# FORM 10-Q

Quarterly report pursuant to sections 13 or 15(d)

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## FILER

**SPS COMMERCE INC**

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# UNITED STATES
# SECURITIES AND EXCHANGE COMMISSION
**WASHINGTON, D.C. 20549**

# FORM 10-Q

**(Mark One)**

☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIESEXCHANGE ACT OF 1934**

**For the Quarterly Period Ended: September 30, 2011**

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIESEXCHANGE ACT OF 1934**

**For the Transition Period from to**

**Commission file number 001-34702**

# SPS COMMERCE, INC.
**(Exact Name of Registrant as Specified in its Charter)**

| | |
|---|---|
| **Delaware** | **41-2015127** |
| ***(State or Other Jurisdiction of Incorporation or Organization)*** | ***(I.R.S. Employer Identification No.)*** |

**333 South Seventh Street, Suite 1000, Minneapolis, MN 55402**
**(Address of Principal Executive Offices, Including Zip Code)**

**(612) 435-9400**
**(Registrant' s Telephone Number, Including Area Code)**

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§229.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

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

| | |
|---|---|
| Large accelerated filer ☐ | Accelerated filer ☐ |
| Non-accelerated filer ☐ (Do not check if a smaller reporting company) | Smaller reporting company ☒ |

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

The number of shares of the registrant’ s common stock, par value $0.001 per share, outstanding at October 28, 2011 was 12,072,686 shares.

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**SPS COMMERCE, INC.**

**QUARTERLY REPORT ON FORM 10-Q**

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**SPECIAL NOTE REGARDING FORWARD-LOOKING INFORMATION**

This Quarterly Report on Form 10-Q contains forward-looking statements regarding us, our business prospects and our results of operations that are subject to certain risks and uncertainties posed by many factors and events that could cause our actual business, prospects and results of operations to differ materially from those that may be anticipated by such forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those described under the heading *"Risk Factors"* included in our Annual Report on Form 10-K for the year ended December 31, 2010 as filed with the Securities and Exchange Commission. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date of this report. We undertake no obligation to revise any forward-looking statements in order to reflect events or circumstances that may subsequently arise. Readers are urged to carefully review and consider the various disclosures made by us in this report and in our other reports filed with the Commission that advise interested parties of the risks and factors that may affect our business.

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## PART I. – FINANCIAL INFORMATION

**Item 1. FinancialStatements**

### SPS COMMERCE, INC.

### CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited; in thousands, except share amounts)

| | September 30, 2011 | December 31, 2010 |
|---|---|---|
| **ASSETS** | | |
| CURRENT ASSETS | | |
| Cash and cash equivalents | $ 31,546 | $ 40,473 |
| Accounts receivable, less allowance for doubtful accounts of $212 and $209, respectively | 7,695 | 5,574 |
| Deferred costs, current | 5,486 | 4,720 |
| Prepaid expenses and other current assets | 1,233 | 874 |
| Total current assets | 45,960 | 51,641 |
| PROPERTY AND EQUIPMENT, net | 3,082 | 2,760 |
| GOODWILL | 5,877 | 1,166 |
| INTANGIBLE ASSETS, net | 6,027 | 290 |
| OTHER ASSETS | | |
| Deferred costs, net of current portion | 2,396 | 1,943 |
| Other non-current assets | 80 | 80 |
| | $ 63,422 | $ 57,880 |
| **LIABILITIES AND STOCKHOLDERS' EQUITY** | | |
| CURRENT LIABILITIES | | |
| Capital lease obligations, current | $ – | $ 122 |
| Accounts payable | 1,387 | 998 |
| Accrued compensation and benefits | 5,189 | 3,577 |
| Accrued expenses and other current liabilities | 1,126 | 807 |
| Deferred revenue, current | 3,806 | 3,585 |
| Total current liabilities | 11,508 | 9,089 |
| OTHER LIABILITIES | | |
| Deferred revenue, less current portion | 6,104 | 5,002 |
| Other non-current liabilities | 225 | 281 |
| Total liabilities | 17,837 | 14,372 |
| COMMITMENTS and CONTINGENCIES | | |
| STOCKHOLDERS' EQUITY | | |
| Preferred stock, $0.001 par value; 5,000,000 shares authorized; 0 shares issued and outstanding | – | – |
| Common stock, $0.001 par value; 55,000,000 shares authorized; 11,980,101 and 11,849,572 shares issued and outstanding, respectively | 12 | 12 |
| Additional paid-in capital | 107,781 | 106,264 |
| Accumulated deficit | (62,208) | (62,768) |
| Total stockholders' equity | 45,585 | 43,508 |
| | $ 63,422 | $ 57,880 |

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

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**SPS COMMERCE, INC.**

**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

(Unaudited; in thousands, except per share amounts)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2011 | 2010 | 2011 | 2010 |
| Revenues | $ 15,529 | $ 11,491 | $ 42,115 | $ 32,678 |
| Cost of revenues | 4,076 | 3,211 | 11,147 | 9,293 |
| Gross profit | 11,453 | 8,280 | 30,968 | 23,385 |
| Operating expenses | | | | |
| Sales and marketing | 6,404 | 4,139 | 17,382 | 11,768 |
| Research and development | 1,605 | 1,108 | 4,259 | 3,218 |
| General and administrative | 2,914 | 2,165 | 8,208 | 5,805 |
| Amortization of intangible assets | 260 | – | 383 | – |
| Total operating expenses | 11,183 | 7,412 | 30,232 | 20,791 |
| Income from operations | 270 | 868 | 736 | 2,594 |
| Other income (expense) | | | | |
| Interest expense | – | (8) | – | (66) |
| Interest income | 16 | 104 | 74 | 104 |
| Other expense | (28) | (85) | (62) | (93) |
| Total other income (expense), net | (12) | 11 | 12 | (55) |
| Income before income taxes | 258 | 879 | 748 | 2,539 |
| Income tax (expense) benefit | (81) | 7 | (188) | (96) |
| Net income | $177 | $886 | $560 | $2,443 |
| Net income per share | | | | |
| Basic | $0.01 | $0.08 | $0.05 | $0.36 |
| Diluted | $0.01 | $0.07 | $0.04 | $0.22 |
| Weighted average common shares used to compute net income per share | | | | |
| Basic | 11,970 | 11,620 | 11,918 | 6,796 |
| Diluted | 12,735 | 12,413 | 12,685 | 11,275 |

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

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**SPS COMMERCE, INC.**

**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(Unaudited; in thousands)

| | Nine Months Ended September 30, | |
|---|---|---|
| | 2011 | 2010 |
| Cash flows from operating activities | | |
| Net income | $560 | $2,443 |
| Reconciliation of net income to net cash provided by operating activities | | |
| Depreciation and amortization of property and equipment | 1,436 | 1,148 |
| Amortization of intangible assets | 383 | – |
| Provision for doubtful accounts | 245 | 225 |
| Stock-based compensation | 1,286 | 458 |
| Change in carrying value of preferred stock warrants | – | 27 |
| Other | – | 1 |
| Changes in assets and liabilities, net of effect of acquisition | | |
| Accounts receivable | (2,265) | (975) |
| Prepaid expenses and other current assets | (264) | 450 |
| Other assets | – | (18) |
| Deferred costs | (1,219) | (724) |
| Accounts payable | 389 | (287) |
| Deferred revenue | 1,323 | 866 |
| Accrued compensation and benefits | 1,612 | 714 |
| Accrued expenses and other current liabilities | 60 | (256) |
| Net cash provided by operating activities | 3,546 | 4,072 |
| Cash flows from investing activities | | |
| Acquisition of Direct EDI | (10,865) | – |
| Purchases of property and equipment | (1,716) | (1,230) |
| Net cash used in investing activities | (12,581) | (1,230) |
| Cash flows from financing activities | | |
| Borrowings on line of credit | – | 4,450 |
| Payments on line of credit | – | (5,950) |
| Payments on equipment loans | – | (732) |
| Payments of capital lease obligations | (122) | (338) |
| Net proceeds from initial public offering | – | 32,902 |
| Stock offering costs | (108) | – |
| Net proceeds from exercise of options to purchase common stock | 338 | 8 |
| Net cash provided by financing activities | 108 | 30,340 |
| Net increase (decrease) in cash and cash equivalents | (8,927) | 33,182 |
| Cash and cash equivalents at beginning of period | 40,473 | 5,931 |
| Cash and cash equivalents at end of period | $ 31,546 | $ 39,113 |

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

**SPS COMMERCE, INC.**

**Notes to Condensed Consolidated Financial Statements (Unaudited)**

## NOTE A – General

*Business Description*

We are a leading provider of on-demand supply chain management solutions, providing integration, collaboration, connectivity, visibility and data analytics to thousands of customers worldwide. We provide our solutions through SPSCommerce.net, a hosted software suite that improves the way suppliers, retailers, distributors and other customers manage and fulfill orders. We deliver our solutions to our customers over the Internet using a Software-as-a-Service model and derive the majority of our revenues from thousands of monthly recurring subscriptions from businesses that utilize our solutions.

