name of Registrant as Specified in Its Charter)

Delaware	**94-3344761**
(State or Other Jurisdiction of Incorporation or Organization)	*(I.R.S. Employer Identification Number)*

One Circle Star Way, Suite 200
San Carlos, California 94070
(Address of Principal Executive Offices)

(650) 226-4600
(Registrant s Telephone Number)

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

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, par value $0.001 per share	The NASDAQ Stock Market LLC (NASDAQ Global Market)

Securities registered pursuant to Section 12(g) of the Exchange Act:
None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes **o** No **þ**

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of 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 **þ** No **o**

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every interactive data file required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes **o** No **o**

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. **þ**

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. (Check one):

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

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

As of August 31, 2008, the last business day of the registrant s most recently completed second fiscal quarter, the aggregate market value of shares of the registrant s common stock held by non-affiliates of the registrant (based upon the closing sale price of $10.37 per share on the NASDAQ Global Market on such date) was approximately $172.5 million.

As of March 31, 2009, there were 28,075,232 shares of the registrant s common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant s definitive proxy statement for its fiscal 2009 Annual Meeting of Stockholders (the Proxy Statement) are incorporated by reference in Part III of this Report on Form 10-K. Except with respect to information specifically incorporated by reference in this Form 10-K, the Proxy Statement is not deemed to be filed as part of this Form 10-K.

DemandTec, Inc.

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PART I

This Annual Report on Form 10-K contains forward-looking statements that involve risks and uncertainties. Please see the section entitled Forward-Looking Statements in Item 7 of this Annual Report on Form 10-K for important information to consider when evaluating these statements.

Item 1. *Business*

Overview

We are a leading provider of Consumer Demand Management, or CDM, solutions. CDM is a software category based on quantifying consumer demand and using that understanding to make better business decisions. Specifically, our software services enable retailers and consumer products, or CP, companies to define merchandising and marketing strategies based on a scientific understanding of consumer behavior and make actionable pricing, promotion, assortment, space and other merchandising and marketing recommendations to achieve their revenue, profitability and sales volume objectives. We deliver our applications by means of a software-as-a-service, or SaaS, model, which allows us to capture and analyze the most recent retailer and market-level data and enhance our software services rapidly to address our customers ever-changing merchandising and marketing needs. We were incorporated in November 1999.

Our CDM solutions consist of software services and complementary analytical services, and analytical insights, derived from the same platform that supports our software services. We offer our solutions individually or as a suite of integrated software services.

Our solutions for the retail and CP industries include:

DemandTec Lifecycle Price Optimization™, which enables retailers to strategically manage pricing for items throughout their stores, including regular items, promoted items, and markdown items.

DemandTec End-to-End Promotion Management™, which supports retailers end-to-end promotion planning processes, including suppliers, internal workflow, and downstream execution.

DemandTec Assortment & Space™, which enables retailers to create localized assortments by store, cluster, or section, based on shopper demographics, the competitive environment, and a science-based, quantitative understanding of each item s ability to add variety and grow incremental sales in the category.

DemandTec Targeted Marketing™, a collection of services delivered by DemandTec and partners for customer segmentation, store clustering, segment-targeted merchandising, and one-to-one marketing.

DemandTec Trade Effectiveness™, a consumer-centric sales and marketing solution that improves the way CP companies develop and sell-in promotion plans, price recommendations, new item introductions, and cost changes with their retail customers.

Connecting our solutions for both the retail and the CP industries is the DemandTec TradePoint Network™, an Internet-based network of software services used by retailers and their suppliers to transact, interact, and collaborate. Using our solutions via the DemandTec TradePoint Network™, retailers and CP companies can streamline business processes, access advanced analytics, and enhance collaboration based on retailer-driven rules of engagement.

Industry Background

Retail trade is one of the world s most widespread activities. There are more than 1,500 retailers worldwide that have annual sales in excess of $500 million, and more than 200 of those retailers have annual sales in excess of $2 billion. Retailing is highly competitive and generally characterized by low profit margins. Furthermore, there are more than 1,300 CP companies worldwide that have annual revenues in excess of $500 million that sell to retailers. The CP industry is becoming increasingly competitive due to factors such as retailer consolidation, more discerning and less loyal consumers, and the growing impact of private label products. To counter these trends, CP companies are making substantial investments in product innovation, market research, branding, and consumer and brand marketing.

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Consumer Demand and Pricing Challenges

Retailers compete for consumers who are becoming more knowledgeable, more selective and, in many instances, more price sensitive. Consumers today devote considerable time to researching products and comparing prices prior to shopping and have a greater array of choices in price, size, brand, color and features. The growth of discount stores, warehouse clubs and dollar stores and the emergence of the Internet as a viable retail destination offer consumers further alternatives when purchasing goods. Increases in the costs of fuel and other commodities have further increased the average consumer s price sensitivity. For retailers to compete effectively, they need to better understand and respond to these changes in consumer demand and behavior through targeted pricing, marketing and merchandising strategies.

A basic principle of economics is that a change in the price of an item will affect demand for that item. Every item in a store has a unique price elasticity, or sensitivity between sales volume and price. Small decreases or increases in the prices of some items may lead to significant changes in the demand for those items, whereas larger decreases or increases in the prices of other items may have little effect on demand. In addition, changes in the prices of items in a store often have an impact on the sales volumes of other items in that store. This interdependence is referred to as the cross elasticity of demand. Demand is influenced by a wide variety of additional factors, including store location, customer demographics, advertising, in-store displays, the availability of complementary or substitute products, seasonality, competitive activity and loyalty and marketing programs. These variables make calculating price elasticity for even a single item an extremely data-intensive and complex process. Calculating the cross-elasticity of demand for thousands of items is exponentially more difficult.

Applying these economic concepts to make day-to-day pricing decisions presents enormous challenges to retailers of all sizes, particularly large retailers that sell tens of thousands of items and have hundreds, if not thousands, of stores. These retailers must determine how to price each particular item and whether to vary the price among different regions or individual locations. They also must determine the price of each item relative to competing products and the likely impact on their aggregate profitability if the prices of that item or competing items are increased or decreased.

Consumer demand, though, is driven by more than just the everyday price of an item. In addition, retailers may want to consider whether promoting an item would result in increased sales volume and, if so, whether that increase would represent incremental revenue or merely cannibalize sales of other items. Retailers must also determine which items should be stocked, by store or store cluster. These pricing and marketing decisions must also strike a balance between the retailer s financial goals and its desired price and brand image in order to enhance consumer loyalty and maximize sustainable, lifetime value from its targeted consumer segments.

CP companies make similar, complex decisions when pricing and promoting their products. Like retailers, CP companies are faced with rising costs, intense competition, less loyal consumers and an operating environment in which it is difficult to raise prices. As raw ingredient costs escalate and competitive threats intensify, predicting the relative impact promotion and everyday price activities will have on volume and margin objectives is an essential planning requirement. CP companies must understand how consumers will respond to promotions, how price changes will affect sales volumes, how often to promote their brands. CP companies also must decide when and how to use trade funds in the form of discounts, offsets or direct cash payments to compensate retailers for offering temporary price reductions on their products and how competitive trade plans will impact their own promoted items, their total portfolio and even the retailer s entire category. According to Capgemini, most CP companies trade promotion budgets represent 15% or more of their net sales, which is second in magnitude only to their cost of goods sold. In 2007, CP companies in North America alone spent over $70 billion on trade promotions according to Cannondale Associates, Inc. Despite the pervasive use of trade funds, studies suggest that over 90% of trade promotions have negative returns on investment after taking into consideration execution costs and unintended cannibalization.

The trade promotion process is not only generally unprofitable, but also highly inefficient. Submitting and negotiating trade promotions historically have been handled through a combination of fax, voicemail and manual, paper-based processes. This has led to frequent inaccuracies and increasing costs for both CP companies and retailers. CP companies and retailers have lacked an accurate, integrated technology platform for improving the efficiency of their trading relationships.

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In order to attain higher revenue growth, improve profit margins and increase market share, while maintaining proper price and brand image, retailers and CP companies must better understand and predict consumer behavior across geographic, demographic, gender, age, income and other segments. However, achieving these objectives through day-to-day pricing and other merchandising and marketing decisions is extremely complex.

Existing Approaches to Understanding Consumer Demand

Retailers and CP companies have made significant investments in information technology, or IT. Most of these IT investments have focused on achieving cost reductions through increased operational efficiencies and transaction automation, including supply chain management, point of sale, or POS, systems, and marketing automation software.

As a result of these IT investments, retailers have accumulated vast amounts of sales data. While a number of academic techniques exist to analyze this data, incorporating advanced statistical analytics into a commercially-useful solution that yields meaningful and actionable insights for retailers and CP companies presents significant scientific, engineering, processing and cost challenges due to the vast amounts of data and the complexities of mathematical computing. Consequently, existing approaches that incorporate an understanding of consumer demand into retail and CP pricing decisions generally have been limited to modeling sample data sets to provide limited insights. As a result, retailers and CP companies historically have made merchandising decisions based on simpler approaches such as:

- cost-plus or competitor-matching pricing;
- national pricing of items, regardless of local consumer demand and competitive dynamics;
- one-size-fits-all assortments of goods, regardless of the unique preferences of consumers who shopped in each location;
- habitual promotions, advertisements, mailers and other marketing programs; and
- engaging business consultants to provide isolated category-based analyses.

In today s environment, retailers and CP companies need scalable enterprise software that is capable of modeling the numerous variables that affect consumer demand and processing massive data sets in a cost-effective manner and that delivers actionable merchandising and marketing recommendations to achieve their revenue, profitability and sales volume objectives.

DemandTec Solution

We are a leading provider of CDM solutions. Our software services enable retailers and CP companies to define merchandising and marketing strategies based on a scientific understanding of consumer behavior and make actionable pricing, promotion, assortment, space and other merchandising and marketing recommendations to achieve their revenue, profitability and sales volume objectives. We deliver our applications by means of a SaaS model, which allows us to capture and analyze the most recent retailer and market-level data and enhance our software services rapidly to address our customers ever-changing merchandising and marketing needs.

Understand and predict consumer behavior to make merchandising and marketing recommendations that achieve revenue, profitability and sales volume objectives

Our software services enable retailers and CP companies to incorporate a scientific understanding of consumer demand into their day-to-day merchandising and marketing decision-making processes. By using our software, our customers can achieve their revenue, profitability and sales volume objectives, while striking a balance with their desired price and brand images in order to enhance consumer loyalty and maximize the lifetime value of the consumer. Specifically, our software services allow retailers and CP companies to:

- make daily pricing, promotion, assortment, space and other merchandising and marketing decisions based on consumer demand;

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balance financial goals with price and brand image in order to maximize the lifetime value of their targeted consumer segments;

enforce pricing rules consistently;

forecast sales more accurately;

devise more targeted promotions based on consumer segmentation insights;

create, version and publish targeted advertisements to be distributed via multiple channels and media vehicles; and

allocate trade funds more effectively and efficiently.

Incorporate scalable science into merchandising and marketing decision-making processes

We incorporate advanced econometric modeling techniques and optimization theory into scalable software services that our customers use to make day-to-day merchandising and marketing decisions. Our software automates the process of predicting consumer response to various merchandising and marketing activities, such as pricing, promotion, assortment, space, loyalty programs and media. Our proprietary demand models quantify consumer response at the individual store and item levels based on a number of factors, including store location, consumer demographics, advertising, in-store displays, the availability of complementary and substitute products, seasonality, competitive activity and loyalty and marketing programs. Our software incorporates optimization science that uses a combination of complex algorithms to help our customers determine in real-time the prices, promotions and markdowns that best accomplish their merchandising and marketing objectives, while complying with their business rules.

Leverage technological advancements through a SaaS delivery model that enables us to adapt to our customers changing business needs rapidly and to deliver results quickly

Our SaaS model leverages a set of pervasive technology trends that includes the availability of greater amounts of computing power at commercially affordable and decreasing prices, dramatic reductions in the cost of data storage and inexpensive and secure access to broadband communication networks. This model represents a dramatic shift from developing and delivering static, highly-customized software code that is installed at the customer s site. Due to the dynamic nature of consumer demand and the changing merchandising and marketing objectives of retailers and CP companies, we believe a CDM solution is delivered most effectively through a SaaS model. By delivering our software as a service, we are able to:

capture and analyze the most current transaction-log/loyalty data from retailers, as well as up-to-date market-level data, syndicated data and other third-party demographic content, in order to better understand the dynamic nature of consumer behavior;

intimately understand how our customers use our software to make their day-to-day merchandising and marketing decisions so we can continuously enhance our offering to address our customers business needs;

improve user productivity with more frequent but smaller incremental updates and training courses;

deliver technical enhancements to our software on a frequent and predictable schedule with little or no disruption to our customers operations;

utilize grid computing and service-oriented-architecture, or SOA, techniques to maximize scalability and processing capacity; and

enable interoperability across our customers diverse legacy systems.

By delivering our software as a service, we quickly enable our customers to make better pricing, promotion, trade funds management and other day-to-day merchandising and marketing decisions. With our SaaS model, our customers are able to begin to achieve measurable financial results within a matter of months.

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Strategy

Our objective is to extend our position as a leading provider of CDM solutions. The three key elements of our strategy to achieve this objective include:

Extending our market position with major retailers worldwide. The retail industry is an international business, with a significant portion of the world s retailers based outside of the United States. We intend to use our market position and distribution investments to pursue additional retail opportunities around the world, leveraging our partnerships and multi-language product capabilities. We believe that our existing retail customers have the ability to influence other retailers worldwide by changing the competitive dynamics in their respective markets.

Expanding our relationships with our existing retail customers. We plan to continue to deliver measurable business results to our existing retail customers in order to encourage their renewals of their existing solutions, as well as their adoption of incremental solutions. A key element of our strategy is to leverage our domain expertise, proprietary software platform and advanced analytical capabilities to expand our CDM solutions.

Using our presence with retailers to create and expand our relationships with their CP trading partners. By leveraging our ability to deliver existing and new software services through our DemandTec TradePoint Network, we intend to use our existing retail customer relationships to create and expand our relationships with their CP trading partners. Our retail customers are able to mandate that their CP trading partners submit and negotiate their future trade promotion offers electronically through the DemandTec TradePoint Network. We believe there is a significant opportunity to expand our market presence by way of a network effect driven by cost efficiencies and a common business language.

Products

Overview

Our CDM solutions consist of one or more software services and complementary analytical services. We offer our solutions individually or as a suite of integrated software services. Our software services are configurable to accommodate individual customer needs.

Our solutions for the retail and CP industries include:

DemandTec Lifecycle Price Optimization^{tm}, which enables retailers to strategically manage pricing for items throughout their stores, including regular items, promoted items, and markdown items;

DemandTec End-to-End Promotion Management^{tm}, which supports retailers end-to-end promotion planning processes, including internal and external collaboration, promotion calendar optimization, and multi-channel, cross-media execution;

DemandTec Assortment & Space^{tm}, which enables retailers to create localized assortments by store, cluster, or section, based on shopper demographics, the competitive environment, and a science-based, quantitative understanding of each item s ability to add variety and grow incremental sales in the category;

DemandTec Targeted Marketing^{tm}, a collection of services delivered by DemandTec and partners for customer segmentation, store clustering, segment-targeted merchandising, and one-to-one marketing; and

DemandTec Trade Effectiveness[tm], a consumer-centric sales and marketing solution that improves the way CP companies develop and sell-in promotion plans, price recommendations, new item introductions, and cost changes with their retail customers.

Connecting our solutions for both the retail and the CP industries is the DemandTec TradePoint Network[tm], an Internet-based network of software services used by retailers and their suppliers to transact, interact, and collaborate. Using our solutions via the DemandTec TradePoint Network[tm], retailers and CP companies can streamline business processes, access advanced analytics, and enhance collaboration based on retailer-driven rules of engagement.

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Our proprietary software platform is the foundation for our software services and analytical services. We have developed this platform to transform vast amounts of raw and underutilized business data into actionable insights in an efficient and cost-effective manner. Our platform provides scalability, advanced analytics and an integrated view of demand for each of the DemandTec services.