*Basis of Presentation*

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, these condensed consolidated financial statements do not include all of the information and footnotes required by GAAP. We have included all normal recurring adjustments considered necessary to give a fair statement of our financial position, results of operations and cash flows for the interim periods shown. Operating results for these interim periods are not necessarily indicative of the results to be expected for the full year. The December 31, 2010 balance sheet data was derived from our audited financial statements at that date. For further information, refer to the consolidated financial statements and accompanying notes for the year ended December 31, 2010 included in our Annual Report on Form 10-K as filed with the Securities and Exchange Commission on March 3, 2011.

*Use of Estimates*

Preparing financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

*Business Combinations*

We account for acquisitions of businesses pursuant to Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 805, Business Combinations. In accordance with ASC Topic 805, we recognize separately from goodwill the fair value of the assets acquired and the liabilities assumed at the acquisition date as defined by FASB ASC Topic 820, Fair Value Measurements and Disclosures. Goodwill as of the acquisition date is measured as the excess of consideration transferred and the net of the acquisition date amounts of the assets acquired and the liabilities assumed. Assets acquired include tangible and intangible assets. We determine the value and useful lives of purchased intangible assets with the assistance of an independent third-party valuation firm using certain estimates and assumptions.

While we use estimates and assumptions that we believe are reasonable as a part of the purchase price allocation process to accurately value the assets acquired and the liabilities assumed at the acquisition date, they are inherently uncertain and subject to refinement. As a result, during the measurement period, which may be up to one year from the acquisition date, we may record adjustments to the fair value of the assets acquired and the liabilities assumed based on new information about facts and circumstances that existed as of the acquisition date. Any such adjustments would be recorded as an offset to goodwill. Upon the conclusion of the measurement period or final determination of the fair values, whichever comes first, any subsequent adjustments would be recorded in our statements of operations.

*Significant Accounting Policies*

During the nine months ended September 30, 2011, there were no material changes in our significant accounting policies. See Note A to the consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2010 as filed with the Securities and Exchange Commission on March 3, 2011 for additional information regarding our significant accounting policies.

*Recent Accounting Pronouncements*

In October 2009, the FASB issued Accounting Standards Update ("ASU") No. 2009-13, Revenue Recognition (ASC Topic 605), *Multiple-Deliverable Revenue Arrangements, a consensus of the FASB Emerging Issues Task Force.* This guidance modifies the fair value requirements of ASC subtopic 605-25, *Revenue Recognition-Multiple Element Arrangements,* by allowing the use of the "best estimate of selling price" in addition to Vendor Specific Objective Evidence and third-party evidence (or TPE) for determining the selling price of a deliverable. A vendor is now required to use its best estimate of the selling price when Vendor Specific Objective Evidence or TPE of the selling price cannot be determined. In addition, the residual method of allocating arrangement consideration is no longer permitted.

In October 2009, the FASB issued ASU No. 2009-14, Software (ASC Topic 985), *Certain Revenue Arrangements That Include Software Elements, a consensus of the FASB Emerging Issues Task Force.* This guidance modifies the scope of ASC subtopic 965-605, *Software-Revenue Recognition,* to exclude from its requirements (a) non-software components of tangible products and (b) software components of tangible products that are sold, licensed or leased with tangible products when the software components and non-software components of the tangible product function together to deliver the tangible product' s essential functionality.

ASU No. 2009-13 and ASU No. 2009-14 both require expanded qualitative and quantitative disclosures and are effective for fiscal years beginning on or after June 15, 2010. We have adopted these updates and they did not have a material impact on our financial statements.

In January 2010, the FASB issued ASU No. 2010-06, Fair Value Measurements and Disclosures (ASC Topic 820), *Improving Disclosures about Fair Value Measurements*. ASU No. 2010-06 enhances the disclosure requirements to include transfers in and out of Level 1 and 2 and the associated reasons, which was effective for fiscal years beginning on or after December 15, 2009. ASU No. 2010-06 also requires the disclosure of a disaggregated gross reconciliation of Level 3 fair value measurements, which is effective for fiscal years beginning on or after December 15, 2010. We have adopted these updates and they did not have a material impact on our financial statements.

In July 2010, the FASB issued ASU No. 2010-20, Receivables (ASC Topic 310), *Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses*. ASU No. 2010-20 enhances the disclosure requirements about the credit quality and related allowance for credit losses of financing receivables. We will be required to disclose the nature of the inherent risk of receivables, the methodology and analytics that support that assessment, and support any changes to the allowance for doubtful accounts. We will also be required to provide a rollforward of the allowance and disclose the accounts receivable on a disaggregated basis. This update is effective for fiscal years beginning on or after December 15, 2010. We have adopted this update and it did not have a material impact on our financial statements.

In December 2010, the FASB issued ASU No. 2010-29, Business Combinations (ASC Topic 805), *Disclosure of Supplementary Pro Forma Information for Business Combinations*. ASU No. 2010-29 amends the disclosure requirements for supplementary pro forma information for business combinations. This update addresses the diversity in practice about the interpretation of the pro forma revenue and earnings disclosure requirements for business combinations. The update specifies that if a public entity presents comparative financial statements, the entity should disclose revenue and earnings of the combined entity as though the business combination(s) that occurred during the current year had occurred as of the beginning of the comparable prior annual reporting period only. It also expands the supplemental pro forma disclosures to include a description of the nature and amount of material, nonrecurring pro forma adjustments directly attributable to the business combination included in the reported pro forma revenue and earnings. This update is effective prospectively for business combinations for

which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2010. We have adopted this update and, with the acquisition of Direct EDI in May 2011, the required supplementary pro forma information is presented in Note B.

In September 2011, the FASB issued ASU No. 2011-08, Intangibles−Goodwill and Other (Topic 350)−*Testing Goodwill for Impairment*. ASU No. 2011-08 provides an entity with the option to perform a qualitative assessment of goodwill to determine whether further impairment testing is necessary. If an entity believes, as a result of its qualitative assessment, that it is more-likely-than-not that the fair value of a reporting unit is less than its carrying amount, the currently prescribed two step quantitative goodwill impairment test is required. Otherwise, no further testing is required. This update is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011 and earlier adoption is permitted. We are currently evaluating the early adoption option. We do not expect the adoption or early adoption of this update to have an impact on our financial statements.

**NOTE B – Acquisition of Direct EDI**

On May 17, 2011, we entered into an asset purchase agreement with Direct EDI LLC, a privately-held provider of cloud-based integration solutions for electronic data interchange, and we completed the asset purchase on May 18, 2011. Under the asset purchase agreement, we purchased and acquired substantially all of the assets of Direct EDI for $10.9 million in cash and assumed certain liabilities of Direct EDI. The acquisition of Direct EDI allows us to expand our base of recurring revenue customers.

*Purchase Price Allocation*

We accounted for the acquisition as a business combination. We allocated the purchase price to the tangible and identifiable intangible assets acquired and liabilities assumed based on their estimated fair values as of the acquisition date. We engaged an independent third-party valuation firm to assist us in the determination of the value of the purchased intangible assets. The excess of the purchase price over the fair value of net tangible and identifiable intangible assets acquired was recorded as goodwill. Goodwill is attributed to a trained workforce and other buyer-specific value resulting from expected synergies, including long-term cost savings, that are not included in the fair values of assets. Goodwill will not be amortized; however it is deductible for tax purposes. Although we believe the purchase price allocation is substantially complete, it is considered preliminary and the finalization of the valuation of the net tangible and intangible assets acquired and liabilities assumed could result in a future adjustment to the purchase price allocation.

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the acquisition date (in thousands):

| | |
|---|---|
| Current assets | $195 |
| Property and equipment | 42 |
| Intangible assets | 6,120 |
| Goodwill | 4,712 |
| Current liabilities | (204) |
| Total purchase price | $ 10,865 |

*Purchased Intangible Assets*

The following table summarizes the estimated fair value of the purchased intangible assets and their estimated useful lives:

| Purchased Intangible Assets | Estimated Fair Value (in thousands) | Estimated Life (in years) |
|---|---|---|
| Subscriber relationships | $ 5,250 | 7 |
| Non-competition agreements | 870 | 3 |
| Total | $ 6,120 | |

The purchased intangible assets are being amortized on a straight-line basis over their estimated useful lives. Amortization expense related to these intangible assets was $260,000 and $383,000 for the three and nine months ended September 30, 2011.

*Acquisition-Related Costs and Post-Acquisition Operating Results*

Acquisition-related costs were approximately $232,000 and are included in our condensed consolidated statements of operations for the nine months ended September 30, 2011. Acquisition-related costs were recorded as general and administrative expense in accordance with the current accounting guidance for business combinations. The operating results of Direct EDI have been included in our condensed consolidated financial statements from May 18, 2011, the date of the acquisition. For the three and nine months ended September 30, 2011, approximately $1.1 million and $1.6 million of our revenues were derived from Direct EDI customers. The amount of operating income or loss from Direct EDI was not separately identifiable due to our integration.

*Unaudited Pro Forma Financial Information*

The unaudited pro forma financial information in the table below presents the combined operating results of SPS Commerce and Direct EDI as if the acquisition had occurred on January 1, 2010. The unaudited pro forma information includes the historical operating results of each company and certain pro forma adjustments, including annual amortization expense for purchased intangible assets of approximately $1.0 million and additional annual compensation expense of approximately $280,000 related to employment arrangements entered into as part of the acquisition.

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| (in thousands, except per share data) | 2011 | 2010 | 2011 | 2010 |
| Pro forma total revenue | $ 15,529 | $ 12,553 | $ 43,961 | $ 35,593 |
| Pro forma net income | $177 | $748 | $433 | $1,945 |
| Pro forma net income per share | | | | |
| Basic | $0.01 | $0.06 | $0.04 | $0.29 |
| Diluted | $0.01 | $0.06 | $0.03 | $0.17 |

The unaudited pro forma financial information is presented for informational purposes only and is not necessarily indicative of the results of operations that would have actually been reported had the acquisition occurred on January 1, 2010, nor is it necessarily indicative of our results of operations for any future periods.

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**NOTE C – Intangible Assets**

Intangible assets included the following (in thousands):

| | September 30, 2011 | | | December 31, 2010 | | |
|---|---|---|---|---|---|---|
| | Carrying Amount | Accumulated Amortization | Net | Carrying Amount | Accumulated Amortization | Net |
| Subscriber relationships | $ 7,180 | $ (2,206 ) | $ 4,974 | $ 1,930 | $ (1,930 ) | $ – |
| Covenants not-to-compete | 1,450 | (397 ) | 1,053 | 580 | (290 ) | 290 |
| | $8,630 | $(2,603 ) | $6,027 | $2,510 | $(2,220 ) | $290 |

Amortization expense for intangible assets was $260,000 and $383,000 for the three and nine months ended September 30, 2011. There was no amortization expense for intangible assets for the three or nine months ended September 30, 2010.

At September 30, 2011, future amortization expense for intangible assets was as follows (in thousands):

| | |
|---|---|
| Remainder of 2011 | $260 |
| 2012 | 1,040 |
| 2013 | 1,040 |
| 2014 | 861 |
| 2015 | 750 |
| Thereafter | 2,076 |
| | $ 6,027 |

**NOTE D – Line of Credit**

On September 30, 2011, we entered into a revolving credit agreement with JPMorgan Chase Bank, N.A. The revolving credit agreement provides for a $20 million revolving credit facility that we may draw upon from time to time, subject to certain terms and conditions, and will mature on September 30, 2016. Proceeds from the credit facility are anticipated to be used for acquisitions and our capital needs.

Interest on amounts borrowed under the credit facility is based on (i) an Adjusted LIBO Rate (as defined in the revolving credit agreement) plus an applicable margin of 175 to 225 basis points based on our net working capital, or (ii) JPMorgan’ s prime rate (provided it is not less than the Adjusted One Month LIBO Rate (as defined in the revolving credit agreement)) plus an applicable margin of -25 to 25 basis points based on our net working capital. Interest is payable monthly in arrears. Availability under the credit facility is subject to a borrowing base equal to the sum of 250% of our eligible monthly recurring revenue (as defined in the revolving credit agreement) and all borrowings are due in full no later than the maturity date of the agreement.

The revolving credit agreement contains customary representations, warranties, covenants and events of default, including, but not limited to financial covenants requiring us to maintain a fixed charge coverage ratio of not less than 1.20 to 1.00, cash and cash equivalents of not less than $10 million and a minimum number of recurring revenue customers. If an event of default occurs, among other things, the applicable interest rate is subject to an increase of 2% and all outstanding obligations may become immediately due and payable.

There were no borrowings outstanding at September 30, 2011 and we were in compliance with all covenants under the revolving credit agreement as of that date.

**NOTE E – Stock-Based Compensation**

Our equity compensation plans provide for the grant of incentive and nonqualified stock options, as well as other stock-based awards, to employees, non-employee directors and other consultants who provide services to us. Stock options generally vest over three to four years and have a contractual term of ten years from the date of grant. At September 30, 2011, there were approximately 667,000 shares available for grant under approved equity compensation plans.

We recorded stock-based compensation expense of $487,000 and $232,000 for the three months ended September 30, 2011 and 2010, respectively. We recorded stock-based compensation expense of $1.3 million and $458,000 for the nine months ended September 30, 2011 and 2010, respectively. This expense was allocated as follows (in thousands):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2011 | 2010 | 2011 | 2010 |
| Cost of revenues | $68 | $31 | $186 | $ 65 |
| Operating expenses: | | | | |
| Sales and marketing | 121 | 64 | 347 | 129 |
| Research and development | 18 | 7 | 41 | 12 |
| General and administrative | 280 | 130 | 712 | 252 |
| Total stock-based compensation expense | $ 487 | $ 232 | $ 1,286 | $ 458 |

As of September 30, 2011, there was approximately $4.7 million of unrecognized stock-based compensation expense under our equity compensation plans, which is expected to be recognized on a straight line basis over a weighted average period of approximately two years.

Our stock option activity was as follows:

| | Options (#) | Weighted Average Exercise Price ($/share) |
|---|---|---|
| Outstanding at December 31, 2010 | 1,549,344 | $ 4.59 |
| Granted | 420,843 | 16.97 |
| Exercised | (130,529 ) | 2.60 |
| Forfeited | (19,129 ) | 10.80 |
| Outstanding at September 30, 2011 | 1,820,529 | 7.53 |

The weighted average fair value per share of options granted during the first nine months of 2011 was $8.11 and this was estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions:

| | |
|---|---|
| Weighted-average volatility | 45.0% |
| Expected dividend yield | 0% |
| Expected life (in years) | 6.25 |
| Weighted-average risk-free interest rate | 2.05%- 3.05% |

**NOTE F – Income Taxes**

We recorded a provision for income taxes of $81,000 for the three months ended September 30, 2011 and a benefit for income taxes of $7,000 for the three months ended September 30, 2010. We recorded a provision for income taxes of $188,000 and $96,000 for the nine months ended September 30, 2011 and 2010, respectively. We record our interim provision for income taxes based on our estimated annual effective tax rate for the year. Our provision for income taxes includes estimated federal alternative minimum taxes and state income taxes, as well as deferred tax expense resulting from the book and tax basis difference in goodwill from asset acquisitions.