MyDemandTec is the common, configurable dashboard for all of our applications. Based on industry-standard portal technology, MyDemandTec consolidates web-based content and information through a common portal, providing users with context to make pricing, promotion, assortment, space and other merchandising and marketing decisions and to organize tasks. MyDemandTec can incorporate third-party content within its windows or can exist within a customer s broader corporate intranet or other portal system.

In February 2009, we completed our acquisition of privately-held Connect3 Systems, Inc. (Connect3), a provider of advertising planning and execution software. Connect3 helped retailers from all industry segments improve the efficiency and effectiveness of their cross-channel and cross-media promotions. The Connect3 solutions support the workflow of customers merchandising and advertising departments and include key capabilities such as cross-media budgeting, workflow management, versioning, and other advertising execution functionality. The former Connect3 product suite is being incorporated into the DemandTec End-to-End Promotion Management™ solution.

DemandTec Lifecycle Price Optimization™ for Retail

Our Lifecycle Price Optimization™ solution for the retail industry consists of one or more of the following software services, along with complementary software, analytical services, and analytical insights:

Everyday Price Optimization and Everyday Price Management

Everyday Price Optimization and Everyday Price Management enable retailers companies to establish everyday prices for their products, using both optimization techniques based on a scientific understanding of consumer behavior, as well as rules-based pricing methods.

Everyday Price Optimization: Everyday Price Optimization enables retailers to determine optimized prices to achieve their sales, volume, profit, and price image objectives for regular, everyday items. Using Everyday Price Optimization, customers create scenarios in which they define strategic objectives such as increased revenues, profitability and/or sales volume and optimize prices to best achieve these objectives. A typical strategic objective might be to maximize net margins, while not sacrificing more than a certain defined percentage of sales volume.

Retailers use Everyday Price Optimization to optimize and set retail prices in their stores based on their unique cost structure and strategic goals. Everyday Price Optimization would likely generate different optimized prices for the same item carried by competing retailers in stores located in the same geographic location, since consumer behavior varies between competitors and each retailer has its own vendor costs and strategic pricing objectives.

Key features of Everyday Price Optimization include:

> *Store/SKU-level modeling* econometric modeling that captures the elasticity of each item, in addition to cannibalization between items, halo effects, cross-category pull-through effects, trends, seasonality, and a variety of other causals to deliver accuracy;

> *Optimization and forecasting* full category price optimization, with store/item level forecasting, enables retailers to develop pricing that conforms to their pricing rules while maximizing their primary and secondary goals, such as driving higher sales, increasing volume, and improving profitability;

Image item analysis determination of effective price image items for key consumer segments;

Natural language pricing rules and rules management non-technical end-users can define and enforce pricing policies by creating pricing scenarios with pricing rules selected from a comprehensive library of retail pricing rules, customized with a rules editor and prioritized with rules relaxation capabilities to handle conflicts;

Scenario management the ability to create and evaluate multiple pricing scenarios to fine-tune pricing strategy before prices hit shelves in order to change goals (maximize profit, sales, or unit volume) or add, remove, modify, or reprioritize pricing rules; and

Benefits reporting the ability to validate the effects of price optimization on actual sales of a particular category and to understand the degree to which factors such as promotions, seasonality and macroeconomic shifts contributed to sales.

Everyday Price Management: Everyday Price Management enables retailers to improve execution and compliance with their pricing strategy, and dramatically boost efficiency by automating their most cumbersome, time-consuming pricing tasks. Using Everyday Price Management, customers define pricing rules and apply those rules-based prices to merchandise categories that are not modeled and optimized using Everyday Price Optimization. In addition, customers maintain both optimized and rules-based prices using Everyday Price Management as vendor costs and competitor prices change.

Key features of Everyday Price Management include:

Rules-based pricing define and enforce pricing policies by creating pricing scenarios with rules selected from a comprehensive library of pricing rules such as last digit rules, competitive price index rules, and cross-zone rules, all of which are configured using easy-to-understand natural language;

Rules management rules editor and rules relaxation capabilities to handle conflicts;

Advanced price maintenance operational price management capabilities to handle frequent vendor cost changes, competitive price changes, and new item introductions; and

Advanced pricing delivery quickly review and approve incoming data and automatically schedule when updated pricing will be delivered to downstream systems.

Both Everyday Price Optimization and Everyday Price Management utilize a library of configurable business rules that act as constraints on the optimization by limiting the set of possible outcomes. For example, a customer can ensure that larger size items always cost more than smaller size items but are a better value, or that an optimized price is within a given percentage of a competitor s price.

Promotion Planning & Optimization

Promotion Planning & Optimization enables retailers to plan, optimize, and execute more effective and more profitable promotion plans. Promotion Planning & Optimization customers create and simulate multiple scenarios based on mathematical forecasts of results in order to evaluate tradeoffs among various promotions such as discounts, advertisements and displays. Key features of Promotion Planning & Optimization include:

Store/SKU-level modeling the ability to plan promotions that maximize total store impact on all categories by taking into account promotional response by item by store, cannibalization, halo effects, and cross-elasticity effects of everyday prices in place;

Category plan management the ability to build complete promotions by defining deal terms, discounts, time periods, and promotion types, and associating these promotions with individual ads, displays, radio spots, and other media, taking into account factors such as pull-through effects, cannibalization between promoted items and regularly priced items, cannibalization between stacked promotions, and the pantry-loading effect of successive promotions;

Master calendar aggregate category plans into a master calendar that provides a single, unified view of all planned events across categories;

Event and tactic management the ability to plan and manage different promotional events and capture individual performance details such as holidays, features and in-store displays;

Deal Management integration the ability for all vendor offers entered into DemandTec s Deal Management software service to flow directly into Promotion Planning & Optimization for analysis, optimization and forecasting; and

Pre-configured outbound interfaces the ability to export promotional forecast information to supply chain systems, promotional details to advertisement execution systems (including our Advertising & Marketing Execution service, as well as other offerings from third parties), and other details to other customer systems.

Retailers use Promotion Planning & Optimization to evaluate and forecast the likely results from incoming vendor offers, as well as to plan private label and other promotions. Retailers can use Promotion Planning & Optimization in conjunction with DemandTec s Deal Management software service to streamline the deal presentation, negotiation, and reconciliation process, and automatically pull deal information into Promotion Optimization for evaluation.

Markdown Optimization

Markdown Optimization incorporates the science of Consumer Demand Management to enable retailers to design optimal plans that set markdown timing and depth to maximize profitability or meet inventory objectives for every clearance item in every store. Markdown Optimization supports a wide range of markdown types, including seasonal, short product lifecycle, event and holiday, category reset, cycle refresh, and standard discount markdowns. Key features of Markdown Optimization include:

Scenario management the ability to create and forecast multiple scenarios in order to evaluate tradeoffs between timing and depth of markdown prices, as well as other factors such as the number of markdowns taken within a time period;

Science-based the ability to design markdown plans based on the unique price elasticity and inventory position at each store;

Rules management the ability to configure markdown-specific rules;

Re-optimization the ability to re-optimize plans and prices on a weekly basis to adjust for changes in demand and inventory position; and

Automated workflow process the ability to create and initiate new markdown plans and scenarios automatically based on category-specific rules defined by the retailer so that merchants can simply log into the system to review the results of planned optimizations.

Retailers use Markdown Optimization to eliminate excess inventory by a specified date after which an item will no longer be sold and to maximize profitability of items sold before that date. Retailers have the flexibility either to allow all stores or zones to share the same schedule or to have each store execute its own unique schedule to maximize overall plan performance. Retailers can also create, forecast, compare, and evaluate multiple markdown pricing scenarios to fine tune their markdown strategy before finalizing in-store prices.

DemandTec End-to-End Promotion Management™ for Retail

Our End-to-End Promotion Management™ solution for the retail industry consists of the Promotion Planning & Optimization software service discussed above as part of the DemandTec Lifecycle Price Optimization™ solution, as well as one or more of the following software services, along with complementary software, analytical services and insights:

Deal Management

Deal Management enables retailers to automate and streamline the presentation, negotiation and reconciliation of trade promotion offers they receive from their CP trading partners in a secure, Web-based environment. The Deal Management and Promotion Planning & Optimization services are integrated such that offers entered by CP companies are available for analysis, optimization and forecasting by retailers, and both parties can manage the status of those trade promotions in an interactive, collaborative environment. Key features of Deal Management for the retailer include:

Proprietary offer sheet mapping uses each retailer s existing paper-based offer format to ease adoption by retailers;

Online collaboration provides a common platform for retailers and their trading partners to present and negotiate the terms of trade promotion offers, eliminating the large number of emails, faxes, and spreadsheets that typically go back and forth between parties, thereby reducing errors;

Web portal boosts the retailer s productivity by pushing data entry work to the suppliers and allowing the suppliers to enter deal information;

Retailer item catalog-based entry provides vendors use of retailer-specific item catalogs in order to eliminate data-entry errors;

Electronic document and deal history archive provides version control of offers, final contract terms, user activity and communications in order to facilitate regulatory compliance and dispute resolution and to eliminate the need for costly post-deal audits; and

Accounting and reconciliation provides for reconciliation of invoicing and deduction notices with CP trading partners.

When a retailer implements Deal Management, that retailer requires that all of its CP trading partners submit and negotiate their future trade promotion offers electronically through the Deal Management software service. We offer two editions of this service for CP companies: Deal Management, which is offered at no charge and allows vendors to submit promotion offers by selecting valid items from the retailer s item catalog, and Advanced Deal Management , which is a paid upgrade that includes additional features specific to a CP company, such as accounting and reconciliation, transaction and workflow reporting, catalog management, vendor item catalog synchronization and deal history archiving.

Advertising & Marketing Execution

Previously referred to as Promotion Manager when marketed and sold by Connect3, Advertising & Marketing Execution and its related ad execution software services Signage, Proofing and iFlyer work hand-in-hand with Promotion Planning & Optimization to manage versioned offers and promotional pricing while addressing the detailed requirements of delivering targeted promotional messages across multiple touch points. Key features of Advertising & Marketing Execution include:

Out-of-the-box enterprise advertising solution provides detailed planning and execution functionality;

Centralized marketing calendar and integrated workflow system enables collaboration between analysts, marketing, buyers/merchants, advertising and other partners;

Dynamic layout and versionsioning capabilities view and select items, build and manage sophisticated promotional offers and create multiple versions customized for different regions, clusters of stores, customer segments, or advertising zones;

Multi-channel/cross-media publishing create content for planned promotional events once and then manage and publish the content and digital assets across print, email, website, mobile device, and other multi-channel/media publishing;

Highly-configurable enterprise architecture supports complex requirements to integrate with key retail production systems; and

Integration with DemandTec Promotion Planning & Optimization the ability to import planned and optimized promotional details directly into the dynamic layout and publishing, enabling a more scientific approach to selecting items and building promotions.

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Retailers use Advertising & Marketing Execution to drive the production process and execute more targeted promotions across multiple channels and media vehicles while also dynamically creating the highly-granular promotion history required to drive effective promotion analytics and close the loop in the promotion cycle with post event measurement and improved modeling for future periods.

DemandTec Assortment & Space^{tm} for Retail

Our Assortment & Space^{tm} solution for the retail industry consists of one or more of the following software services, along with complementary software, analytical services, and analytical insights:

Assortment Optimization

Assortment Optimization enables retailers to determine which items should be stocked, by store or store cluster, based on the customers that shop at each store, the competitive environment, and a quantified understanding of whether each item in a category is merely duplicative or truly provides variety and adds incremental sales to the category. Key features of Assortment Optimization include:

Advanced modeling and optimization science enables the creation of efficient, customer-centric assortments based on a quantitative understanding of incrementality (an item s ability to increase overall category sales) and transferable demand (the degree to which sales volume shifts to similar items or leaves the store when one item is delisted);

Multiple data inputs incorporates market, loyalty card, planogram, and cost data into the optimization process;

Automated processes includes automated processes and wizards to address the assortment challenges merchants face every day, such as performing straight optimizations, increasing or decreasing SKU count and space, and making one-in-one-out changes to assortments; and

What if analyses enables retailers to run multiple scenarios and compare results to identify the best strategy to meet company objectives such as protecting private label items and image items.

Retailers use Assortment Optimization to optimize assortments based on sales, profit, space productivity, and gross margin return on inventory investment (GMROII) goals. Retailers can choose to generate these assortments by store, store cluster, or section, and view recommended facings. With Assortment Optimization, merchants can receive a set of specific recommendations for assortment changes, and a highly accurate forecast of how the addition or removal of each item will impact category sales.

Assortment Optimization is augmented by a number of DemandTec analytical services and analytical insights, including Image Item Analysis (where we analyze item and basket-level data to determine key items by chain, store, or customer segment in order to enhance price image), Market Basket Profile Analysis (which helps our customers to understand which consumer purchasing behaviors drive larger, more profitable market baskets), and Zone Analysis (where we analyze store-level demand and geo-demographic factors to create or reconfigure ad zones that improve volume and profit potential).

DemandTec Targeted Marketing^{tm} for Retail

Our Targeted Marketing^{tm} solution for the retail industry is a collection of services delivered by DemandTec and its partners that enable retailers to better understand key customer segments, align segmentation and targeted merchandising and marketing initiatives, and create targeted marketing programs that leverage customer insights to build loyalty, increase sales, and improve profitability.

Analytical services that comprise this solution include Market Basket Profile Analysis (helps retailers understand which consumer purchasing behaviour drives larger, more profitable market baskets), Customer Segmentation Analysis (enables retailers to create a new segmentation scheme or refine an existing one to better target their customers), Affinity Analysis (helps retailers determine the probability of a follow-on purchase to improve their merchandising and secondary placements), Image Item Analysis (allows retailers to enhance their price image by analyzing item and basket-level data to determine key items by chain, store, or customer segment), and Zone Analysis / Store Clustering (helps retailers analyze customer segments, store-level demand and geo-demographic factors to create or reconfigure ad zones that improve volume and profit potential).

DemandTec Trade Effectiveness*[tm] *for CP

Our Trade Effectiveness[tm] solution for the CP industry consists of one or more of the following software services, along with complementary software, analytical services, and analytical insights:

Trade Planning & Optimization

Trade Planning & Optimization empowers CP company managers to forecast promotion and pricing activity in a unified planning environment. With this capability, manufacturers can develop and predict trade volume and profitability metrics that will help transform the trade planning function and provide a sustainable competitive advantage. Key features of Trade Planning & Optimization for CP companies include:

- *Optimization and forecasting* accurately predict key volume and financial metrics for brands and overall retail category;

- *Common analytical platform* optimize trade planning with unified pricing and promotion planning based on the same underlying consumption data;

- *Comprehensive trade planning use cases* create, forecast and build plans that include periodic trade promotions (i.e., temporary discounts with or without ad or display support) as well as price advances or buy-downs of the retail price using trade funds; and

- *Demand elasticity curves for every item in the category* quantify the financial impact of competitive trade activity against promoted items, total portfolio and even a retailer s entire category.

CP companies use Trade Planning & Optimization to build a total trade marketing plan that incorporates both everyday price assumptions and promotion tactics, which results in a more complete planning picture and ensures tighter forecast accuracy. Leveraging the science of consumer demand management to pinpoint optimal pricing and promotion strategies, Trade Planning & Optimization provides powerful predictive planning capability to customer account teams and headquarters users to deliver highly effective forecasts that yield documented business results.

Advanced Deal Management

Advanced Deal Management provides capabilities that are tailored for CP companies and brokers to capture greater value from the online deal management experience. As a paid upgrade to the basic Deal Management service (which is offered at no charge), Advanced Deal Management provides a manufacturer-centric set of reports and workflow privileges that help further reduce costs, increase user effectiveness and enhance data visibility. Advanced Deal Management subscribers also have access to add-on services that are unavailable to basic Deal Management subscribers. Key features of Deal Management for CP companies and brokers include:

- *Role-based access* access to multiple users by product line enables rapid and more effective user adoption;

- *Customized item catalog* manufacturer-centric item catalog customized by promoted group supports a more logical way of building and entering promotions;

Long-term deal archive full seven-year history of all deal data, including full documentation of offer versions and written negotiations between trading partners supports, among other benefits, compliance with regulatory requirements;

Advanced data reporting detailed reporting and data export features support better business decisions; and

Funds tracking accurate visibility into available trade spending balances and the ability to reconcile planned trade promotion activity against actual in-store execution.

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CP companies upgrade to Advanced Deal Management in order to derive more value from the online deal management initiative. For a relatively small investment, our CP company customers are provided with access to features that help to further reduce costs, increase user effectiveness and enhance data visibility.

Professional Services

Our professional services organization works closely with our customers to implement our software so that our customers can rapidly begin to achieve their merchandising and marketing objectives. The organization consists of field consultants and project managers, technology integration specialists, modeling experts, and training specialists with experience in implementing software in various retail and CP segments. Depending on a specific customer s requirements, we also may engage third parties to assist with implementations. We generally make our software available to a customer within two weeks of signing its agreement, with several product categories being fully operational within a matter of months.

The analytical services group within our professional services organization works with prospects and customers to identify actionable insights in order to improve our customers returns on investment from using our software. Leveraging our software platform, retailer transaction-log/loyalty data, and additional third-party data sources, we offer a number of strategic analytical insights both as part of our software and as customer-specific services. For example, we offer an affinity analysis, which summarizes millions of transaction-level records to identify sets of products frequently purchased together, and recommend subsequent strategies for maximizing consumer purchases.

The education group within our professional services organization provides education and training services to our customers and partners. The education group works closely with each customer or partner to design and deliver a training curriculum to match its needs. We deliver courses through lectures, written materials and e-learning modules. We also offer a train-the-trainer program for customers with extensive or ongoing training requirements.

Science and Technology

Science

Our science-based CDM software applies advanced statistical analytics in the following areas:

Demand Modeling. Our CDM software uses complex econometric models designed to predict accurately the sales volume of products under varying merchandising conditions and at various prices, which enables customers to determine the factors that influence consumer demand for a given product and location, and to what extent. Our proprietary demand models quantify consumer response to different merchandising and marketing activities, environmental factors and elements of consumer behavior across various consumer segments. Since our models are non-linear, they are able to capture the complex underlying relationships between consumer demand and the factors that influence that demand.

Consumer-Centric Merchandising and Marketing. Individual consumers and particular consumer segments respond differently to price changes for different items. By applying various data mining and statistical techniques to analyze sales data and combining the results with additional data such as demographics, buying histories and item affinities, our software enables our customers to understand consumer and product segmentation more fully, to determine more effective product assortments, and to design more individualized promotion offers. These techniques enable our customers to make more granular, and therefore more effective, merchandising and marketing decisions.

Forecasting and Simulation. Our forecasting software enables our customers to determine the likely revenue, profit and sales volumes for specific product categories, brands or promoted groups at the store/item level for a given set of prices and merchandising conditions. Our software does this by incorporating and analyzing factors such as product distribution, assortment and complementarity, cannibalization, incrementality, transferable demand, stockpiling by consumers, equivalent volumes and discrete events such as holidays and localized merchandising categories. Our software also quantifies and forecasts the store/item level margin impact caused by varying supply chain costs.

Optimization and Rules Enforcement. While demand modeling is a powerful tool that can provide quantifiable benefits, achieving those benefits would be difficult if our software relied solely upon modeling, because of the large number of possibilities that our models generate. Our optimization science uses a combination of complex algorithms to help customers determine prices, promotions and markdowns that best accomplish their objectives, while complying with their business rules. These algorithms are designed to ensure accurate results and incorporate rule relaxation that automatically resolves conflicts in business rules according to the customer s preferences.

Technology

Data Processing. We receive and process terabytes of customer data, including transaction-log/loyalty data. This information is provided by retailers, CP companies and syndicated data providers on a daily or weekly basis. We process data through our proprietary software platform, which integrates, validates and cleanses multiple data types and enhances data quality by identifying and correcting common data problems.

Grid Computing. The implementation of our advanced mathematical software requires substantial computing resources. To address this challenge, we distribute our software across a scalable grid of servers. This approach allows us to automatically partition large computational problems into smaller computations and to execute those computations in parallel across the grid. We design our grid architecture to ensure that optimizations are completed reliably and that computing resources are allocated dynamically to our various customers.

Enterprise Application Technology. With the exception of customers who licensed Connect3 software prior to its acquisition by DemandTec, our customers access our software through a web browser and no software is installed on our customers premises. Our portal technology allows us to incorporate content from other sources and allows our content to be shown in other applications and portals. Customers can configure the user interface, customer-specific fields, customer-specific workflow behavior and portal layout and content. Our scalable architecture allows us to add new customers without requiring us to make substantial incremental investments in IT infrastructure.

Enterprise Integration. We provide multiple integration points with our customers IT systems. Large incoming and outgoing data feeds use data-level integration to transfer bulk files on an automated basis. We use industry-standard web services protocols to communicate with customer systems and to process customer system requests. Our MyDemandTec portal technology enables user interface-layer integration between our system and our customers systems, allowing us to display content served by customer systems and to serve content to customer systems using industry-standard protocols.

SaaS Operations

Our operations organization is responsible for delivering our software as a service to our customers, which includes quality assurance, release deployment, database management and application tuning, systems monitoring and proactive problem detection and prevention, application availability and customer support.

Under our SaaS model, we currently release a new software version approximately every quarter. Since June 1, 2004, we have released 36 new versions of our software, each one containing significant new functionality. Releases are deployed simultaneously to all of our customers. Prior to deployment, each release undergoes multi-stage testing and substantial quality assurance, including build acceptance tests, regression test cases, customer integration tests and final system verification tests.

Our software is hosted in two data centers, one in San Jose, California and one in Sacramento, California. Each of these facilities includes advanced security, power redundancy, and disaster mediation safeguards and procedures such as biometric access control, onsite power generation and earthquake hardening.

We have implemented a comprehensive information security management program. As part of this program, our processes and procedures include: logical access controls such as certificate authentication, role-based authorization and detailed system logging; vulnerability management assessment and remediation; network security measures including encryption, firewalls and monitoring; strict data and software back-up procedures with regular rotations to a secure, offsite storage location; and network and system redundancy to provide application resiliency.

In January 2009, an independent accounting and auditing firm completed an audit of our controls over information technology and processes in accordance with Statement on Auditing Standards No. 70, or SAS 70. This firm issued a SAS 70 Type II report confirming that suitably-designed controls were in place and operating effectively.

Superior customer support is critical to customer satisfaction and to retaining and expanding our customer base. By leveraging our relationship with Sonata Services Limited in Shanghai, China, discussed below in Research and Development, we are able to provide customer support 24 hours a day, seven days a week through our support web portal and by telephone. Since we manage our software for our customers, we often are able to detect and resolve delivery problems or processing capacity needs well in advance of when a customer might actually notice the problem.

Our Customers

Today, our software as a service is used by over 195 customers worldwide in the retail and CP industries. Retailers together accounted for approximately 86% of our revenue in fiscal 2009 and CP companies accounted for approximately 14% of our revenue in fiscal 2009. Wal-Mart Stores, Inc., our largest customer in fiscal 2009, accounted for approximately 14% of our revenue in fiscal 2009.

Sales and Marketing

We sell our CDM solutions through our direct sales organization, often in cooperation with entities such as systems integration firms, strategy consultants and syndicated data providers. Our sales organization is comprised of two distinct teams, one for retailers and one for the CP industry. We assign our sales directors to specific named target accounts. Solution consultants assist our sales directors in providing detailed technical and business expertise. After the first year of a customer s agreement term, we assign a strategic account executive who is responsible for managing the customer s satisfaction, agreement renewals and sales of additional software and services. Outside the United States, we have a sales presence in the United Kingdom, France and Japan.

Our marketing group assists our direct sales, partner and professional services organizations by providing sales tools, programs and training. Our outbound marketing programs are designed to develop awareness of DemandTec and to build our brand through participation in a variety of industry events, public relations, web-based seminar campaigns and other activities targeted at key executives and decision-makers in the industries we serve.

Every year, we host DemandBetter, a two-day conference for our customers that brings together executives from retailers and CP companies to share strategies and best practices. The conference features in-depth product, science and customer case study sessions.

Strategic Relationships

We continually seek to develop and foster alliances with third parties whose products, technologies and services complement our offerings. We work with industry leaders that assist in joint sales activities and software implementation. These relationships vary in complexity and scope and range from formal global alliances to informal regional relationships. Three firms with which we collaborate globally are ACNielsen, Inc., International Business Machines Corporation, or IBM, and Accenture LLP. We have had success working with these companies, and we believe that we can continue to work together to provide complementary solutions.

ACNielsen is a leading marketing information provider. In 2005, we entered into an exclusive agreement with ACNielsen to deliver consumer-centric merchandising solutions to fast moving consumer goods (FMCG) retailers around the globe. Retailers utilizing both our and ACNielsen s offerings can access a combination of consumer and market information, demand-modeling science and optimization software to generate merchandising plans.

The Global Business Services division of IBM provides business process outsourcing, systems integration and general consulting services. IBM has pre-existing relationships with many of our retail customers and prospects. We have worked with IBM to jointly sell and implement our solutions in multiple geographies.

Accenture has a strong retail industry practice that includes expertise and solutions focused on precision pricing. We have successfully collaborated with Accenture on joint sales and implementation efforts for a number of retail customers around the globe.

Research and Development

Under our SaaS model, we maintain and support only one version of our software. This enables us to focus our research and development expenditures on researching new methodologies for understanding and predicting consumer demand and developing new features and functionality. We concentrate our research and development efforts on:

improving our statistical modeling capabilities and advanced optimization techniques to enhance our understanding of consumer demand and consumer segmentation;

enhancing existing applications and developing new applications that leverage our software platform to address a broader set of CDM business requirements; and

enhancing our existing analytical services and developing new analytics and tools.

We have assembled an experienced science and modeling organization comprised of experts in econometrics and advanced mathematics, as well as a core group of engineers with experience working with massive amounts of data and backgrounds in scientific engineering. Our engineering design team is located in San Carlos, California, but we also utilize a group of software engineers employed by Sonata in Shanghai, China. Under our agreement, Sonata provides dedicated engineers for software development, sustaining engineering, quality assurance and testing, operations and customer support. We pay a negotiated, fixed monthly fee for each dedicated individual. Fees are paid monthly in arrears in U.S. dollars. The term of the agreement runs through the end of April 2012. We may terminate this agreement at any time upon written notice, subject to certain scale-down restrictions. We have an option to acquire the operations of Sonata that relate to our business at any time at a pre-negotiated price.

As of February 28, 2009, we had 141 employees in our science, product management and engineering groups located in California, and an additional 64 Sonata engineers in China dedicated to our projects. Our research and development expenses were approximately $26.8 million in fiscal 2009, $22.4 million in fiscal 2008, and $15.3 million in fiscal 2007.

Competition

The market for CDM software varies greatly by industry and business application, is rapidly evolving and fragmented, and is subject to shifting customer needs and changing technology. We compete primarily with vendors of packaged software, whose software is installed by customers on their own premises. We also compete with internally-developed solutions. Our current principal competitors include:

enterprise software application vendors such as SAP AG and Oracle Corporation;

niche retail software vendors targeting smaller retailers such as KSS Group;

- statistical tool vendors such as SAS, Inc.;
- marketing information providers for the CP industry such as ACNielsen and Information Resources, Inc.; and
- business consulting firms such as McKinsey & Company, Inc., Deloitte & Touche LLP and Accenture.

Many of our current and potential competitors have a larger installed base of users, longer operating histories, greater brand recognition and substantially greater financial, technical, marketing, service and other resources. Competitors with greater financial resources may be able to offer lower prices, additional products or services, or other incentives that we cannot match or offer. In addition, niche retail software vendors may compete with us on

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price to attract smaller retailers. Further, larger retailers and CP companies historically have tended to invest in in-house applications and advanced analytics provided by business consulting firms, marketing information providers and statistical tools vendors.

We believe the principal competitive factors in our markets include the following:

- demonstrated customer successes and the attendant retail and CP domain expertise;
- the quality and comprehensiveness of science and technology to manage large data sets, model consumer demand accurately, and optimize pricing and other merchandising and marketing decisions;
- the ability to drive predictable revenue, profitability and sales volume improvements;
- the ease and speed of software implementation and use;
- the ability to enhance science and technology rapidly to meet a broader set of consumer behavior dynamics;
- the performance, scalability and flexibility of the software;
- the interoperability of the software with the customer s legacy systems;
- the cost of the software and the related implementation process; and
- the vendor s reputation.

We believe that we compete favorably with our competitors on the basis of these factors, when evaluated in totality. Enterprise software application vendors offer applications that require implementation of highly-customized, static software code at each customer s site. These providers market multiple applications to the same customer, advertising a more uniform and interoperable IT environment. Our CDM software is provided through a SaaS delivery model that is designed to allow quick access to more dynamic software with significantly less costly and time-consuming on-site implementation. Our SaaS model also reduces dependence upon a customer s internal IT resources and therefore decreases the costs associated with interoperability with legacy systems. We believe that we may not compete as favorably for retail customers with annual sales below $500 million, which may not consider their potential return from incremental changes in revenue or profitability sufficiently compelling to purchase a higher cost, higher value CDM solution. These retailers may instead choose less expensive, less feature rich solutions offered by niche retail software vendors, statistical tools companies or business consulting firms.

If we are not able to compete successfully against our current or future competitors, it will be difficult to acquire and retain customers, and our business, financial condition and operating results will be harmed.

Intellectual Property

We believe that our proprietary mathematical algorithms, statistical models and techniques and unique software architecture differentiate us from other CDM companies, as they enable us to understand and forecast consumer behavior more completely. Our success depends on our ability to continue to innovate in science and engineering and to protect our core intellectual property. Our intellectual property strategy relies on a combination of trade secrets, patents, copyrights, trademarks and contractual confidentiality agreements.

We currently have 14 issued patents and 16 patent applications in the United States, and five issued patents and five patent applications internationally. The expiration dates of our issued patents range from 2020 to 2023. We focus our patent efforts in the United States, but from time to time we will file corresponding foreign patent applications in strategic areas such as Europe and Asia. Our patent strategy balances strategic importance, competitive assessment and the need to maintain costs at a reasonable level, and we do not depend on any specific patent or set of patents to conduct our business operations. We may not receive competitive advantages from any rights granted under our existing patents. We do not know whether any of our patent applications will result in the issuance of any further patents or whether the examination process will require us to narrow the scope of our claims. To the extent any of our applications proceeds to issuance as a patent, the future patent may be opposed, contested, circumvented, designed around by a third party, or found to be unenforceable or invalidated. In addition, our future patent applications may not be issued with the scope of the claims sought by us, if at all, or the scope of claims we are seeking may not be sufficiently broad to protect our proprietary technologies. Others may develop technologies that are similar or superior to our proprietary technologies, duplicate our proprietary technologies or design around patents owned or licensed by us. If our products, patents or patent applications are found to conflict with any patent held by third parties, we could be prevented from selling our products, our patents could be declared invalid or our patent applications might not result in issued patents.

We have registered the trademark DemandTec in the United States, China, Japan, the European Union, Colombia and certain other countries. We have also registered the DemandTec logo in the United States and the European Union. We have filed other trademark applications in the United States and certain other countries.

In addition to filing patent applications and registering trademarks, we also rely in part on United States and international copyright laws to protect our software. Furthermore, we control access to and use of our proprietary software and other confidential information through the use of internal and external controls, including signing non-disclosure agreements with contractors, customers and partners. In addition, all of our employees and consultants are required to execute proprietary information and invention assignment agreements in connection with their employment and consulting relationships with us, pursuant to which they agree to maintain the confidentiality of our proprietary information and they grant us ownership rights in all inventions they reduce to practice in the scope of performing their employment or consulting services. However, we cannot provide any assurance that employees and consultants will abide by these agreements.

Despite our efforts to protect our trade secrets and proprietary rights through patents, licenses and confidentiality agreements, unauthorized parties may still copy or otherwise obtain and use our software and technology. In addition, we intend to expand our international operations, and effective patent, copyright, trademark and trade secret protection may not be available or may be limited in foreign countries. If we fail to protect our intellectual property and other proprietary rights, our business could be harmed.