As of December 31, 2010, and updated for the filing of our tax returns in September 2011, we had net operating loss carryforwards of $50.8 million for U.S. federal tax purposes and $30.2 million for state tax purposes. These loss carryforwards expire between 2011 and 2029. Section 382 of the U.S. Internal Revenue Code generally imposes an annual limitation on the amount of net operating loss carryforwards that might be used to offset taxable income when a corporation has undergone significant changes in stock ownership. We have performed a Section 382 analysis for the time period from our inception through December 8, 2010. During this time period it was determined that we had six separate ownership changes under Section 382. We believe that approximately $17.6 million of federal losses and $15.4 million of state losses will expire unused due to Section 382 limitations. This limitation could be further restricted if ownership changes occur in future years. In addition, the state limitation will vary depending on future apportionment factors. Our deferred tax asset is reported net of this limitation.

Realization of our net operating loss carryforwards and other deferred tax temporary differences are contingent upon future taxable earnings. Our net deferred tax assets have been reduced fully by a valuation allowance, as realization is not considered to be likely based on an assessment of the history of losses and the likelihood of sufficient future taxable income. Our deferred tax liability relates to goodwill created in a prior asset acquisition which is deductible for tax purposes.

We are subject to income taxes in the U.S. federal jurisdiction and various state jurisdictions. As of September 30, 2011, we are generally subject to U.S. federal and state tax examinations for all tax years 2010 and prior due to net operating loss carryforwards.

As of September 30, 2011, we do not have any unrecognized tax benefits. It is our practice to recognize interest and penalties accrued on any unrecognized tax benefits as a component of income tax expense. We do not expect any material changes in our unrecognized tax positions over the next 12 months.

**NOTE G – Net Income Per Share**

Basic net income per share has been computed using the weighted average number of shares of common stock outstanding during each period. Diluted net income per share also includes the impact of our outstanding potential common shares, such as options, warrants and redeemable convertible preferred stock. Potential common shares that are anti-dilutive are excluded from the calculation of diluted net income per share.

The following table presents the components of the computation of basic and diluted net income per share for the periods indicated (in thousands, except per share amounts):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2011 | 2010 | 2011 | 2010 |
| Numerator: | | | | |
| Net income | $177 | $886 | $560 | $2,443 |
| Denominator: | | | | |
| Weighted average common shares outstanding, basic | 11,970 | 11,620 | 11,918 | 6,796 |
| Options and warrants to purchase common andpreferred stock | 765 | 793 | 767 | 1,023 |
| Redeemable convertible preferred stock | – | – | – | 3,456 |
| Weighted average common shares outstanding, diluted | 12,735 | 12,413 | 12,685 | 11,275 |
| Net income per share: | | | | |
| Basic | $0.01 | $0.08 | $0.05 | $0.36 |
| Diluted | $0.01 | $0.07 | $0.04 | $0.22 |

For the three and nine months ended September 30, 2011, approximately 1,000 outstanding options to purchase common stock were excluded from the calculation of diluted net income per share because they were anti-dilutive. For the three and nine months ended September 30, 2010, approximately 417,000 outstanding options to purchase common stock were excluded from the calculation of diluted net income per share because they were anti-dilutive.

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

### Overview

We are a leading provider of on-demand supply chain management solutions, providing integration, collaboration, connectivity, visibility and data analytics to thousands of trading partners worldwide. We provide our solutions through SPSCommerce.net, a hosted software suite that improves the way suppliers, retailers, distributors and other trading partners manage and fulfill orders. We deliver our solutions to our customers over the Internet using a Software-as-a-Service model.

We plan to grow our business by further penetrating the supply chain management market, increasing revenues from our customers as their businesses grow, expanding our distribution channels, expanding our international presence and developing new solutions and applications. We also intend to selectively pursue acquisitions that will add customers, allow us to expand into new regions or industries or allow us to offer new functionalities.

On May 18, 2011, we purchased substantially all of the assets of Direct EDI LLC, a privately-held provider of cloud-based integration solutions for electronic data interchange, which expanded our base of recurring revenue customers. See Note B to our condensed consolidated financial statements included in this Quarterly Report on Form 10-Q for additional information regarding the acquisition of Direct EDI.

### Key Financial Terms and Metrics

We have several key financial terms and metrics, including annualized average recurring revenues per recurring revenue customer. During the nine months ended September 30, 2011, there were no changes in the definitions of our key financial terms and metrics, which are discussed in more detail under the heading "*Management' s Discussion and Analysis of Financial Condition and Results of Operations*" included in our Annual Report on Form 10-K for the year ended December 31, 2010 as filed with the Securities and Exchange Commission on March 3, 2011.

To supplement our financial statements, we also provide investors with Adjusted EBITDA and non-GAAP income per share, both of which are non-GAAP financial measures. We believe that these non-GAAP measures provide useful information to management and investors regarding certain financial and business trends relating to our financial condition and results of operations. Our management uses these non-GAAP measures to compare the company' s performance to that of prior periods for trend analyses and planning purposes. Adjusted EBITDA is also used for purposes of determining executive and senior management incentive compensation. These measures are also presented to our board of directors.

These non-GAAP measures should not be considered a substitute for, or superior to, financial measures calculated in accordance with generally accepted accounting principles in the United States of America ("GAAP"). These non-GAAP financial measures exclude significant expenses and income that are required by GAAP to be recorded in our financial statements and are subject to inherent limitations. Investors should review the reconciliations of non-GAAP financial measures to the comparable GAAP financial measures that are included in this "*Management' s Discussion and Analysis of Financial Condition and Results of Operations.*"

### Critical Accounting Policies and Estimates

This discussion of our financial condition and results of operations is based upon our financial statements, which are prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires us to make estimates, judgments and assumptions that affect the reported amounts of assets, liabilities, revenues, costs and expenses and related disclosures. We base our estimates of the carrying value of certain assets and liabilities on historical experience and on various other assumptions that we believe to be reasonable. On an ongoing basis, we evaluate our estimates and assumptions. Our actual results may differ from these estimates under different assumptions or conditions.

We believe that of our significant accounting policies, the following accounting policies involve a greater degree of judgment, complexity and effect on materiality. A critical accounting policy is one that is both material to the presentation of our financial statements and requires us to make difficult, subjective or complex judgments for uncertain matters that could have a material effect on our financial condition and results of operations. Accordingly, we believe that our policies for revenue recognition, the allowance for doubtful accounts, income taxes, stock-based compensation and the valuation of goodwill and intangible assets are the most critical to aid in fully understanding and evaluating our financial condition and results of operations.

During the nine months ended September 30, 2011, except as noted below, there were no significant changes in our critical accounting policies or estimates. With the acquisition of Direct EDI, we have expanded our critical accounting policy for the valuation of goodwill to include the valuation of purchased intangible assets.

*Valuation of Goodwill and Purchased Intangible Assets*

We account for acquisitions pursuant to FASB ASC 805, *Business Combinations*. Goodwill represents the excess of the purchase price over the fair value of identifiable net assets acquired. Assets acquired may include identifiable intangible assets such as subscriber relationships. In accordance with ASC 805, we recognize separately from goodwill the fair value of the identifiable intangible assets acquired. We have determined the fair value and useful lives of our purchased intangible assets with the assistance of an independent third-party valuation firm using certain estimates and assumptions. We test goodwill for impairment annually at December 31, or more frequently if events or changes in circumstances indicate that the asset might be impaired. The impairment test is conducted by comparing the fair value of the net assets with the carrying value of the reporting unit. Fair value is determined using the direct market observation of market price and outstanding equity of the reporting unit at December 31. If the carrying value of the goodwill exceeds the fair value of the reporting unit, goodwill may be impaired. If this occurs, the fair value is then allocated to its assets and liabilities in a manner similar to a purchase price allocation in order to determine the implied fair value of goodwill. This implied fair value is then compared to the carrying amount of goodwill and, if it is less, we would recognize an impairment loss. For the years ended December 31, 2009 and prior, the impairment test compared the carrying value of the company to the fair value of the company, which was based on a analysis of the discounted future cash flows. The methodology for evaluating the fair value of the company was changed with the completion of our initial public offering to use the per share prices as a direct market observable measure. There has been no impairment of our goodwill to date.

See Note A to our financial statements included in this Quarterly Report on Form 10-Q and in our Annual Report on Form 10-K for the year ended December 31, 2010 as filed with the Securities and Exchange Commission on March 3, 2011 for additional information regarding our critical accounting policies, as well as a description of our other significant accounting policies.