Employees

As of February 28, 2009, we employed 329 full-time employees, including 141 in research and development, 65 in professional services, 42 in sales and marketing, 46 in general and administrative, and 35 in operations and support. We have never had a work stoppage, and none of our employees is represented by a labor organization or under any collective-bargaining arrangements. We consider our employee relations to be good.

Available Information

Our Internet website address is *www.demandtec.com*. We provide free access to various reports that we file with or furnish to the Securities and Exchange Commission, or SEC, through our website, as soon as reasonably practicable after they have been filed or furnished. These reports include, but are not limited to, our Annual Reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and any amendments to those reports. Our SEC reports can be accessed through the investor relations section of our website, or through *www.sec.gov*. Information on our website does not constitute part of this Annual Report on Form 10-K or any other report we file or furnish with the SEC. Stockholders may request copies of these documents from:

DemandTec, Inc.
One Circle Star Way, Suite 200
San Carlos, CA 94070
Attention: Investor Relations

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Item 1A. *Risk Factors*

Set forth below and elsewhere in this Annual Report on Form 10-K, and in other documents we file with the Securities and Exchange Commission, or SEC, are risks and uncertainties that could cause actual results to differ materially from the results contemplated by the forward-looking statements contained in this Annual Report on Form 10-K and in other written and oral communications from time to time. Because of the following factors, as well as other variables affecting our operating results, past financial performance should not be considered as a reliable indicator of future performance and investors should not use historical trends to anticipate results or trends in future periods.

Risks Related to Our Business and Industry

We have a history of losses and we may not achieve or sustain profitability in the future.

We have a history of losses and have not achieved profitability in any fiscal year. We experienced net losses of $5.0 million, $4.5 million and $1.5 million in fiscal 2009, fiscal 2008 and fiscal 2007, respectively. At February 28, 2009, we had an accumulated deficit of $77.4 million. We may continue to incur net losses in the future. In addition, we expect our cost of revenue and operating expenses to continue to increase as we implement initiatives to continue to grow our business. If our revenue does not increase to offset these expected increases in cost of revenue and operating expenses, we will not be profitable. You should not consider our revenue growth in recent periods as indicative of our future performance. In fact, in future periods our revenue could decline. Accordingly, we cannot assure you that we will be able to achieve or maintain profitability in the future.

The effects of the recent global economic crisis may adversely impact our business, operating results or financial condition.

The recent global economic crisis has caused a general tightening in the credit markets, lower levels of liquidity, increases in the rates of default and bankruptcy, extreme volatility in credit, equity and fixed income markets, and a growing economic contraction. The retail and consumer products industries have been and may continue to be especially hard hit by these economic developments. For example, current or potential customers may not have funds to enter into or renew their agreements for our software and services, which could cause them to delay, decrease or cancel purchases of our software and services or to not pay us or to delay paying us for previously purchased software and services. Financial institution failures may cause us to incur increased expenses or make it more difficult either to utilize our existing debt capacity or otherwise obtain financing for our operations, investing activities (including the financing of any future acquisitions), or financing activities. Finally, our investment portfolio, which includes short-term debt securities, is subject to general credit, liquidity, counterparty, market and interest rate risks that may be exacerbated by the recent global financial crisis. If the banking system or the fixed income, credit or equity markets continue to deteriorate or remain volatile, our investment portfolio may be impacted and the values and liquidity of our investments could be adversely affected.

We may experience significant quarterly fluctuations in our operating results due to a number of factors, which makes our future operating results difficult to predict and could cause our operating results to fall below expectations.

Our quarterly operating results may fluctuate significantly due to a variety of factors, many of which are outside of our control. As a result, comparing our operating results on a period-to-period basis may not be meaningful. You should not rely on our past results as an indication of our future performance. If our operating results fall below the expectations of investors or securities analysts or below the guidance, if any, we provide to the market, the price of our common stock could decline substantially.

Factors that may affect our operating results include:

our ability to increase sales to existing customers and to renew agreements with our existing customers, particularly larger retail customers;

our ability to attract new customers, particularly larger retail customers and consumer products customers;

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- changes in our pricing policies or those of our competitors;
- outages and capacity constraints with our hosting partners;
- fluctuations in demand for our software;
- volatility in the sales of our solutions on a quarterly basis;
- reductions in customers budgets for information technology purchases and delays in their purchasing cycles, particularly in light of recent deteriorating economic conditions;
- our ability to develop and implement in a timely manner new software and enhancements that meet customer requirements;
- our ability to hire, train and retain key personnel;
- any significant changes in the competitive dynamics of our market, including new entrants or substantial discounting of products;
- our ability to control costs, including our operating expenses;
- any significant change in our facilities-related costs;
- the timing of hiring personnel and of large expenses such as those for trade shows and third-party professional services;
- general economic conditions in the retail and CP markets; and
- the impact of a recession or any other adverse economic conditions on our business, including a delay in signing or a failure to sign significant customer agreements.

We have in the past experienced, and we may continue to experience, significant variations in our level of sales on a quarterly basis. Such variations in our sales, or delays in signing or a failure to sign significant customer agreements, may lead to significant fluctuations in our cash flows and deferred revenue on a quarterly basis. If we experience a delay in signing or a failure to sign a significant customer agreement in any particular quarter, then our operating results for such quarter and for subsequent quarters may be below the expectations of securities analysts or investors, which may result in a decline in our stock price.

In addition, in the past, certain of our customers have filed for bankruptcy protection. For example, in March 2009, one of our customers, Bi-Lo LLC, filed a voluntary petition for relief under Chapter 11 of the United States Bankruptcy Code. While we do not believe that any such bankruptcy filing to date has had a material impact on our results of operations in fiscal 2009, it is possible that in the future any customers or potential customers seeking bankruptcy protection could seek to cancel their agreements with us, or could elect not to purchase new or additional services or renew such services with us, or could fail to pay us according to our contractual terms, any of which would negatively impact our results of operations or financial position in the future.

We depend on a small number of customers, which are primarily large retailers, and our growth, if any, depends upon our ability to add new and retain existing large customers.

We derive a significant percentage of our revenue from a relatively small number of customers, and the loss of any one or more of those customers could decrease our revenue and harm our current and future operating results. Our retail customers accounted for 86% of our revenue in fiscal 2009. Our three largest customers accounted for approximately 33% and 29% of our revenue in fiscal 2009 and 2008, respectively. Although our largest customers may vary from period to period, we anticipate that we will continue to depend on revenue from a relatively small number of retail customers. Further, our ability to grow revenue depends on our ability to increase sales to existing customers, to renew agreements with our existing customers and to attract new customers. If economic factors, including the recent global economic crisis, were to have a continued or increasingly negative impact on the retail market segment, it could reduce the amount that these customers spend on information technology, and in particular CDM software, which would adversely affect our revenue and results of operations.

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Our business depends substantially on customers renewing their agreements for our software. Any decline in our customer renewals would harm our operating results.

To maintain and grow our revenue, we must achieve and maintain high levels of customer renewals. We sell our software pursuant to agreements with initial terms that are generally from one to three years in length. Our customers have no obligation to renew their agreements after the expiration of their term, and we cannot assure you that these agreements will be renewed on favorable terms or at all. The fees we charge for our solutions vary based on a number of factors, including the software, service and hosting components provided and the duration of the agreement term. Our initial agreements with customers may include fees for software, services or hosting components that may not be needed upon renewal. As a consequence, upon renewal of these agreements, if any, we may receive lower total fees. In addition, if an agreement is renewed for a term longer than the preceding term, we may receive total fees in excess of total fees received in the initial agreement but a smaller average annual fee because we generally charge lower annual fees in connection with agreements with longer terms. In any of these situations, we would need to sell additional software, services or hosting in order to maintain the same level of annual fees from that customer. There can be no assurance that we will be able to renew these agreements, sell additional software or services or sell to new customers. Some of our customers have elected not to renew their agreements with us or have renewed on less favorable terms. For instance, Sainsbury plc, which accounted for 21.2% of our fiscal 2006 revenue, did not renew its agreement when its term expired in the fourth quarter of fiscal 2006. We have limited historical data with respect to customer renewals, so we may not be able to predict future customer renewal rates and amounts accurately. Our customers renewal rates may decline or fluctuate as a result of a number of factors, including their satisfaction or dissatisfaction with our software, the price of our software, the prices of competing products and services, consolidation within our customer base or reductions in our customers information technology spending levels. If our customers do not renew their agreements for our software for any reason or if they renew on less favorable terms, our revenue will decline.

Because we recognize revenue ratably over the terms of our customer agreements, the lack of renewals or the failure to enter into new agreements will not immediately be reflected in our operating results but will negatively affect revenue in future quarters.

We recognize revenue ratably over the terms of our customer agreements, which typically range from one to three years. As a result, most of our quarterly revenue results from agreements entered into during previous quarters. Consequently, a decline in new or renewed agreements in a particular quarter, as well as any renewals at reduced annual dollar amounts, will not be reflected in any significant manner in our revenue for that quarter, but it will negatively affect revenue in future quarters.

We may expand through acquisitions of other companies, which may divert our management s attention and result in unexpected operating difficulties, increased costs and dilution to our stockholders.

Our business strategy may include acquiring complementary software, technologies, or businesses. For instance, in February 2009, we acquired Connect3 Systems, Inc., a provider of advertising planning and execution software. Acquisitions may result in unforeseen operating difficulties and expenditures. In particular, we may encounter difficulties in assimilating or integrating the businesses, technologies, services, products, personnel or operations of the acquired companies (including those of Connect3), especially if the key personnel of the acquired company choose not to work for us, and we may have difficulty retaining the customers of any acquired business due to changes in management and ownership. Acquisitions may also disrupt our ongoing business, divert our resources and require significant management attention that would otherwise be available for ongoing development of our current business. We also may be required to use a substantial amount of our cash or issue equity securities to complete an acquisition, which could deplete our cash reserves and dilute our existing stockholders and could adversely affect the market price of our common stock. Moreover, we cannot assure you that the anticipated benefits of any acquisition would be realized or that we would not be exposed to unknown liabilities.

In addition, an acquisition may negatively impact our results of operations because we may incur additional expenses relating to one-time charges, write-downs or tax-related expenses. For example, our acquisition of TradePoint in November 2006 resulted in approximately $970,000 of amortization of purchased intangible assets in each of fiscal 2009 and 2008, and $321,000 in fiscal 2007, and will result in amortization of approximately

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$911,000 in fiscal 2010 with declining amounts for seven years thereafter. Our acquisition of Connect3 resulted in the write-off of $150,000 of in-process research and development cost in fiscal 2009, and will result in amortization of purchased intangibles of approximately $2.4 million, $1.8 million and $626,000 in fiscal 2010, 2011, and 2012, respectively.

Our sales cycles are long and unpredictable, and our sales efforts require considerable time and expense.

We market our software to large retailers and CP companies, and sales to these customers are complex efforts that involve educating our customers about the use and benefits of our software, including its technical capabilities. Customers typically undertake a significant evaluation process that can result in a lengthy sales cycle, in some cases over 12 months. We spend substantial time, effort and money in our sales efforts without any assurance that our efforts will generate long-term agreements. In addition, customer sales decisions are frequently influenced by macroeconomic factors, budget constraints, multiple approvals, and unplanned administrative, processing and other delays. If sales expected from a specific customer are not realized, our revenue and, thus, our future operating results could be adversely impacted.

Our business will be adversely affected if the retail and CP industries do not widely adopt technology solutions incorporating scientific techniques to understand and predict consumer demand to make pricing and other merchandising decisions.

Our software addresses the new and emerging market of applying econometric modeling and optimization techniques in software to enable retailers and CP companies to understand and predict consumer demand in order to improve their pricing, promotion, and other merchandising and marketing decisions. These decisions are fundamental to retailers and CP companies; accordingly, our target customers may be hesitant to accept the risk inherent in applying and relying on new technologies or methodologies to supplant traditional methods. Our business will not be successful if retailers and CP companies do not accept the use of software to enable more strategic pricing and other merchandising decisions.

If we are unable to continue to enhance our current software or to develop or acquire new software to address changing consumer demand management business requirements, we may not be able to attract or retain customers.

Our ability to attract new customers, renew agreements with existing customers and maintain or increase revenue from existing customers will depend in large part on our ability to anticipate the changing needs of the retail and CP industries, to enhance existing software and to introduce new software that meet those needs. Any new software may not be introduced in a timely or cost-effective manner and may not achieve market acceptance, meet customer expectations, or generate revenue sufficient to recoup the cost of development or acquisition of such software. If we are unable to successfully develop or acquire new software and enhance our existing applications to meet customer requirements, we may not be able to attract or retain customers.

Understanding and predicting consumer behavior is dependent upon the continued availability of accurate and relevant data from retailers and third-party data aggregators. If we are unable to obtain access to relevant data, or if we do not enhance our core science and econometric modeling methodologies to adjust for changing consumer behavior, our software may become less competitive or obsolete.

The ability of our econometric models to forecast consumer demand depends upon the assumptions we make in designing the models and in the quality of the data we use to build them. Our models rely on point of sale, or POS, data, and in some cases transaction log or loyalty program data provided to us directly by our retail customers and by third-party data aggregators. Consumer behavior is affected by many factors, including evolving consumer needs and preferences, new competitive product offerings, more targeted merchandising and marketing, emerging industry standards, and changing technology. Data adequately representing all of these factors may not be readily available in certain geographies or in certain markets. In addition, the relative importance of the variables that influence demand will change over time, particularly with the continued growth of the Internet as a viable retail alternative and the emergence of non-traditional marketing channels. If our retail customers are unable to collect

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POS, transaction log or loyalty program data or we are unable to obtain such data from them or from third-party data aggregators, or if we fail to enhance our core science and modeling methodologies to adjust for changes in consumer behavior, customers may delay or decide against purchases or renewals of our software.

We rely on our management team and will need additional personnel to grow our business, and the loss of one or more key employees or our inability to attract and retain qualified personnel could harm our business.

Our success depends to a significant degree on our ability to attract, retain and motivate our management team and our other key personnel. Our professional services organization and other customer-facing groups, in particular, play an instrumental role in ensuring our customers satisfaction. In addition, our science, engineering and modeling team requires experts in econometrics and advanced mathematics, and there are a limited number of individuals with the education and training necessary to fill these roles should we experience employee departures. All of our employees work for us on an at-will basis, and there is no assurance that any employee will remain with us. Our competitors may be successful in recruiting and hiring members of our executive management team or other key employees, and it may be difficult for us to find suitable replacements on a timely basis. Many of the members of our management team and key employees are substantially vested in their shares of our common stock or options to purchase shares of our common stock, and therefore retention of these employees may be difficult in the highly competitive market and geography in which we operate our business.

We have experienced growth in recent periods. If we fail to manage our growth effectively, we may be unable to execute our business plan, maintain high levels of customer service or address competitive challenges adequately.

We have substantially expanded our overall business, headcount and operations in recent periods. For instance, our headcount grew from 198 employees at February 28, 2007 to 251 employees at February 29, 2008, and to 329 employees at February 28, 2009. Headcount in research and development increased from 99 at February 28, 2007 to 141 at February 28, 2009. In addition, our revenue grew from $43.5 million in fiscal 2007 to $61.3 million in fiscal 2008, and to $75.0 million in fiscal 2009. We will need to continue to expand our operations in order to increase our customer base and to develop additional software. Increases in our customer base could create challenges in our ability to implement our software and support our customers. In addition, we will be required to continue to improve our operational, financial and management controls and our reporting procedures. As a result, we may be unable to manage our business effectively in the future, which may negatively impact our operating results.

We have derived most of our revenue from sales to our retail customers. If our software is not widely accepted by CP companies, our ability to grow our revenue and achieve our strategic objectives will be harmed.

To date, we have derived most of our revenue from retail customers. During fiscal 2009, we generated approximately 86% of our revenue from sales to retail customers while we generated approximately 14% of our revenue from sales to CP companies. In fiscal 2008 we generated 90% of our revenue from sales to retail customers while we generated 10% of our revenue from sales to CP companies. In order to grow our revenue and to achieve our long-term strategic objectives, it is important for us to expand our sales to derive a more significant portion of our revenue from new and existing CP customers. If CP companies do not widely accept our software, our revenue growth and business will be harmed.