**Results of Operations**

The following table presents our results of operations for the periods indicated (dollars in thousands):

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| | Three Months Ended September 30, | | | | Change | |
|---|---|---|---|---|---|---|
| | 2011 | | 2010 | | | |
| | | % of revenue | | % of revenue | $ | % |
| Revenues | $ 15,529 | 100.0% | $ 11,491 | 100.0% | $ 4,038 | 35.1 % |
| Cost of revenues | 4,076 | 26.2 | 3,211 | 27.9 | 865 | 26.9 |
| Gross profit | 11,453 | 73.8 | 8,280 | 72.1 | 3,173 | 38.3 |
| Operating expenses: | | | | | | |
| Sales and marketing | 6,404 | 41.2 | 4,139 | 36.0 | 2,265 | 54.7 |
| Research and development | 1,605 | 10.3 | 1,108 | 9.6 | 497 | 44.9 |
| General and administrative | 2,914 | 18.8 | 2,165 | 18.8 | 749 | 34.6 |
| Amortization of intangible assets | 260 | 1.7 | – | – | 260 | * |
| Total operating expenses | 11,183 | 72.0 | 7,412 | 64.5 | 3,771 | 50.9 |
| Income from operations | 270 | 1.7 | 868 | 7.6 | (598) | (68.9) |
| Other income (expense): | | | | | | |
| Interest expense | – | – | (8) | (0.1) | 8 | (100.0) |
| Interest income | 16 | 0.1 | 104 | 0.9 | (88) | (84.6) |
| Other expense | (28) | (0.2) | (85) | (0.7) | 57 | (67.1) |
| Total other income (expense), net | (12) | (0.1) | 11 | 0.1 | (23) | * |
| Income before income taxes | 258 | 1.7 | 879 | 7.6 | (621) | (70.6) |
| Income tax (expense) benefit | (81) | (0.5) | 7 | 0.1 | (88) | * |
| Net income | $177 | 1.1 | $886 | 7.7 | (709) | (80.0) |

| | Nine Months Ended September 30, | | | | Change | |
|---|---|---|---|---|---|---|
| | 2011 | | 2010 | | | |
| | | % of revenue | | % of revenue | $ | % |
| Revenues | $ 42,115 | 100.0% | $ 32,678 | 100.0% | $9,437 | 28.9 % |
| Cost of revenues | 11,147 | 26.5 | 9,293 | 28.4 | 1,854 | 20.0 |
| Gross profit | 30,968 | 73.5 | 23,385 | 71.6 | 7,583 | 32.4 |
| Operating expenses: | | | | | | |
| Sales and marketing | 17,382 | 41.3 | 11,768 | 36.0 | 5,614 | 47.7 |
| Research and development | 4,259 | 10.1 | 3,218 | 9.8 | 1,041 | 32.3 |
| General and administrative | 8,208 | 19.5 | 5,805 | 17.8 | 2,403 | 41.4 |
| Amortization of intangible assets | 383 | 0.9 | – | – | 383 | * |
| Total operating expenses | 30,232 | 71.8 | 20,791 | 63.6 | 9,441 | 45.4 |
| Income from operations | 736 | 1.7 | 2,594 | 7.9 | (1,858) | (71.6) |
| Other income (expense): | | | | | | |
| Interest expense | – | – | (66) | (0.2) | 66 | (100.0) |
| Interest income | 74 | 0.2 | 104 | 0.3 | (30) | (28.8) |
| Other expense | (62) | (0.1) | (93) | (0.3) | 31 | (33.3) |
| Total other income (expense), net | 12 | – | (55) | (0.2) | 67 | * |
| Income before income taxes | 748 | 1.8 | 2,539 | 7.8 | (1,791) | (70.5) |
| Income tax expense | (188) | (0.4) | (96) | (0.3) | (92) | 95.8 |
| Net income | $560 | 1.3 | $2,443 | 7.5 | (1,883) | (77.1) |

Dueto rounding, totals may not equal the sum of the line items in the table above.

* Percentage is not meaningful.

***Three and Nine Months Ended September 30, 2011 compared to Three and Nine Months Ended September 30, 2010***

*Revenues.* Revenues for the three months ended September 30, 2011 increased $4.0 million, or 35%, to $15.5 million from $11.5 million for the same period in 2010. Revenues for the nine months ended September 30, 2011 increased $9.4 million, or 29%, to $42.1 million from $32.7 million for the same period in 2010. Our fiscal quarter ended September 30, 2011 represented our 43rd consecutive quarter of increased revenues.

The increase in revenues resulted from two primary factors: the increase in recurring revenue customers and the increase in annualized average recurring revenues per recurring revenue customer.

The number of recurring revenue customers increased 31% to 15,896 at September 30, 2011 from 12,117 at September 30, 2010. This increase included the approximately 1,800 recurring revenue customers gained from the acquisition of Direct EDI.

Annualized average recurring revenues per recurring revenue customer increased 5% to $3,376 for the three months ended September 30, 2011 from $3,226 for the same period in 2010. This increase was primarily attributable to increased fees resulting from increased usage of our solutions by our recurring revenue customers.

Recurring revenues from recurring revenue customers accounted for 85% and 84% of our total revenues for the three and nine months ended September 30, 2011, compared to 84% and 83% for each of the same periods in 2010. We anticipate that the number of recurring revenue customers and the recurring revenues per recurring revenue customer will continue to increase as we increase the number of solutions we offer, such as the Trading Partner Intelligence solution we introduced in late 2009, and increase the penetration of those solutions across our customer base.

*Cost of Revenues.* Cost of revenues for the three months ended September 30, 2011 increased $865,000, or 27%, to $4.1 million from $3.2 million for the same period in 2010. Cost of revenues for the nine months ended September 30, 2011 increased $1.8 million, or 20%, to $11.1 million from $9.3 million for the same period in 2010. The increase for both periods was attributable to increased costs for personnel, resale of adapters and referral fees, as well as increased network services, occupancy and stock-based compensation expenses. As a percentage of revenues, cost of revenues was 26% for each of the three and nine months ended September 30, 2011, compared to 28% for each of the same periods in 2010. Increased revenues allowed us to leverage our personnel and infrastructure costs and decrease our cost of revenues as a percentage of total revenues. Going forward, we anticipate that cost of revenues will increase in absolute dollars as we continue to build our business.

*Sales and Marketing Expenses.* Sales and marketing expenses for the three months ended September 30, 2011 increased $2.3 million, or 55%, to $6.4 million from $4.1 million for the same period in 2010. Sales and marketing expenses for the nine months ended September 30, 2011 increased $5.6 million, or 48%, to $17.4 million from $11.8 million for the same period in 2010. The increase in sales and marketing expenses for both periods was primarily due to increased personnel costs; higher commissions earned by sales personnel from new business; and increased promotional, occupancy and stock-based compensation costs. As a percentage of revenues, sales and marketing expenses were 41% for each of the three and nine months ended September 30, 2011, compared to 36% for each of the same periods in 2010. As we build our business, we will continue to add resources to our sales and marketing efforts over time, and we expect that these expenses will continue to increase in absolute dollars.

*Research and Development Expenses.* Research and development expenses for the three months ended September 30, 2011 increased $497,000, or 45%, to $1.6 million from $1.1 million for the same period in 2010. Research and development expenses for the nine months ended September 30, 2011 increased $1.1 million, or 32%, to $4.3 million from $3.2 million for the same period in 2010. The increase in research and development expenses for both periods was due primarily to increased personnel costs. As a percentage of revenues, research and development expenses were 10% for each of the three and nine month periods ended September 30, 2011 and 2010. As we enhance and expand our solutions and applications, we expect that research and development expenses will continue to increase in absolute dollars.

*General and Administrative Expenses.* General and administrative expenses for the three months ended September 30, 2011 increased $749,000, or 35%, to $2.9 million from $2.2 million for the same period in 2010. General and administrative expenses for the nine months ended September 30, 2011 increased $2.4 million, or 41%, to $8.2 million from $5.8 million for the same period in 2010. The increase in general and administrative expenses for both periods was primarily due to increased personnel costs, as well as increased stock-based compensation and software maintenance expenses. For the nine months ended September 30, 2011, the increase was also due to increased expenses related to being a public company, including legal and insurance expenses, as well as costs related to the Direct EDI acquisition in May 2011. As a percentage of revenues, general and administrative expenses were 19% for each of the three and nine months ended September 30, 2011, compared to 19% and 18% for the same periods in 2010. Going forward, we expect that general and administrative expenses will continue to increase in absolute dollars as we continue to build our business.

*Amortization of Intangible Assets.* Amortization expense was $260,000 and $383,000 for the three and nine months ended September 30, 2011 related to intangible assets recorded with the acquisition of Direct EDI in May 2011. There was no amortization expense for the comparable periods in 2010.

*Other Income (Expense).* We did not incur any interest expense for the three and nine months ended September 30, 2011 as our capital lease obligations were fully repaid in early January 2011. For the same periods in 2010, interest expense was $8,000 and $66,000 and was related to outstanding indebtedness under our equipment loans and credit facility, which were repaid in the second quarter of 2010, as well as our capital lease obligations. Interest income for the three and nine months ended September 30, 2011 was $16,000 and $74,000, respectively, as the result of interest earned on our cash and cash equivalents. Other expense for the three and nine months ended September 30, 2011 was $28,000 and $62,000, respectively, compared to other expense of $85,000 and $93,000 for the comparable periods in 2010.

*Income Tax Expense (Benefit).* Income tax expense was $81,000 for the three months ended September 30, 2011, compared to an income tax benefit of $7,000 for the three months ended September 30, 2010. Income tax expense was $188,000 and $96,000 for the nine months ended September 30, 2011 and 2010, respectively. We record our interim provision for income taxes based on our estimated annual effective tax rate for the year. Our provision for income taxes includes estimated federal alternative minimum taxes and state income taxes, as well as deferred tax expense resulting from the book and tax basis difference in goodwill from asset acquisitions.

*Adjusted EBITDA.* Adjusted EBITDA, which is a non-GAAP measure of financial performance, consists of net income plus depreciation and amortization, interest expense, interest income, income tax expense (benefit) and non-cash, stock-based compensation expense. We use Adjusted EBITDA as a measure of operating performance because it assists us in comparing performance on a consistent basis, as it removes from our operating results the impact of our capital structure. We believe Adjusted EBITDA is useful to an investor in evaluating our operating performance because it is widely used to measure a company' s operating performance without regard to items such as depreciation and amortization, which can vary depending upon accounting methods and the book value of assets, and to present a meaningful measure of corporate performance exclusive of our capital structure and the method by which assets were acquired.

The following table provides a reconciliation of net income to Adjusted EBITDA (in thousands):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2011 | 2010 | 2011 | 2010 |
| Net income | $177 | $886 | $560 | $ 2,443 |
| Depreciation and amortization of property and equipment | 541 | 403 | 1,436 | 1,148 |
| Amortization of intangible assets | 260 | – | 383 | – |
| Interest expense | – | 8 | – | 66 |
| Interest income | (16 ) | (104 ) | (74 ) | (104 ) |
| Income tax expense (benefit) | 81 | (7 ) | 188 | 96 |
| EBITDA | 1,043 | 1,186 | 2,493 | 3,649 |
| Stock-based compensation expense | 487 | 232 | 1,286 | 458 |
| Adjusted EBITDA | $ 1,530 | $ 1,418 | $ 3,779 | $4,107 |

*Non-GAAP Income per Share.* Non-GAAP income per share, which is also a non-GAAP measure of financial performance, consists of net income plus non-cash, stock-based compensation expense and amortization expense related to intangible assets divided by the weighted average number of shares of common stock outstanding during each period. We believe non-GAAP income per share is useful to an investor because it is widely used to measure a company' s operating performance.

The following table provides a reconciliation of net income to non-GAAP income per share (in thousands, except per share amounts):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2011 | 2010 | 2011 | 2010 |
| Net income | $177 | $886 | $560 | $2,443 |
| Stock-based compensation expense | 487 | 232 | 1,286 | 458 |
| Amortization of intangible assets | 260 | – | 383 | – |
| Non-GAAP income | $924 | $1,118 | $2,229 | $2,901 |
| Shares used to compute non-GAAP incomeper share | | | | |
| Basic | 11,970 | 11,620 | 11,918 | 6,796 |
| Diluted | 12,735 | 12,413 | 12,685 | 11,275 |
| Non-GAAP income per share | | | | |
| Basic | $0.08 | $0.10 | $0.19 | $0.43 |
| Diluted | $0.07 | $0.09 | $0.18 | $0.26 |

**Liquidity and Capital Resources**

At September 30, 2011, our principal sources of liquidity were cash and cash equivalents of $31.5 million and accounts receivable, net of allowance for doubtful accounts, of $7.7 million. Our working capital at September 30, 2011 was $34.5 million compared to $42.6 million at December 31, 2010. The decrease in working capital from December 31, 2010 to September 30, 2011 resulted primarily from the following:

$8.9 million decrease in cash and cash equivalents, due primarily to $10.9 million of cash used for the acquisition of Direct EDI in May 2011;

$2.1 million increase in net accounts receivable, due to new business for the nine months ended September 30, 2011;

$766,000 increase in deferred costs, current, for expenses related to increased implementation resources and commission payments for new business;

$359,000 increase in prepaid expenses and other current assets, primarily related to the renewals of insurance coverage and a prepaid service contract;

$122,000 decrease in capital lease obligations, current, as all of our outstanding capital leases were repaid;

$389,000 increase in accounts payable, primarily due to timing of payments for equipment purchases, professional services and rent;

$1.6 million increase in accrued compensation and benefits, due to increases in salary, vacation and commission accruals, slightly offset by payments made in early 2011 for bonuses accrued as of December 31, 2010;

$319,000 increase in accrued expenses and other current liabilities, primarily due to an increase in accruals for professional services; and,

$221,000 increase in deferred revenue, current, due to new business for the nine months ended September 30, 2011.

*Net Cash Flows from Operating Activities*

Net cash provided by operating activities was $3.5 million for the nine months ended September 30, 2011 compared to $4.1 million for the same period in 2010. The approximate $1.9 million decrease in net income, the changes in non-cash expenses, including increased amortization and stock-based compensation, and the changes in working capital accounts discussed above all contributed to the decrease in net cash provided by operations.

*Net Cash Flows from Investing Activities*

Net cash used in investing activities was $12.6 million for the nine months ended September 30, 2011 and $1.2 million for the same period in 2010. In 2011, we used approximately $10.9 million for the acquisition of Direct EDI. Our capital expenditures, which totaled $1.7 million in 2011 and $1.2 million in 2010, are for supporting our business growth and existing customer base, as well as for our internal use such as equipment for our employees.

*Net Cash Flows from Financing Activities*

Net cash provided by financing activities was $108,000 for the nine months ended September 30, 2011, representing cash received from the exercise of stock options offset by payments of capital lease obligations and stock offering costs. Net cash provided by financing activities was $30.3 million for the nine months ended September 30, 2010, representing the approximate $33.0 million of net proceeds from our initial public offering slightly offset by $2.6 million of net repayments on our outstanding indebtedness.

*Credit Facility*

On September 30, 2011, we entered into a revolving credit agreement with JPMorgan Chase Bank, N.A. The revolving credit agreement provides for a $20 million revolving credit facility that we may draw upon from time to time, subject to certain terms and conditions, and will mature on September 30, 2016. Proceeds from the credit facility are anticipated to be used for acquisitions and our capital needs.

Interest on amounts borrowed under the credit facility is based on (i) an Adjusted LIBO Rate (as defined in the revolving credit agreement) plus an applicable margin of 175 to 225 basis points based on our net working capital, or (ii) JPMorgan' s prime rate (provided it is not less than the Adjusted One Month LIBO Rate (as defined in the revolving credit agreement)) plus an applicable margin of -25 to 25 basis points based on our net working capital. Interest is payable monthly in arrears. Availability under the credit facility is subject to a borrowing base equal to the sum of 250% of our eligible monthly recurring revenue (as defined in the revolving credit agreement) and all borrowings are due in full no later than the maturity date of the agreement.

The revolving credit agreement contains customary representations, warranties, covenants and events of default, including, but not limited to financial covenants requiring us to maintain a fixed charge coverage ratio of not less than 1.20 to 1.00, cash and cash equivalents of not less than $10 million and a minimum number of recurring revenue customers. If an event of default occurs, among other things, the applicable interest rate is subject to an increase of 2% and all outstanding obligations may become immediately due and payable.