We face intense competition that could prevent us from increasing our revenue and prevent us from becoming profitable.

The market for our software is highly competitive and we expect competition to intensify in the future. Competitors vary in size and in the scope and breadth of the products and services they offer. Currently, we face competition from traditional enterprise software application vendors such as Oracle Corporation and SAP AG, niche retail software vendors targeting smaller retailers such as KSS Group, and statistical tool vendors such as SAS, Inc. To a lesser extent, we also compete or potentially compete with marketing information providers for the

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CP industry such as ACNielsen, Inc. and Information Resources, Inc., as well as business consulting firms such as McKinsey & Company, Inc., Deloitte & Touche LLP and Accenture LLP, which offer merchandising consulting services and analyses. Because the market for CDM solutions is relatively new, we expect to face additional competition from other established and emerging companies and, potentially, from internally-developed applications. This competition could result in increased pricing pressure, reduced profit margins, increased sales and marketing expenses and a failure to increase, or the loss of, market share.

Competitive offerings may have better performance, lower prices and broader acceptance than our software. Many of our current or potential competitors have longer operating histories, greater name recognition, larger customer bases and significantly greater financial, technical, sales, research and development, marketing and other resources than we have. As a result, our competition may be able to offer more effective software or may opt to include software competitive to our software as part of broader, enterprise software solutions at little or no charge.

We may not be able to maintain or improve our competitive position against our current or future competitors, and our failure to do so could seriously harm our business.

We rely on two third-party service providers to host our software, and any interruptions or delays in services from these third parties could impair the delivery of our software as a service.

We deliver our software to customers over the Internet. The software is hosted in two third-party data centers located in California. We do not control the operation of either of these facilities, and we rely on these service providers to provide all power, connectivity and physical security. These facilities could be vulnerable to damage or interruption from earthquakes, floods, fires, power loss, telecommunications failures and similar events. They are also subject to break-ins, computer viruses, sabotage, intentional acts of vandalism and other misconduct. The occurrence of a natural disaster or intentional misconduct, a decision to close these facilities without adequate notice or other unanticipated problems could result in lengthy interruptions in our services. Additionally, because we currently rely upon disk and tape bond back-up procedures, but do not operate or maintain a fully-redundant back-up site, there is an increased risk of service interruption.

If our security measures are breached and unauthorized access is obtained to our customers data, our operations may be perceived as not being secure, customers may curtail or stop using our software and we may incur significant liabilities.

Our operations involve the storage and transmission of our customers confidential 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, and, as a result, someone obtains unauthorized access to our customers data, our reputation will be damaged, our business may suffer and we could incur significant liability. Because 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 potential sales and existing customers.

If we fail to respond to rapidly changing technological developments or evolving industry standards, our software may become less competitive or obsolete.

Because our software is designed to operate on a variety of network, hardware and software platforms using standard Internet tools and protocols, we will need to modify and enhance our software continuously to keep pace with changes in Internet-related hardware, software, communication, browser and database technologies. 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. If we are unable to respond in a timely manner to these rapid technological developments, our software may become less marketable and less competitive or obsolete.

Our use of open source software and third-party technology could impose limitations on our ability to commercialize our software.

We incorporate open source software into our software. Although we monitor our use of open source software closely, the terms of many open source licenses have not been interpreted by United States courts, and there is a risk that these licenses could be construed in a manner that imposes unanticipated conditions or restrictions on our ability to commercialize our software. In that event, we could be required to seek licenses from third parties in order to continue offering our software, to re-engineer our technology or to discontinue offering our software in the event re-engineering cannot be accomplished on a timely basis, any of which could adversely affect our business, operating results and financial condition. We also incorporate certain third-party technologies, including software programs and algorithms, into our software and may desire to incorporate additional third-party technologies in the future. Licenses to new third-party technologies may not be available to us on commercially reasonable terms, or at all.

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

To protect our proprietary technology, including our core statistical and mathematic models and our software, we rely on trade secret, patent, copyright, service mark, trademark and other proprietary rights laws and confidentiality agreements with employees and third parties, all of which offer only limited protection. Despite our efforts, the steps we have taken to protect our proprietary rights may not be adequate to preclude misappropriation of our proprietary information or infringement of our intellectual property rights, and our ability to police that misappropriation or infringement is uncertain, particularly in countries outside of the United States, including China where a third party conducts a portion of our development activity for us. Further, we do not know whether any of our pending patent applications will result in the issuance of patents or whether the examination process will require us to narrow our claims. Our current patents and any future patents that may be issued may be contested, circumvented or invalidated. Moreover, the rights granted under any issued patents may not provide us with proprietary protection or competitive advantages, and, as with any technology, competitors may be able to develop technologies similar or superior to our own now or in the future.

Protecting against the unauthorized use of our trade secrets, patents, copyrights, service marks, trademarks and other proprietary rights is expensive, difficult and not always possible. Litigation may be necessary in the future to enforce or defend our intellectual property rights, to protect our trade secrets or to determine the validity and scope of the proprietary rights of others. This litigation could be costly and divert management resources, either of which could harm our business, operating results and financial condition. Furthermore, many of our current and potential competitors have the ability to dedicate substantially greater resources to enforcing their intellectual property rights than we do. Accordingly, despite our efforts, we may not be able to prevent third parties from infringing upon or misappropriating our intellectual property.

We cannot be certain that the steps we have taken will prevent the unauthorized use or the reverse engineering of our technology. Moreover, others may independently develop technologies that are competitive to ours or infringe our intellectual property. The enforcement of our intellectual property rights also depends on our legal actions against these infringers being successful, but we cannot be sure these actions will be successful, even when our rights have been infringed. Furthermore, effective patent, trademark, service mark, copyright and trade secret protection may not be available in every country in which our services are available or where we have development work performed. In addition, the legal standards relating to the validity, enforceability and scope of protection of intellectual property rights in Internet-related industries are uncertain and still evolving.

Material defects or errors in our software could harm our reputation, result in significant expense to us and impair our ability to sell our software.

Our software is inherently complex and may contain material defects or errors that may cause it to fail to perform in accordance with customer expectations. Any defects that cause interruptions to the availability of our software could result in lost or delayed market acceptance and sales, require us to pay sales credits or issue refunds to our customers, cause existing customers not to renew their agreements and prospective customers not to purchase

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our software, divert development resources, hurt our reputation and expose us to claims for liability. After the release of our software, defects or errors may also be identified from time to time by our internal team and by our customers. The costs incurred in correcting any material defects or errors in our software may be substantial.

Because our long-term success depends, in part, on our ability to expand sales of our software to customers located outside of the United States, our business will be increasingly susceptible to risks associated with international operations.

We have limited experience operating in international jurisdictions. In fiscal 2009 and fiscal 2008, 14% and 12%, respectively, of our revenue was attributable to sales to companies located outside the United States. Our inexperience in operating our business outside of the United States increases the risk that any international expansion efforts that we may undertake will not be successful. In addition, conducting international operations subjects us to new risks that we have not generally faced in the United States. These include:

- fluctuations in currency exchange rates;
- unexpected changes in foreign regulatory requirements;
- localization of our software, including translation of the interface of our software into foreign languages and creation of localized agreements;
- longer accounts receivable payment cycles and difficulties in collecting accounts receivable;
- tariffs and trade barriers and other regulatory or contractual limitations on our ability to sell or develop our software in certain international markets;
- difficulties in managing and staffing international operations;
- potentially adverse tax consequences, including the complexities of international value added tax systems and restrictions on the repatriation of earnings;
- the burdens of complying with a wide variety of international laws and different legal standards, including local data privacy laws and local consumer protection laws that could regulate retailers permitted pricing and promotion practices;
- political, social and economic instability abroad, terrorist attacks and security concerns in general; and
- reduced or varied protection of intellectual property rights in some countries.

The occurrence of any of these risks could negatively affect our international business and, consequently, our results of operations.

Because portions of our software development, sustaining engineering, quality assurance and testing, operations and customer support are provided by a third party in China, our business will be susceptible to risks associated with having substantial operations overseas.

Portions of our software development, sustaining engineering, quality assurance and testing, operations and customer support are provided by Sonata Services Limited, or Sonata, a third party located in Shanghai, China. As of February 28, 2009, in addition to our 176 employees in our operations, customer support, science, product management and engineering groups located in the United States, an additional 64 Sonata personnel were dedicated to our projects. Remotely coordinating a third party in China requires significant management attention and substantial resources, and there can be no assurance that we will be successful in coordinating these activities. Furthermore, if there is a disruption to these operations in China, it will require that substantial management attention and time be devoted to achieving resolution. If Sonata were to stop providing these services or if there was widespread departure of trained Sonata personnel, this could cause a disruption in our product development process, quality assurance and product release cycles and customer support organizations and require us to incur additional costs to replace and train new personnel.

Enforcement of intellectual property rights and contractual rights may be more difficult in China. China has not developed a fully integrated legal system, and the array of new laws and regulations may not be sufficient to cover all aspects of economic activities in China. In particular, because these laws and regulations are relatively new, and because of the limited volume of published decisions and their non-binding nature, the interpretation and enforcement of these laws and regulations involve uncertainties. Accordingly, the enforcement of our contractual arrangements with Sonata, our confidentiality agreements with each Sonata employee dedicated to our work, and the interpretation of the laws governing this relationship are subject to uncertainty.

If we fail to maintain proper and effective internal controls, our ability to produce accurate financial statements could be impaired, which could adversely affect our operating results, our ability to operate our business and investors views of us.

Ensuring that we have internal financial and accounting controls and procedures adequate to produce accurate financial statements on a timely basis is a costly and time-consuming effort that needs to be re-evaluated frequently. The Sarbanes-Oxley Act requires, among other things, that we maintain effective internal control over financial reporting and disclosure controls and procedures. In particular, commencing in fiscal 2009, we are required to perform annual system and process evaluation and testing of our internal control over financial reporting to allow management and our independent registered public accounting firm to report on the effectiveness of our internal control over financial reporting, as required by Section 404 of the Sarbanes-Oxley Act. In the future, our testing, or the subsequent testing by our independent registered public accounting firm, may reveal deficiencies in our internal control over financial reporting that are deemed to be material weaknesses. Our compliance with Section 404 requires that we incur substantial accounting expense and expend significant management time on compliance-related issues. Moreover, if we are not able to comply with the requirements of Section 404 in the future, or if we or our independent registered public accounting firm identifies deficiencies in our internal control over financial reporting that are deemed to be material weaknesses, the market price of our common stock could decline and we could be subject to sanctions or investigations by the NASDAQ Stock Market, the Securities and Exchange Commission, or SEC, or other regulatory authorities, which would require additional financial and management resources.

Furthermore, implementing any appropriate future changes to our internal control over financial reporting may entail substantial costs in order to modify our existing accounting systems, may take a significant period of time to complete and may distract our officers, directors and employees from the operation of our business. These changes, however, may not be effective in maintaining the adequacy of our internal control over financial reporting, and any failure to maintain that adequacy, or consequent inability to produce accurate financial statements on a timely basis, could increase our operating costs and could materially impair our ability to operate our business. In addition, investors perceptions that our internal control over financial reporting is inadequate or that we are unable to produce accurate financial statements may adversely affect our stock price. While neither we nor our independent registered public accounting firm has identified deficiencies in our internal control over financial reporting that are deemed to be material weaknesses, there can be no assurance that material weaknesses will not be subsequently identified.

If one or more of our key strategic relationships were to become impaired or if these third parties were to align with our competitors, our business could be harmed.

We have relationships with a number of third parties whose products, technologies and services complement our software. Many of these third parties also compete with us or work with our competitors. If we are unable to maintain our relationships with the key third parties that currently recommend our software or that provide consulting services on our software implementations or if these third parties were to begin to recommend our competitors products and services, our business could be harmed.

Claims by others that we infringe their proprietary technology could harm our business.

Third parties could claim that our software infringes their proprietary rights. In recent years, there has been significant litigation involving patents and other intellectual property rights, and we expect that infringement claims may increase as the number of products and competitors in our market increases and overlaps occur. In addition, to the extent that we gain greater visibility and market exposure as a public company, we will face a higher risk of being the subject of intellectual property infringement claims. Any claims of infringement by a third party, even those without merit, could cause us to incur substantial defense costs and could distract our management from our business. Furthermore, a party making such a claim, if successful, could secure a judgment that requires us to pay substantial damages. A judgment could also include an injunction or other court order that could prevent us from offering our software. In addition, we might be required to seek a license for the use of the infringed intellectual property, which may not be available on commercially reasonable terms or at all. Alternatively, we might be required to develop non-infringing technology, which could require significant effort and expense and might ultimately not be successful.

Third parties may also assert infringement claims relating to our software against our customers. Any of these claims might require us to initiate or defend potentially protracted and costly litigation on their behalf, regardless of the merits of these claims, because in certain situations we agree to indemnify our customers from claims of infringement of proprietary rights of third parties. If any of these claims succeeds, we might be forced to pay damages on behalf of our customers, which could materially adversely affect our business.

Changes in financial accounting standards or practices may cause adverse, unexpected financial reporting fluctuations and affect our reported results of operations.

A change in accounting standards or practices could have a significant effect on our reported results and might affect our reporting of transactions completed before the change is effective. New accounting pronouncements and varying interpretations of accounting pronouncements have occurred in the past and may occur in the future. Changes to existing rules or the questioning of current practices may adversely affect our reported financial results or the way we conduct our business. For example, on March 1, 2006 we adopted Statement of Financial Accounting Standards, or SFAS, No. 123(R), *Share-Based Payment,* which requires that employee stock-based compensation be measured based on its fair value on the grant date and treated as an expense that is reflected in the financial statements over the related service period. As a result, our operating results for fiscal 2007, fiscal 2008 and fiscal 2009 include expenses that are not reflected in prior periods, increasing our net loss and making it more difficult for investors to evaluate our results of operations for fiscal 2007, fiscal 2008 and fiscal 2009 relative to prior periods.

We might require additional capital to support our business growth, and this capital might not be available on acceptable terms, or at all.

We intend to continue to make investments to support our business growth and may require additional funds to respond to business challenges, including the need to develop new software or enhance our existing software, enhance our operating infrastructure and acquire complementary businesses and technologies. In April 2008, we secured a $15.0 million revolving credit line with a financial institution that replaced our $5.0 million credit line in order to increase our access to available capital. However, we may need to engage in equity or debt financings or enter into additional credit agreements to secure additional funds. If we raise additional funds through further issuances of equity or convertible debt securities, our existing stockholders could suffer significant dilution, and any new equity securities we issue could have rights, preferences and privileges superior to those of holders of our common stock. Any debt financing secured by us in the future could involve restrictive covenants relating to our capital-raising activities and other financial and operational matters that make it more difficult for us to obtain additional capital and to pursue business opportunities, including potential acquisitions. In addition, we may not be able to obtain additional financing on terms favorable to us, if at all. If we are unable to obtain adequate financing or financing on terms satisfactory to us, when we require it, our ability to continue to support our business growth and to respond to business challenges could be significantly limited.

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 our software and restricting our ability to store and process data for our customers. In addition, taxation of software 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 software, which could harm our business, financial condition and operating results.

We incur significantly increased costs as a result of operating as a public company, and our management is required to devote substantial time to compliance efforts.

As a public company, we incur significant legal, accounting and other expenses that we did not incur as a private company. The Sarbanes-Oxley Act and rules subsequently implemented by the SEC and the NASDAQ Global Market impose additional requirements on public companies, including enhanced corporate governance practices. For example, the listing requirements for the NASDAQ Global Market provide that listed companies satisfy certain corporate governance requirements relating to independent directors, audit committees, distribution of annual and interim reports, stockholder meetings, stockholder approvals, solicitation of proxies, conflicts of interest, stockholder voting rights and codes of business conduct. Our management and other personnel need to devote a substantial amount of time to complying with these requirements. Moreover, these rules and regulations have increased our legal and financial compliance costs and make some activities more time-consuming and costly. These rules and regulations could also make it more difficult for us to attract and retain qualified persons to serve on our board of directors and board committees or as executive officers and more expensive for us to obtain or maintain director and officer liability insurance.

Risks Related to Ownership of Our Common Stock

The trading price of our common stock has been volatile in the past, may continue to be volatile, and may decline.

The trading price of our common stock has fluctuated widely in the past and may do so in the future. Further, our common stock has limited trading history. Factors affecting the trading price of our common stock, many of which are beyond our control, could include:

- variations in our operating results;
- announcements of technological innovations, new products and services, acquisitions, strategic alliances or significant agreements by us or by our competitors;
- recruitment or departure of key personnel;
- the financial projections we may provide to the public, any changes in these projections or our failure to meet these projections;
- changes in the estimates of our operating results or changes in recommendations by any securities analysts that elect to follow our common stock;
- market conditions in our industry, the retail industry and the economy as a whole;
- price and volume fluctuations in the overall stock market;
- lawsuits threatened or filed against us;
- adoption or modification of regulations, policies, procedures or programs applicable to our business; and
- the volume of trading in our common stock, including sales upon exercise of outstanding options.

In addition, if the market for technology stocks or the stock market in general continues to experience loss of investor confidence as has happened in recent periods, 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 in our industry even if these events do not directly affect us. Some companies that have had volatile market prices for their securities have had securities class actions filed against them. A suit filed against us, regardless of its merits or outcome, could cause us to incur substantial costs and could divert management s attention.

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Future sales of shares by existing stockholders, or the perception that such sales may occur, could cause our stock price to decline.

If our existing stockholders, particularly our directors and executive officers and the venture capital funds affiliated with our former directors, sell substantial amounts of our common stock in the public market, or are perceived by the public market as intending to sell, the trading price of our common stock could decline.

If securities analysts do not publish research or publish unfavorable research about our business, our stock price and trading volume could decline.

The trading market for our common stock depends in part on the research and reports that securities analysts publish about us or our business. We have limited research coverage by securities analysts. If we do not obtain further securities analyst coverage, or if one or more of the analysts who cover us downgrade our stock or publish unfavorable research about our business, our stock price would likely decline. If one or more of these analysts cease coverage of our company or fail to publish reports on us regularly, demand for our stock could decrease, which could cause our stock price and trading volume to decline.

Insiders and other affiliates have substantial control over us and will be able to influence corporate matters.

At February 28, 2009, our directors, executive officers and other affiliates beneficially owned, in the aggregate, approximately 57.9% of our outstanding common stock. As a result, these stockholders will be able to exercise significant influence over all matters requiring stockholder approval, including the election of directors and approval of significant corporate transactions, such as a merger or other sale of our company or its assets. This concentration of ownership could limit your ability to influence corporate matters and may have the effect of delaying or preventing a third party from acquiring control over us.

Anti-takeover provisions in our charter documents and Delaware law could discourage, delay or prevent a change in control of our company and may affect the trading price of our common stock.

We are a Delaware corporation and the anti-takeover provisions of the Delaware General Corporation Law may discourage, delay or prevent a change in control by prohibiting us from engaging in a business combination with an interested stockholder for a period of three years after the person becomes an interested stockholder, even if a change in control would be beneficial to our existing stockholders. In addition, our restated certificate of incorporation and amended and restated bylaws may discourage, delay or prevent a change in our management or control over us that stockholders may consider favorable. Our restated certificate of incorporation and amended and restated bylaws:

- authorize the issuance of blank check preferred stock that could be issued by our board of directors to thwart a takeover attempt;
- establish a classified board of directors, as a result of which the successors to the directors whose terms have expired will be elected to serve from the time of election and qualification until the third annual meeting following their election;
- require that directors only be removed from office for cause and only upon a majority stockholder vote;
- provide that vacancies on our board of directors, including newly created directorships, may be filled only by a majority vote of directors then in office;
- limit who may call special meetings of stockholders;

prohibit stockholder action by written consent, thus requiring all actions to be taken at a meeting of the stockholders;

require supermajority stockholder voting to effect certain amendments to our restated certificate of incorporation and amended and restated bylaws; and

require advance notification of stockholder nominations and proposals.

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Item 1B. ***Unresolved Staff Comments***

None.

Item 2. ***Properties***

Our corporate headquarters and our primary facilities occupy approximately 40,000 square feet in San Carlos, California under a lease that expires in February 2010. In addition, we lease approximately 9,200 square feet in Pleasanton, California that expires in October 2010 and approximately 7,200 square feet in Cerritos, California that expires in December 2010. We also lease small sales and marketing offices in the United States and Europe. The size and location of these properties change from time to time on the basis of business requirements. We do not own any real property. We believe our facilities are adequate for our current needs and that suitable additional or substitute space will be available to accommodate foreseeable expansion of our operations.

Item 3. ***Legal Proceedings***

We are from time to time involved in legal matters that arise in the normal course of business. Based on information currently available, we do not believe that the ultimate resolution of any current matters, individually or in the aggregate, will have a material adverse effect on our business, financial condition or results of operations.

Item 4. ***Submission of Matters to a Vote of Security Holders***

None.

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PART II

Item 5. *Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities*

Market Information. Our common stock has been listed on the NASDAQ Global Market under the symbol DMAN since August 9, 2007. Prior to that time, there was no public market for our common stock. The following table sets forth for the indicated periods the high and low sales prices by quarter for our common stock as reported by the NASDAQ Global Market.

Fiscal Year 2009 Quarters Ended:	**High**	**Low**
February 28, 2009	$ 9.25	$ 5.86
November 30, 2008	$ 11.00	$ 5.77
August 31, 2008	$ 11.05	$ 7.02
May 31, 2008	$ 11.00	$ 6.65

Fiscal Year 2008 Quarters Ended:	**High**	**Low**
February 29, 2008	$ 20.55	$ 8.75
November 30, 2007	$ 20.50	$ 9.45
August 31, 2007 (from August 9, 2007)	$ 10.75	$ 8.95

Stockholders of Record. As of February 28, 2009, we had approximately 140 stockholders of record of our common stock.

Dividends. We have never declared or paid any cash dividends on our common stock. We currently intend to retain earnings to finance future growth, and therefore do not expect to pay cash dividends on our common stock in the foreseeable future.

Securities Authorized for Issuance Under Equity Compensation Plans. For equity plan compensation information, please refer to Item 12 in Part III of this Annual Report on Form 10-K.

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Stock Performance Graph and Cumulative Total Return

Notwithstanding any statement to the contrary in any of our previous or future filings with the Securities and Exchange Commission, or SEC, the following information relating to the price performance of our common stock shall not be deemed to be filed with the SEC or to be soliciting material under the Securities Exchange Act of 1934, as amended, or the Exchange Act, and it shall not be deemed to be incorporated by reference into any of our filings under the Securities Act or the Exchange Act, except to the extent we specifically incorporate it by reference into such filing.

The graph below compares the cumulative total stockholder return of our common stock with that of the Nasdaq Composite Index and the Nasdaq Computer Index from August 9, 2007 (the date on which our common stock commenced trading on the NASDAQ Global Market) through February 28, 2009. The graph assumes that $100 was invested in shares of our common stock, the Nasdaq Composite Index and the Nasdaq Computer Index at the close of market on August 9, 2007, and that dividends, if any, were reinvested. The comparisons in this graph are based on historical data and are not intended to forecast or be indicative of future performance of our common stock.

Comparison of Cumulative Total Returns of DemandTec, Inc., Nasdaq Composite Index and Nasdaq Computer Index

	8/9/07	**8/31/07**	**11/30/07**	**2/29/08**	**5/31/08**	**8/31/08**	**11/31/08**	**2/28/09**
DemandTec, Inc.	$ 100.00	$ 95.90	$ 164.10	$ 101.50	$ 87.80	$ 103.70	$ 72.60	$ 73.60
Nasdaq Composite Index	100.00	102.02	104.56	89.26	99.13	93.03	60.34	54.14
Nasdaq Computer Index	100.00	102.64	110.49	88.45	103.90	94.56	59.36	55.86

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Unregistered Sales of Equity Securities

(1) On December 19, 2007, we issued 80,884 shares upon the net exercise of a warrant to purchase 113,759 shares of our common stock held by a financial institution.

(2) On January 29, 2008, we issued 22,455 shares upon the net exercise of a warrant to purchase 30,488 shares of our common stock held by a financial institution.

(3) During our fourth quarter ended February 29, 2008, we issued 5,000 shares of our common stock to Silicon Valley Community Foundation, for the benefit of the DemandTec Foundation, at an aggregate issue price of $5.00.

The sales of securities described in Items (1), (2) and (3) above were deemed to be exempt from registration under the Securities Act in reliance upon Section 4(2) of the Securities Act. The recipients of securities in each transaction represented their intention to acquire the securities for investment only and not with a view to or for sale in connection with any distribution, and appropriate legends were affixed to the share certificates issued in these transactions. All recipients had adequate access, through their relationships with us, to information about us. All shares issued pursuant to an exemption under Section 4(2) of the Securities Act were issued to purchasers who were accredited investors or sophisticated with access to information regarding us.

Use of Proceeds from Sales of Registered Securities

In August 2007, we completed our initial public offering, or IPO, pursuant to a registration statement on Form S-1 (Registration No. 333-143248) which the U.S. Securities and Exchange Commission declared effective on August 7, 2007. Under the registration statement, we registered the offering and sale of an aggregate of up to 6,900,000 shares of our common stock. Of the registered shares, 6,000,000 of the shares of common stock issued pursuant to the registration statement were sold at a price to the public of $11.00 per share. As a result of the IPO, we raised a total of $57.6 million in net proceeds after deducting underwriting discounts and commissions and expenses.

On August 14, 2007, we used $3.0 million of our proceeds to settle our credit facility. On August 16, 2007, we used $10.2 million of our proceeds to settle our term loan with Silicon Valley Bank and Gold Hill Venture Lending 03, LP. As of February 28, 2009, approximately $44.4 million of aggregate net proceeds remained invested in short-term interest-bearing obligations, investment-grade instruments, certificates of deposit or direct or guaranteed obligations of the United States government or in operating cash accounts.

In March 2009, subsequent to our fiscal year end, we used $11.3 million of our proceeds to pay Connect3 s former shareholders in connection with our February 2009 acquisition of Connect3, and $1.3 million cash to pay off short-term notes payable held by a former Connect3 officer and principal shareholder.

We have used and intend to continue to use the remaining net proceeds from the offering for working capital and other general corporate purposes, including to finance our growth, develop new software and fund capital expenditures. Additionally, we may choose to expand our current business through acquisitions of other complementary businesses, products, services or technologies. Pending such uses, we plan to invest the net proceeds in short-term, interest-bearing, investment grade securities.

There were no material differences in the actual use of proceeds from our IPO as compared to the planned use of proceeds as described in the final prospectus filed with the Securities and Exchange Commission pursuant to Rule 424(b).

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Purchases of Equity Securities by the Issuer and Affiliated Purchasers

Period	Total Number of Shares Purchased(1)	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Program	Maximum Approximate Dollar Value of Shares that May Yet be Purchased Under the Program
December 1, 2008 December 31, 2008		$		$
January 1, 2009 January 31, 2009	2,865	1.90		
February 1, 2009 February 28, 2009				
Total	2,865	$ 1.90		$

(1) Under our 1999 Equity Incentive Plan we granted options to purchase common stock that permit the optionee to exercise the option before vesting, with us retaining a right to repurchase any unvested shares at the optionee s original cost in the event of the optionee s cessation of service. We ceased to grant further options with this repurchase feature after December 2, 2005. This table shows the shares acquired by us upon our repurchase of unvested shares upon an employee s termination during the quarter ended February 28, 2009.

Item 6. ***Selected Financial Data***

The following selected consolidated financial data should be read in conjunction with our audited consolidated financial statements and related notes thereto and with Management s Discussion and Analysis of Financial Condition and Results of Operation, which are included elsewhere in this Annual Report on Form 10-K. The consolidated statement of operations data for fiscal 2009, 2008 and 2007, and the selected consolidated balance sheet data as of February 28, 2009 and February 29, 2008, are derived from, and are qualified by reference to, the audited consolidated financial statements that are included in this Annual Report on Form 10-K. The consolidated statement of operations data for fiscal 2006 and 2005 and the consolidated balance sheet data as of February 28, 2007, 2006 and 2005 are derived from audited consolidated financial statements which are not included in this Annual Report on Form 10-K. Our historical results are not necessarily indicative of results to be expected for any future period.

	Year Ended February 28, 2009(1)	Year Ended February 29, 2008	Year Ended February 28, 2007(1)	2006	2005
Consolidated Statements of Operations Data:					
Revenue	$ 75,005	$ 61,270	$ 43,485	$ 32,539	$ 19,537
Cost of revenue(2)(3)	23,331	20,444	14,230	12,584	8,881
Gross profit	51,674	40,826	29,255	19,955	10,656
Operating expenses:					
Research and development(3)	26,787	22,445	15,340	11,021	9,737
Sales and marketing(3)	20,343	17,290	12,108	10,170	8,105
General and administrative(3)	9,888	6,292	2,673	2,388	1,798
Amortization of purchased intangible assets	1,241	360	118		
Total operating expenses	58,259	46,387	30,239	23,579	19,640
Loss from operations	(6,585)	(5,561)	(984)	(3,624)	(8,984)
Other income (expense), net	1,585	1,542	(480)	850	(284)
Loss before provision for income taxes and cumulative effect of change in accounting principle	(5,000)	(4,019)	(1,464)	(2,774)	(9,268)
Provision (benefit) for income taxes	(47)	455	52	14	8
Loss before cumulative effect of change in accounting principle	(4,953)	(4,474)	(1,516)	(2,788)	(9,276)
Cumulative effect of change in accounting principle				(54)	
Net loss	(4,953)	(4,474)	(1,516)	(2,734)	(9,276)
		13	32	32	32

Accretion to redemption value of preferred stock										
Net loss attributable to common stockholders	$	(4,953)	$	(4,487)	$	(1,548)	$	(2,766)	$	(9,308)
Net loss per common share, basic and diluted	$	(0.18)	$	(0.25)	$	(0.28)	$	(0.62)	$	(2.30)
Shares used in computing basic and diluted net loss per common share		27,372		17,612		5,531		4,449		4,039

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	As of February 28, 2009(1)	As of February 29, 2008	2007(1)	As of February 28, 2006	2005
Consolidated Balance Sheet Data:					
Cash, cash equivalents and marketable securities(4)	$ 87,884	$ 75,889	$ 25,478	$ 14,771	$ 11,594
Working capital (deficit)	21,788	44,739	(66)	(10,731)	(8,593)
Total assets	134,155	113,796	56,795	21,016	19,299
Deferred revenue	48,815	55,375	42,172	25,124	24,536
Debt	1,720	442	15,063	2,219	1,646
Merger consideration payable	13,343				
Redeemable convertible preferred stock			49,073	48,976	49,211
Stockholders equity (deficit)	56,649	50,297	(58,660)	(62,529)	(60,595)

(1) We acquired TradePoint in November 2006 and Connect3 in February 2009. See Note 2 to the consolidated financial statements.

(2) Includes amortization of purchased intangible assets of $610 in fiscal 2009, $608 in fiscal 2008, and $203 in fiscal 2007.

(3) Includes stock-based compensation expense as follows:

	Year Ended February 28, 2009	Year Ended February 29, 2008	Year Ended February 28, 2007	2006	2005
Cost of revenue	$ 1,712	$ 1,261	$ 41	$	$
Research and development	2,261	1,824	62	6	14
Sales and marketing	2,263	1,367	74	1	11
General and administrative	1,743	883	156	64	6
Total stock-based compensation expense	$ 7,979	$ 5,335	$ 333	$ 71	$ 31

(4) Cash, cash equivalents, and marketable securities includes net proceeds of $57.6 million from our sale of 6.0 million shares of common stock in August 2007 in our initial public offering, but does not reflect the reduction of $11.3 million in merger consideration to Connect3 s former shareholders and $1.3 million of short-term notes payable to a former Connect3 officer and principal shareholder, as those payments were made in March 2009, subsequent to our fiscal year end.