There were no borrowings outstanding at September 30, 2011 and we were in compliance with all covenants under the revolving credit agreement as of that date.

*Adequacy of Capital Resources*

Our future capital requirements may vary significantly from those now planned and will depend on many factors, including the costs to develop and implement new solutions and applications, the sales and marketing resources needed to further penetrate our market and gain acceptance of new solutions and applications we develop, the expansion of our operations in the United States and internationally, the response of competitors to our solutions and applications and our use of capital for acquisitions, if any. Historically, we have experienced increases in our expenditures consistent with the growth in our operations and personnel, and we anticipate that our expenditures will increase as we continue to grow our business.

We believe our cash and cash equivalents and cash flows from our operations will be sufficient to meet our working capital and capital expenditure requirements for at least the next twelve months.

Inflation and changing prices did not have a material effect on our business during the nine months ended September 30, 2011. We do not expect that inflation or changing prices will materially affect our business in the foreseeable future.

**Off-Balance Sheet Arrangements**

We do not have any off-balance sheet arrangements, investments in special purpose entities or undisclosed borrowings or debt. Additionally, we are not a party to any derivative contracts or synthetic leases.

**Recent Accounting Pronouncements**

See Note A to our financial statements in this Quarterly Report on Form 10-Q and in our Annual Report on Form 10-K for the year ended December 31, 2010 as filed with the Securities and Exchange Commission on March 3, 2011 for a full description of recent accounting pronouncements, including the respective expected dates of adoption and effects on our results of operations and financial condition.

### Item 3. Quantitative and Qualitative Disclosures About Market Risk

We are a smaller reporting company as defined by Rule 12b-2 of the Exchange Act and are not required to provide the information required under this item.

### Item 4. Controls and Procedures

*Evaluation of Disclosure Controls and Procedures*

As of the end of the period covered by this Quarterly Report on Form 10-Q, our management has evaluated, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934). Disclosure controls and procedures are designed to ensure that information required to be disclosed in our reports filed under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission' s rules and forms and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of September 30, 2011.

*Changes in Internal Control over Financial Reporting*

There were no changes in our internal control over financial reporting during the quarter ended September 30, 2011 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## PART II. – OTHER INFORMATION

### Item 1. Legal Proceedings

We are not currently subject to any material legal proceedings. From time to time, however, we may be engaged in legal actions arising from our normal business activities. Any such actions, even those that lack merit, could result in the expenditure of significant financial and managerial resources.

### Item 1A. Risk Factors

There have been no material changes in our risk factors from those disclosed under the heading *"Risk Factors"* in our Annual Report on Form 10-K for the year ended December 31, 2010 as filed with the Securities and Exchange Commission on March 3, 2011.

### Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Not Applicable.

### Item 3. Defaults Upon Senior Securities

Not Applicable.

### Item 5. Other Information

Not Applicable.

### Item 6. Exhibits

The exhibits filed as part of this Quarterly Report on Form 10-Q are listed in the Exhibit Index immediately following the signatures to this report.

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**SIGNATURES**

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

| | |
|---|---|
| Dated: November 7, 2011 | **SPS COMMERCE, INC.** |
| | /s/ KIMBERLY K. NELSON |
| | Kimberly K. Nelson |
| | *Executive Vice President and Chief Financial Officer* |
| | *(principal financial and accounting officer)* |

## EXHIBIT INDEX

| Exhibit Number | Description |
| --- | --- |
| 10.1 | Credit agreement (incorporated by reference to Exhibit 10.1 to the registrant' s Current Report on Form 8-K filed with the Commission on October 3, 2011 (File No. 001-34702)). |
| 31.1 | Certification of Principal Executive Officer pursuant to Rules 13a-14(a) under the Securities Exchange Act of 1934, as amended (filed herewith). |
| 31.2 | Certification of Principal Financial Officer pursuant to Rules 13a-14(a) under the Securities Exchange Act of 1934, as amended (filed herewith). |
| 32.1 | Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Sec. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (filed herewith). |
| 101 | Interactive Data Files Pursuant to Rule 405 of Regulation S-T. |

**EXHIBIT 31.1**

**CERTIFICATION PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT**

I, Archie C. Black, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of SPS Commerce, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this report;

4. The Registrant' s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Registrant and have:

    a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

    b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

    c. Evaluated the effectiveness of the Registrant' s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

    d. Disclosed in this report any change in the Registrant' s internal control over financial reporting that occurred during the Registrant' s most recent fiscal quarter (the Registrant' s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Registrant' s internal control over financial reporting; and

5. The Registrant' s other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant' s auditors and the audit committee of the Registrant' s board of directors (or persons performing the equivalent functions):

    a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant' s ability to record, process, summarize and report financial information; and

    b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant' s internal control over financial reporting.

/s/ ARCHIE C. BLACK

Archie C. Black

*President and Chief Executive Officer*
*(principal executive officer)*
November 7, 2011

**EXHIBIT 31.2**

**CERTIFICATION PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT**

I, Kimberly K. Nelson, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of SPS Commerce, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this report;

4. The Registrant' s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Registrant and have:

   a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   c. Evaluated the effectiveness of the Registrant' s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   d. Disclosed in this report any change in the Registrant' s internal control over financial reporting that occurred during the Registrant' s most recent fiscal quarter (the Registrant' s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Registrant' s internal control over financial reporting; and

5. The Registrant' s other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant' s auditors and the audit committee of the Registrant' s board of directors (or persons performing the equivalent functions):

   a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant' s ability to record, process, summarize and report financial information; and

   b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant' s internal control over financial reporting.

/s/ KIMBERLY K. NELSON

Kimberly K. Nelson

*Executive Vice President and Chief Financial Officer*
*(principal financial and accounting officer)*
November 7, 2011

**EXHIBIT 32.1**

**CERTIFICATION PURSUANT TO**
**18 U.S.C. §1350**
**AS ADOPTED PURSUANT TO**
**SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report on Form 10-Q of SPS Commerce, Inc. (the "Company") for the period ended September 30, 2011, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned, the Chief Executive Officer and the Chief Financial Officer of the Company, hereby certify, pursuant to and for purposes of 18 U.S.C. §1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ ARCHIE C. BLACK

Archie C. Black
*President and Chief Executive Officer*

/s/ KIMBERLY K. NELSON

Kimberly K. Nelson
Executive Vice President and Chief Financial Officer

November 7, 2011

| Condensed Consolidated Balance Sheets (Unaudited) (Parenthetical) (USD $) In Thousands, except Share data | Sep. 30, 2011 | Dec. 31, 2010 |
| --- | --- | --- |
| **CURRENT ASSETS** | | |
| Accounts receivable, less allowance for doubtful accounts of Parenthetical Value 1 | $ 212 | $ 209 |
| **STOCKHOLDERS' EQUITY** | | |
| Preferred stock, par value | $ 0.001 | $ 0.001 |
| Preferred stock, shares authorized | 5,000,000 | 5,000,000 |
| Preferred stock, shares issued | 0 | 0 |
| Preferred stock, shares outstanding | 0 | 0 |
| Common stock, par value | $ 0.001 | $ 0.001 |
| Common stock, shares authorized | 55,000,000 | 55,000,000 |
| Common stock, shares issued | 11,980,101 | 11,849,572 |
| Common stock, shares outstanding | 11,980,101 | 11,849,572 |