Item 7. *Management s Discussion and Analysis of Financial Condition and Results of Operations*

Forward-Looking Statements

This Annual Report on Form 10-K contains forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended. In addition, we may make other written and oral communications from time to time that contain such statements. Forward-looking statements include statements as to industry trends and future expectations of ours and other matters that do not relate strictly to historical facts. These statements are often identified by the use of words such as may, will, expect, believe, anticipate, intend, could, estimate, or similar expressions or variations. These statements are based on the beliefs and assumptions of our management based on information currently available to management. Such forward-looking statements are subject to risks, uncertainties and other factors that could cause actual results and the timing of certain events to differ materially from future results expressed or implied by such forward-looking statements. These forward-looking statements include statements in this Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations. Factors that could cause or contribute to such differences include, but are not limited to, those identified below, and those discussed under the heading Risk Factors in Item 1A of this Annual Report on Form 10-K and in our other Securities and Exchange Commission filings. Furthermore, such forward-looking statements speak only as of the date of this report. We undertake no obligation to update any forward-looking statements to reflect events or circumstances after the date of such statements.

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the consolidated financial statements and related notes thereto appearing elsewhere in this Annual Report on Form 10-K. Our fiscal year ends on the last day of February; fiscal 2009, for example, refers to our fiscal year ended February 28, 2009.

Overview

We are a leading provider of Consumer Demand Management, or CDM, solutions. Our software services enable retailers and consumer products, or CP, companies to define merchandising and marketing strategies based on a scientific understanding of consumer behavior and make actionable pricing, promotion, assortment, space and other merchandising and marketing recommendations to achieve their revenue, profitability and sales volume objectives. We deliver our applications by means of a software-as-a-service, or SaaS, model, which allows us to capture and analyze the most recent retailer and market-level data and enhance our software services rapidly to address our customers ever-changing merchandising and marketing needs.

Our CDM solutions consist of one or more software services and complementary analytical services. We offer our solutions individually or as a suite of integrated applications. Our software services are configurable to accommodate individual customer needs. Our solutions for the retail and CP industries include DemandTec Lifecycle Price Optimization™, DemandTec End-to-End Promotion Management™, DemandTec Assortment & Space™, DemandTec Targeted Marketing™ and DemandTec Trade Effectiveness™. The DemandTec TradePoint Network™ connects our solutions for the retail and CP industries. We were incorporated in November 1999 and began selling our software in fiscal 2001. Our revenue has grown from $9.5 million in fiscal 2004 to $75.0 million in fiscal 2009. Our operating expenses have also increased significantly during these same periods. We have incurred losses to date and had an accumulated deficit of approximately $77.4 million at February 28, 2009.

We sell our software to retailers and CP companies under agreements with initial terms that generally are one to three years in length and provide a variety of services associated with our customers use of our software. We recognize the revenue we generate from each agreement ratably over the term of the agreement. Our revenue growth depends on our attracting new customers, renewing existing agreements, and selling add-on software services to existing customers.

Our ability to maintain or increase our rate of growth will be directly affected by the continued acceptance of our software in the marketplace, as well as the timing, size and term length of our customer agreements.

Our software service agreements with retailers and CP companies are large contracts that generally are two to three years in length. The annual contract value for each retail and CP company customer agreement is largely related to their size, and therefore can fluctuate from period to period. Our Advance Deal Management agreements with CP companies that leverage the DemandTec TradePoint Network are principally one year in length and much smaller in annual and aggregate contract value than our retail and CP Companies customer software services contracts. A significant percentage of our new customer agreements are entered into during the last month, weeks or even days of each quarter-end.

We are headquartered in San Carlos, California, and have sales and marketing offices in North America and Europe. We sell our software through our direct sales force and receive a number of customer prospect introductions through third-parties such as systems integrators and a data syndication company. In fiscal 2009, approximately 86% of our revenue was attributable to sales of our software to companies located in the United States. Our ability to achieve profitability will be affected by our revenue as well as our other operating expenses associated with growing our business. Our largest category of operating expenses is research and development expenses, and the largest component of our operating expenses is personnel costs.

In February 2009, we acquired Connect3 Systems, Inc., a provider of advertising planning and execution software. The Connect3 product suite is being incorporated into the DemandTec End-to-End Promotion ManagementTM solution, which supports retailers end-to-end promotion planning process. The aggregate purchase price was approximately $13.5 million. We will amortize intangible assets associated with the Connect3 acquisition over one to two and a half years on a straight-line basis, which, absent any impairment, will result in amortization expense of approximately $2.4 million, $1.8 million, and $626,000 in fiscal 2010, 2011, and 2012, respectively.

In August 2007, we completed our initial public offering, or IPO, in which we sold and issued 6,000,000 shares of our common stock at an issue price of $11.00 per share. We raised a total of $66.0 million in gross proceeds from the IPO, or approximately $57.6 million in net proceeds after deducting underwriting discounts and commissions of $4.6 million and other offering costs of $3.8 million. Upon the closing of the IPO, all shares of convertible preferred stock outstanding automatically converted into 13,511,107 shares of common stock, and all outstanding warrants to purchase shares of convertible preferred stock automatically converted to warrants to purchase 181,747 shares of common stock.

In November 2006, we acquired TradePoint Solutions, Inc., a provider of on-demand promotion offer management software linking manufacturers, sales agencies and retailers on one platform. The aggregate purchase price was approximately $9.8 million. In this acquisition, we purchased intangible assets. We are amortizing these purchased intangible assets over three to ten years on a straight-line basis, which, absent any impairment, will result in annual amortization expense of approximately $970,000 from the date of acquisition through November 2009 and declining amounts thereafter.

Sources of Revenue

We derive all of our revenue from customer agreements that cover the use of our software and various services associated with our customers use of our software. We recognize all revenue ratably over the term of the agreement.

Our agreements are generally non-cancelable, but customers typically have the right to terminate their agreement for cause if we materially breach our obligations under the agreement and, in certain situations, may have the ability to extend the duration of their agreement on pre-negotiated terms. We invoice our customers in accordance with contractual terms, which generally provide that our customers are invoiced in advance for annual use of our software and for services other than implementation and training services. We provide implementation services on a time and materials basis and invoice our customers monthly in arrears. To a lesser extent, we also provide implementation services on a fixed fee basis and invoice our customers in advance. We invoice in arrears for our training classes on implementing and using our software on a per person, per class basis. Our payment terms typically require our customers to pay us within 30 days of the invoice date. For those billings for which the service period has begun and is non-cancellable, we include amounts invoiced in accounts receivable until collected and in deferred revenue until recognized as revenue.

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Cost of Revenue and Operating Expenses

Cost of Revenue

Cost of revenue includes expenses related to data center costs, depreciation expenses associated with computer equipment and software, compensation and related expenses of operations, technical customer support and professional services personnel, amortization of purchased intangible assets, and allocated overhead expenses. We have contracts with two third parties for the use of their data center facilities, and our data center costs principally consist of the amounts we pay to these third parties for rack space, power and similar items. Amortization of purchased intangible assets in fiscal 2009 relates to developed technology associated with the TradePoint acquisition. We are amortizing the purchased developed technology associated with the TradePoint acquisition over five years on a straight-line basis. We will amortize the purchased developed technology associated with the Connect3 acquisition over two and a half years on a straight line basis beginning in our fiscal year 2010. We allocate overhead costs, such as rent and occupancy costs, employee benefits, information management costs, and legal and other costs, to all departments based on headcount. As a result, we include allocated overhead expenses in cost of revenue and each operating expense category. We expect that, in the future, cost of revenue will increase in absolute dollars but decrease as a percentage of revenue as we spread our data center infrastructure and personnel costs over a larger customer base. In addition, we expect that stock-based compensation charges included in cost of revenue will vary depending on the timing and magnitude of equity incentive grants.

Research and Development

Research and development expenses include compensation and related expenses for our research, product management and software development personnel and allocated overhead expenses. We devote substantial resources to extending our existing software applications as well as to developing new software. We intend to continue to invest significantly in our research and development efforts because we believe these efforts are essential to maintaining our competitive position. In addition, we expect that stock-based compensation charges included in research and development expenses will vary depending on the timing and magnitude of equity incentive grants. In the near term, we expect that research and development expenses will increase in absolute dollars and as a percentage of revenue, and in the long term, we expect these expenses to increase in absolute dollars and decrease as a percentage of revenue.

Sales and Marketing

Sales and marketing expenses include compensation and related expenses for our sales and marketing personnel, including commissions and incentives, travel and entertainment expenses, marketing programs such as product marketing, events, corporate communications and other brand building expenses, and allocated overhead expenses. We expect that, in the future, sales and marketing expenses will increase in absolute dollars as we hire additional personnel, and spend more on marketing programs, but remain relatively constant or decrease slightly as a percentage of revenue. In addition, we expect that stock-based compensation charges included in sales and marketing expenses will vary depending on the timing and magnitude of equity incentive grants.

General and Administrative

General and administrative expenses include compensation and related expenses for our executive, finance and accounting, human resources, legal and information management personnel, third-party professional services fees, travel and entertainment expenses, other corporate expenses and overhead not allocated to cost of revenue, research and development expenses, or sales and marketing expenses. Third-party professional services primarily include outside legal, audit and tax-related consulting costs. We expect that, in the future, general and administrative expenses will remain relatively constant or decrease slightly as a percentage of revenue. We expect that stock-based compensation charges included in general and administrative expenses will vary depending on the timing and magnitude of equity incentive grants.

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Amortization of Purchased Intangible Assets

In February 2009, we acquired Connect3. The aggregate purchase price was approximately $13.5 million, which consisted of approximately $13.3 million in cash and $201,000 of acquisition costs. We are amortizing purchased intangible assets related to developed technology, customer relationships, non-compete covenants and backlog over one to two and a half years on a straight-line basis. Accordingly, annual amortization expenses, absent any impairment, will be approximately $2.4 million, $1.8 million, and $626,000 in fiscal 2010, 2011 and 2012, respectively.

In May 2008, we purchased rights to develop assortment optimization technology for $1.5 million. We are amortizing this intangible asset over 18 months on a straight-line basis. This resulted in $734,000 of amortization expense in fiscal 2009.

In November 2006, we acquired TradePoint. The aggregate purchase price was approximately $9.8 million, which consisted of approximately $3.7 million in cash, approximately $4.1 million in our common stock, a $1.8 million promissory note and $219,000 of acquisition costs. In this acquisition, we purchased intangible assets related to developed technology, customer relationships, a trade name, and non-compete covenants. We are amortizing purchased intangible assets over three to ten years on a straight-line basis. Intangible asset amortization expense was approximately $360,000 in operating expenses and $610,000 in cost of revenue in each of fiscal 2009 and 2008. In fiscal 2007, amortization expense was approximately $118,000 in operating expenses and $203,000 in cost of revenue. The amortization expense associated with TradePoint purchased intangible assets will decline beginning in December 2009.

Other Income (Expense), Net

Other income (expense), net includes interest income on our cash and marketable securities balances, interest expense related to debt, and losses or gains on conversions of non-U.S. dollar transactions into U.S. dollars. In the past two fiscal years, we have invested a majority of our cash in money market funds, treasury bills, corporate bonds, U.S. agencies, and commercial paper. In the first half of fiscal 2008 and fiscal 2007 (the periods preceding our IPO before convertible preferred stock was automatically converted to common stock), other income (expense), net included the impact of recording our outstanding redeemable convertible preferred stock warrants at fair value under Statement of Financial Accounting Standards No. 150, *Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity*, or SFAS No. 150. In fiscal 2010 and thereafter, other income (expense), net will depend on a number of factors, including our ability to generate cash from operations, interest rates and the rates of return on our investments and whether or not we incur debt.

Critical Accounting Policies and Estimates

We prepare our consolidated financial statements in accordance with accounting principles generally accepted in the United States, or GAAP. These accounting principles often require us to make certain estimates and judgments that can affect the reported amounts of assets and liabilities as of the date of our consolidated financial statements, as well as the reported amounts of revenue and expenses during the periods presented. In some cases, the accounting treatment of a particular transaction is specifically dictated by GAAP and does not require management s judgment in its application or our judgments in selecting among available accounting policy alternatives, as they would not produce a materially different result. In other cases, our judgments among available alternatives can have a material impact on our accounting results. We believe that our estimates and judgments were reasonable based upon information available to us at the time that these estimates and judgments were made. On an ongoing basis, we evaluate our estimates and judgments. 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 Consolidated Financial Statements included in Item 8, *Financial Statements and Supplementary Data* of this Annual Report on Form 10-K, the following accounting polices involve the greatest degree of judgment and complexity and have the potential for the greatest impact on our consolidated financial statements. Accordingly, we believe these policies are the most critical in fully understanding and evaluating our reported financial results.

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Revenue Recognition

We generate revenue from fees under agreements with initial terms that generally are one to three years in length. Our agreements contain multiple elements, which include the use of our software, SaaS delivery services, professional services, maintenance, and customer support. Professional services consist of implementation, training, data modeling, and analytical services related to our customers use of our software.

Because we provide our applications as a service, we follow the provisions of the Securities and Exchange Commission, or SEC, Staff Accounting Bulletin No. 104, *Revenue Recognition*, and Emerging Issues Task Force, or EITF, Issue No. 00-21, *Revenue Arrangements with Multiple Deliverables*, or EITF 00-21. We recognize 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 probable; and
- the amount of fees to be paid by the customer is fixed or determinable.

In applying the provisions of EITF 00-21, we have determined that we do not have objective and reliable evidence of fair value for each element of our offering. As a result, the elements within our agreements do not qualify for treatment as separate units of accounting. Therefore, we account for all fees received under our agreements as a single unit of accounting and recognize them ratably over the term of the related agreement, commencing upon the later of the agreement start date or the date access to the application is provided to the customer.

Deferred Commissions

We capitalize certain commission costs directly related to the acquisition of a customer agreement in accordance with Financial Accounting Standards Board, or FASB, Technical Bulletin 90-1, *Accounting for Separately Priced Extended Warranty and Product Maintenance Contracts*. Our commission payments are paid shortly after our receipt of the related customer payment. The commissions are deferred and amortized to sales and marketing expense over the revenue recognition term of the related non-cancelable customer agreement. The deferred commission amounts are recoverable through their accompanying future revenue streams under non-cancellable customer agreements. We believe this is the appropriate method of accounting as the commission charges are so closely related to the revenue from the customer contracts that they should be recorded as an asset and charged to expense over the same period that the related revenue is recognized. Commission expense was approximately $3.4 million, $2.8 million, and $1.5 million in fiscal 2009, 2008, and 2007, respectively. Deferred commissions on our consolidated balance sheet totaled $1.3 million at February 28, 2009 and $2.6 million at February 29, 2008.

Stock-Based Compensation

Effective March 1, 2006, we adopted the fair value recognition provisions of SFAS No. 123 (Revised 2004), *Share-Based Payment*, or SFAS No. 123(R), using the prospective transition method, which required us to apply the provisions of SFAS No. 123(R) only to new awards granted, and to awards modified, repurchased or cancelled after the adoption date. Under this transition method, we began amortizing the grant-date fair value of outstanding stock options granted or modified on or after March 1, 2006 to stock-based compensation expense on a straight-line basis over the requisite service period of the award. Prior to our IPO in August 2007, our board of directors used the services of an unrelated third-party valuation firm to perform contemporaneous valuations at various points in time to determine the fair value of our common stock and to establish the exercise prices of stock options granted. During this time, our approach to valuation was based, in part, on a discounted future cash flow approach that used our estimates of revenue and costs, driven by assumed market growth rates. These estimates were consistent with the plans and estimates that we used to manage the business. There is inherent uncertainty in making these estimates.

In addition, we have performance-based awards outstanding that vest only pursuant to certain performance and time-based vesting criteria set by our Compensation Committee. We amortize the fair value of those awards, net of

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estimated forfeitures, as stock-based compensation expense over the vesting period of the awards. We evaluate the probability of meeting the performance criteria at the end of each reporting period to determine how much compensation expense to record. Because the actual number of shares to be issued is not known until the end of the performance period, the actual compensation expense related to these awards could differ from our current expectations. Beginning in fiscal 2009, we also have restricted stock units, or RSUs, outstanding that entitle the recipient to receive shares of our common stock upon vesting and settlement of the awards pursuant to time-based vesting criteria set by our Compensation Committee. We measure the value of the RSUs at fair value on the measurement date, based on the number of units granted and the market value of our common stock on that date. We amortize the fair value of those awards, net of estimated forfeitures, as stock-based compensation expense over the vesting period of the awards.

Income Taxes

We account for income taxes under Statement of Financial Accounting Standards No. 109, *Accounting for Income Taxes.* Under this method, deferred tax assets and liabilities are determined based on the temporary differences between their financial reporting and tax bases and are measured using the enacted tax rates that are anticipated to be in effect when the differences are expected to reverse. Valuation allowances are established when necessary to reduce deferred tax assets to the amounts more likely than not expected to be realized. We have established a valuation allowance against substantially all of our deferred tax assets as we believe it is more likely than not that the deferred tax assets will not be realized.

We will continue to evaluate the continued need for and amount of the valuation allowance. We may determine that some, or all, of our deferred tax assets will be realized, in which case we will reduce our valuation allowance in the quarter in which such determination is made. If the valuation allowance is reduced, we may recognize a benefit from income taxes on our income statement in that period. In subsequent periods, we may have higher income tax expenses.

Goodwill and Intangible Assets

We record as goodwill the excess of the acquisition purchase price over the fair value of the tangible and identifiable intangible assets acquired. In accordance with SFAS No. 142, *Goodwill and Other Intangible Assets*, or SFAS No. 142, we do not amortize goodwill, but perform an annual impairment review of our goodwill during our third quarter, or more frequently if indicators of potential impairment arise. Following the criteria of SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information*, and SFAS No. 142, we have a single operating segment and consequently evaluate goodwill for impairment based on an evaluation of the fair value of our company as a whole. We record purchased intangible assets at their respective estimated fair values at the date of acquisition. Purchased intangible assets are being amortized using the straight-line method over their estimated useful lives, which range from approximately one to ten years. We evaluate the remaining useful lives of intangible assets on a periodic basis to determine whether events or circumstances warrant a revision to the remaining estimated amortization period.

Impairment of Long-Lived Assets

We evaluate the recoverability of our long-lived assets, including purchased intangible assets and property and equipment, in accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. Long-lived assets are reviewed for possible impairment whenever events or circumstances indicate that the carrying amount of these assets may not be recoverable. We measure recoverability of each asset by comparison of its carrying amount to the future undiscounted cash flows we expect the asset to generate. If we consider the asset to be impaired, we measure the amount of any impairment as the difference between the carrying amount and the fair value of the impaired asset. We observed no impairment indicators through February 28, 2009.

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Results of Operations

The following table sets forth selected consolidated statements of operations data as a percentage of revenue for each of the periods indicated:

	Year Ended February 28, 2009	February 29, 2008	February 28, 2007
Revenue	100%	100%	100%
Cost of revenue	31	33	33
Gross margin	69	67	67
Operating expenses:			
Research and development	36	37	35
Sales and marketing	27	28	28
General and administrative	13	10	6
Amortization of purchased intangible assets	2	1	
Total operating expenses	78	76	69
Loss from operations	(9)	(9)	(2)
Other income (expense), net	2	2	(1)
Loss before provision for income taxes	(7)	(7)	(3)
Provision for income taxes			
Net loss attributable to common stockholders	(7)%	(7)%	(3)%

Revenue

	Year Ended February 28, 2009	February 29, 2008 (In thousands)	February 28, 2007
Revenue	$ 75,005	$ 61,270	$ 43,485

Fiscal 2009 Compared to Fiscal 2008. Fiscal 2009 revenue increased approximately $13.7 million, or 22.4%, from fiscal 2008 revenue. The revenue increase was primarily due to a $11.8 million increase in revenue from customers that had contributed revenue in prior years, which we refer to as existing customers. Revenue from existing customers was approximately 97% and 89% of our total revenue in fiscal 2009 and 2008, respectively. Revenue from customers that did not contribute any revenue in prior years, which we refer to as new customers, was approximately $1.9 million in fiscal 2009. In fiscal 2009, the economic environment deteriorated as compared to fiscal 2008 and has resulted in the signing of customer contracts taking longer, particularly new customer contracts. New customer revenue in any given period can fluctuate depending upon the period in which the contract signs, the number of new customer contracts in any given period and the size of the new customer retailer or CP customer. The impact of the deteriorating economic environment on our future revenue growth rates, or upon the contribution between existing and new customers is currently unknown. We generated 86% of our revenue from retail companies in fiscal 2009 and the remaining 14% from consumer products companies. In fiscal 2008 we generated 90% of our revenue from retail companies and the remaining 10% from consumer products companies. We expect that, in the future, revenue from CP companies will continue to increase as a percentage of total revenue on an annual basis.

In fiscal 2009, revenue from customers located outside the United States increased to 14% from 12% in fiscal 2008 .The increase resulted from increased revenue in existing international locations as well as revenue generated in new locations. Revenue from Wal-Mart Stores, Inc. accounted for 14.4% and 11.7% of our total revenue in fiscal 2009 and 2008, respectively. No other customer accounted for more than 10% of our revenue in fiscal 2009 or fiscal 2008.

Fiscal 2008 Compared to Fiscal 2007. Fiscal 2008 revenue increased approximately $17.8 million, or 41%, from fiscal 2007 revenue. The revenue increase was primarily due to a $10.9 million increase in revenue from existing customers. In addition, revenue from new customers, was $6.9 million in fiscal 2008. The TradePoint acquisition in November 2006 had a full year impact on revenue in fiscal 2008 compared to four months in fiscal 2007. We generated 90% of our revenue from retail companies in fiscal 2008 and the remaining 10% from consumer products companies. In fiscal 2007 we generated 94% of our revenue from retail companies and the remaining 6% from consumer products companies.

In fiscal 2008, revenue from customers located outside the United States increased to 12% from 6% in fiscal 2007. The increase resulted from increased revenue in existing international locations as well as revenue generated in new locations. In fiscal 2008, revenue from Wal-Mart Stores, Inc. accounted for 11.7% of our total revenue. In fiscal 2007, revenue from Safeway Inc. accounted for 11.8% of our revenue. No other customer accounted for more than 10% of our revenue in fiscal 2008 or fiscal 2007.

Cost of Revenue

	Year Ended		
	February 28, 2009	**February 29, 2008**	**February 28, 2007**
	(Dollars in thousands)		
Revenue	$ 75,005	$ 61,270	$ 43,485
Cost of revenue	23,331	20,444	14,230
Gross profit	51,674	40,826	29,255
Gross margin	69%	67%	67%

Fiscal 2009 Compared to Fiscal 2008. Fiscal 2009 cost of revenue increased approximately $2.9 million, or 14.1%, from fiscal 2008 cost of revenue. This increase was due primarily to increased personnel costs, equipment maintenance and depreciation expense offset by a decrease in third-party contractor and consulting costs.

Personnel costs increased approximately $1.6 million in fiscal 2009 compared to fiscal 2008, primarily as a result of increased compensation and employee benefit costs, stock-based compensation expense and headcount in fiscal 2009. Personnel costs include all compensation, benefits and hiring costs. Consulting services, support services, and production operations headcount increased to 87 (excluding Connect3 s former employees) at February 28, 2009 from 82 at February 29, 2008. Salary and employee benefit costs increased approximately $1.1 million in fiscal 2009 as a result of increased employee benefit costs and merit and promotion salary adjustments. Stock-based compensation expense increased approximately $451,000 to $1.7 million in fiscal 2009 compared to $1.2 million in fiscal 2008. The increase in stock-based compensation expense was primarily due to new stock options and time-based RSUs granted under the 2007 Equity Incentive Plan in fiscal 2009. There were no time-based RSUs granted in fiscal 2008. In addition, in fiscal 2009, equipment and maintenance contract expenses increased approximately $549,000, data center facility rental costs increased approximately $499,000, and depreciation expense increased approximately $606,000 as a result of $2.8 million of capital expenditures, predominantly related to the expansion of data infrastructure facilities to support customer growth.

Third-party contractor and consulting expense decreased approximately $664,000 in fiscal 2009 compared to fiscal 2008, primarily due to increased use of DemandTec personnel to provide integration services as opposed to third-party consulting firms.

Our gross margin increased to 69% in fiscal 2009 as compared to 67% in fiscal 2008 due to economies of scale gained from spreading our data center infrastructure and personnel costs over a larger customer base, partially offset by higher stock-based compensation and intangible amortization expenses in fiscal 2009. We anticipate that our gross margin will decrease in the short term as a result of the impact of the Connect3 acquisition, but that in the future, our gross margin will increase as we continue to grow our customer base and gain economies of scale.

Fiscal 2008 Compared to Fiscal 2007. Fiscal 2008 cost of revenue increased approximately $6.2 million, or 44%, from fiscal 2007 cost of revenue. This increase was due primarily to personnel expenses which increased approximately $4.2 million, depreciation and amortization expense which increased approximately $820,000, and allocated overhead expenses which increased approximately $480,000. Personnel costs increased in fiscal 2008 primarily as a result of increased headcount and stock-based compensation expense. Professional services, technical support and data center operations headcount increased to 82 at February 29, 2008 from 57 at February 28, 2007, and stock-based compensation increased $1.2 million from fiscal 2007 as a result of new stock option and performance-based stock unit, or PSU, grants.

Depreciation and amortization expense increased in fiscal 2008 largely due to an additional $405,000 of intangibles amortization related to the TradePoint acquisition compared to fiscal 2007 as we had twelve months of amortization in fiscal 2008 compared to four months in fiscal 2007. The remaining increase in depreciation and amortization expense was due to purchases of computers, software and equipment. In fiscal 2008, capital expenditures associated with the expansion of data infrastructure facilities were approximately $1.7 million.

Allocated overhead expenses increased as a result of increased professional services headcount and an increase in total allocated overhead costs.

Our gross margin remained unchanged at 67% in fiscal 2008 and 2007 as cost benefits from spreading our data center infrastructure and personnel costs over a larger customer base were partially offset by substantially higher stock-based compensation and intangibles amortization expense.

Research and Development Expenses

	Year Ended		
	February 28, 2009	**February 29, 2008**	**February 28, 2007**
	(Dollars in thousands)		
Research and development	$ 26,787	$ 22,445	$ 15,340
Percent of revenue	36%	37%	35%

Fiscal 2009 Compared to Fiscal 2008. Fiscal 2009 research and development expenses increased approximately $4.3 million, or 19%, from fiscal 2008, primarily due to increased personnel costs and allocated overhead costs associated with increased headcount, increased third-party contractor and consulting costs, and increased equipment maintenance and depreciation expense. Research and development headcount increased to 119 at February 28, 2009 from 99 at February 29, 2008. Personnel costs, including all compensation, benefits and hiring costs, increased by $3.2 million in fiscal 2009 as compared to fiscal 2008. Stock-based compensation expense, which is a component of personnel costs, increased approximately $437,000 from fiscal 2008. Allocated overhead expenses increased approximately $331,000, primarily due to increased headcount and increased infrastructure support expenses associated with growth. Third-party contractor and consulting expense increased approximately $418,000 compared to fiscal 2008, primarily as a result of a new development process methodology initiated with an outside consultation firm in May 2008. Equipment maintenance and depreciation expense increased approximately $282,000 as compared to fiscal 2008 and was primarily due to increased capital expenditures to support our research and development labs, infrastructure and increased headcount.

Fiscal 2008 Compared to Fiscal 2007. Fiscal 2008 research and development expenses increased $7.1 million, or 46%, from fiscal 2007 research and development expenses, primarily due to increased personnel costs, allocated overhead costs, and depreciation and amortization expense. Personnel costs increased $6.4 million as a result of increased headcount, increased third-party development expenses, and stock-based compensation expense. Research and development headcount increased to 99 at February 29, 2008 from 89 at February 28, 2007. Of the 89 research and development personnel at February 28, 2007, approximately 19 were added as a result of the TradePoint acquisition in November 2006. Third-party development costs increased approximately $475,000, primarily due to increased off-shore development activities related to sustaining engineering and quality assurance, which we have outsourced to the off-shore engineering firm Sonata. Stock-based compensation expense increased approximately $1.8 million from fiscal 2007 and allocated overhead expenses increased approximately $640,000 as a result of increased research and development headcount and an increase in total allocated overhead costs.

Sales and Marketing Expenses

	Year Ended February 28, 2009	February 29, 2008	February 28, 2007
	(Dollars in thousands)		
Sales and marketing	$ 20,343	$ 17,290	$ 12,108
Percent of revenue	27%	28%	28%

Fiscal 2009 Compared to Fiscal 2008. Fiscal 2009 sales and marketing expenses increased by approximately $3.1 million, or 18%, from fiscal 2008, primarily as a result of increased personnel costs of approximately $2.5 million. Sales and marketing personnel costs include all compensation, benefits and hiring costs. Sales and marketing headcount increased to 39 at February 28, 2009 from 35 at February 29, 2008. Compensation and employee benefit costs, including commissions, increased approximately $1.6 million in fiscal 2009 as a result of increased headcount, employee benefit costs, and merit and promotion salary adjustments. Stock-based compensation, which is a component of personnel costs and is included in sales and marketing expenses, increased by approximately $896,000, primarily due to stock awards granted under the 2007 Equity Incentive Plan. Marketing-related costs increased $112,000 in fiscal 2009, primarily for tradeshows, events and advertising.

Fiscal 2008 Compared to Fiscal 2007. Fiscal 2008 sales and marketing expenses increased by approximately $5.2 million, or 43%, from fiscal 2007 sales and marketing expenses, primarily as a result of increased personnel costs of approximately $3.7 million, increased selling and marketing expenses of approximately $615,000, and increased allocated overhead expenses of approximately $630,000. Personnel costs increased primarily due to an increase in headcount to 35 at February 29, 2008 from 31 at February 28, 2007, increased stock-based compensation expense of approximately $1.3 million, increased commission expense of approximately $1.4 million, and increased contract labor of approximately $430,000 compared to fiscal 2007. Sales and marketing expenses increased as a result of increased travel costs associated with our expanding customer base, increased business development expenses and marketing expenses associated with trade shows, events and other promotional activities. Allocated overhead expenses increased as a result of increased sales and marketing headcount and an increase in total allocated overhead costs.

General and Administrative Expenses

	Year Ended February 28, 2009	February 29, 2008	February 28, 2007
	(Dollars in thousands)		
General and administrative	$ 9,888	$ 6,292	$ 2,673
Percent of revenue	13%	10%	6%

Fiscal 2009 Compared to Fiscal 2008. Fiscal 2009 general and administrative expenses increased approximately $3.6 million, or 57%, over fiscal 2008 general and administrative expenses, primarily due to increased personnel costs associated with headcount increases and increased third-party professional services, principally for legal, accounting and auditing expenses associated with being a public company. General and administrative headcount increased to 44 at February 28, 2009 from 35 at February 29, 2008. Personnel costs increased approximately $1.7 million in fiscal 2009 compared to the prior year, primarily as a result of headcount increases and stock-based compensation expense.

Stock-based compensation, which is a component of personnel costs, increased approximately $860,000 to $1.7 million in fiscal 2009 from $824,000 in fiscal 2008. Third-party professional services costs increased approximately $1.3 million, primarily due to costs associated with being a public company related to Sarbanes-Oxley compliance and audit expenses.

Fiscal 2008 Compared to Fiscal 2007. Fiscal 2008 general and administrative expenses increased approximately $3.6 million, or 135%, over fiscal 2007 general and administrative expenses, primarily due to increased personnel costs associated with headcount and contract labor expenses. General and administrative headcount increased to 35 at February 29, 2008 from 21 at February 28, 2007 resulting in higher salary and benefit costs and higher stock-based compensation expense, which increased approximately $730,000 in fiscal 2008. Contract labor costs increased approximately $890,000 in fiscal 2008 as a result of the increased use of contract staff to assist with our IPO, systems implementation, and Sarbanes-Oxley related control compliance.

Amortization of Purchased Intangible Assets

	Year Ended February 28, 2009	February 29, 2008	February 28, 2007
	(Dollars in thousands)		
Amortization of purchased intangible assets	$ 1,241	$ 360	$ 118
Percent of revenue	1.7%	0.6%	0.3%

Fiscal 2009 Compared to Fiscal 2008. Fiscal 2009 amortization of purchased intangible assets increased approximately $881,000 from fiscal 2008, primarily due to our May 2008 acquisition of rig