| Condensed Consolidated Statements of Operations (Unaudited) (USD $) In Thousands, except Per Share data | 3 Months Ended | | 9 Months Ended | |
|---|---|---|---|---|
| | Sep. 30, 2011 | Sep. 30, 2010 | Sep. 30, 2011 | Sep. 30, 2010 |
| **Condensed Consolidated Statements of Operations [Abstract]** | | | | |
| Revenues | $ 15,529 | $ 11,491 | $ 42,115 | $ 32,678 |
| Cost of revenues | 4,076 | 3,211 | 11,147 | 9,293 |
| Gross profit | 11,453 | 8,280 | 30,968 | 23,385 |
| **Operating expenses** | | | | |
| Sales and marketing | 6,404 | 4,139 | 17,382 | 11,768 |
| Research and development | 1,605 | 1,108 | 4,259 | 3,218 |
| General and administrative | 2,914 | 2,165 | 8,208 | 5,805 |
| Amortization of intangible assets | 260 | | 383 | |
| Total operating expenses | 11,183 | 7,412 | 30,232 | 20,791 |
| Income from operations | 270 | 868 | 736 | 2,594 |
| **Other income (expense)** | | | | |
| Interest expense | | (8) | | (66) |
| Interest income | 16 | 104 | 74 | 104 |
| Other expense | (28) | (85) | (62) | (93) |
| Total other income (expense), net | (12) | 11 | 12 | (55) |
| Income before income taxes | 258 | 879 | 748 | 2,539 |
| Income tax (expense) benefit | (81) | 7 | (188) | (96) |
| Net income | $ 177 | $ 886 | $ 560 | $ 2,443 |
| **Net income per share** | | | | |
| Basic | $ 0.01 | $ 0.08 | $ 0.05 | $ 0.36 |
| Diluted | $ 0.01 | $ 0.07 | $ 0.04 | $ 0.22 |
| **Weighted average common shares used to compute net income per share** | | | | |
| Basic | 11,970 | 11,620 | 11,918 | 6,796 |
| Diluted | 12,735 | 12,413 | 12,685 | 11,275 |

| Document and Entity Information (USD $) In Millions, except Share data | 9 Months Ended Sep. 30, 2011 | Oct. 28, 2011 | Jun. 30, 2010 |
|---|---|---|---|
| **Document and Entity Information [Abstract]** | | | |
| Entity Registrant Name | SPS COMMERCE INC | | |
| Entity Central Index Key | 0001092699 | | |
| Document Type | 10-Q | | |
| Document Period End Date | Sep. 30, 2011 | | |
| Amendment Flag | false | | |
| Document Fiscal Year Focus | 2011 | | |
| Document Fiscal Period Focus | Q3 | | |
| Current Fiscal Year End Date | --12-31 | | |
| Entity Well-known Seasoned Issuer | No | | |
| Entity Voluntary Filers | No | | |
| Entity Current Reporting Status | Yes | | |
| Entity Filer Category | Smaller Reporting Company | | |
| Entity Public Float | | | $ 68.9 |
| Entity Common Stock, Shares Outstanding | | 12,072,686 | |

| Net Income Per Share | 9 Months Ended Sep. 30, 2011 |
|---|---|
| Earnings Per Share [Abstract] | |
| Net Income Per Share | |

**NOTE G – Net Income Per Share**

Basic net income per share has been computed using the weighted average number of shares of common stock outstanding during each period. Diluted net income per share also includes the impact of our outstanding potential common shares, such as options, warrants and redeemable convertible preferred stock. Potential common shares that are anti-dilutive are excluded from the calculation of diluted net income per share.

The following table presents the components of the computation of basic and diluted net income per share for the periods indicated (in thousands, except per share amounts):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2011 | 2010 | 2011 | 2010 |
| Numerator: | | | | |
| Net income | $177 | $886 | $560 | $2,443 |
| Denominator: | | | | |
| Weighted average common shares outstanding, basic | 11,970 | 11,620 | 11,918 | 6,796 |
| Options and warrants to purchase common andpreferred stock | 765 | 793 | 767 | 1,023 |
| Redeemable convertible preferred stock | — | — | — | 3,456 |
| Weighted average common shares outstanding, diluted | 12,735 | 12,413 | 12,685 | 11,275 |
| Net income per share: | | | | |
| Basic | $0.01 | $0.08 | $0.05 | $0.36 |
| Diluted | $0.01 | $0.07 | $0.04 | $0.22 |

For the three and nine months ended September 30, 2011, approximately 1,000 outstanding options to purchase common stock were excluded from the calculation of diluted net income per share because they were anti-dilutive. For the three and nine months ended September 30, 2010, approximately 417,000 outstanding options to purchase common stock were excluded from the calculation of diluted net income per share because they were anti-dilutive.

| Intangible Assets | 9 Months Ended Sep. 30, 2011 |
|---|---|
| **Intangible Assets [Abstract]** | |
| Intangible Assets | |

**NOTE C – Intangible Assets**

Intangible assets included the following (in thousands):

| | September 30, 2011 | | | December 31, 2010 | | |
|---|---|---|---|---|---|---|
| | Carrying Amount | Accumulated Amortization | Net | Carrying Amount | Accumulated Amortization | Net |
| Subscriber relationships | $ 7,180 | $ (2,206) | $ 4,974 | $ 1,930 | $ (1,930) | $ — |
| Covenants not-to-compete | 1,450 | (397) | 1,053 | 580 | (290) | 290 |
| | $8,630 | $(2,603) | $6,027 | $2,510 | $(2,220) | $290 |

Amortization expense for intangible assets was $260,000 and $383,000 for the three and nine months ended September 30, 2011. There was no amortization expense for intangible assets for the three or nine months ended September 30, 2010.

At September 30, 2011, future amortization expense for intangible assets was as follows (in thousands):

| | |
|---|---|
| Remainder of 2011 | $260 |
| 2012 | 1,040 |
| 2013 | 1,040 |
| 2014 | 861 |
| 2015 | 750 |
| Thereafter | 2,076 |
| | $ 6,027 |

| General | 9 Months Ended Sep. 30, 2011 |
|---|---|
| **General [Abstract]** | |
| General | |

**NOTE A – General**

*Business Description*

We are a leading provider of on-demand supply chain management solutions, providing integration, collaboration, connectivity, visibility and data analytics to thousands of customers worldwide. We provide our solutions through SPSCommerce.net, a hosted software suite that improves the way suppliers, retailers, distributors and other customers manage and fulfill orders. We deliver our solutions to our customers over the Internet using a Software-as-a-Service model and derive the majority of our revenues from thousands of monthly recurring subscriptions from businesses that utilize our solutions.

*Basis of Presentation*

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, these condensed consolidated financial statements do not include all of the information and footnotes required by GAAP. We have included all normal recurring adjustments considered necessary to give a fair statement of our financial position, results of operations and cash flows for the interim periods shown. Operating results for these interim periods are not necessarily indicative of the results to be expected for the full year. The December 31, 2010 balance sheet data was derived from our audited financial statements at that date. For further information, refer to the consolidated financial statements and accompanying notes for the year ended December 31, 2010 included in our Annual Report on Form 10-K as filed with the Securities and Exchange Commission on March 3, 2011.

*Use of Estimates*

Preparing financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

*Business Combinations*

We account for acquisitions of businesses pursuant to Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 805, Business Combinations. In accordance with ASC Topic 805, we recognize separately from goodwill the fair value of the assets acquired and the liabilities assumed at the acquisition date as defined by FASB ASC Topic 820, Fair Value Measurements and Disclosures. Goodwill as of the acquisition date is measured as the excess of consideration transferred and the net of the acquisition date amounts of the assets acquired and the liabilities assumed. Assets acquired include tangible and intangible assets. We determine the value and useful lives of purchased intangible assets with the assistance of an independent third-party valuation firm using certain estimates and assumptions.

While we use estimates and assumptions that we believe are reasonable as a part of the purchase price allocation process to accurately value the assets acquired and the liabilities assumed at the acquisition date, they are inherently uncertain and subject to refinement. As a result, during the measurement period, which may be up to one year from the acquisition date, we may record adjustments to the fair value of the assets acquired and the liabilities assumed based on new information about facts and circumstances that existed as of the acquisition date. Any such adjustments would be recorded as an offset to goodwill. Upon the conclusion of the measurement period or final determination of the fair values, whichever comes first, any subsequent adjustments would be recorded in our statements of operations.

*Significant Accounting Policies*

During the nine months ended September 30, 2011, there were no material changes in our significant accounting policies. See Note A to the consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2010 as filed with the Securities and Exchange Commission on March 3, 2011 for additional information regarding our significant accounting policies.

*Recent Accounting Pronouncements*

In October 2009, the FASB issued Accounting Standards Update ("ASU") No. 2009-13, Revenue Recognition (ASC Topic 605), *Multiple-Deliverable Revenue Arrangements, a consensus of the FASB Emerging Issues Task Force.* This guidance modifies the fair value requirements of ASC subtopic 605-25, *Revenue Recognition-Multiple Element Arrangements,* by allowing the use of the "best estimate of selling price" in addition to Vendor Specific Objective Evidence and third-party evidence (or TPE) for determining the selling price of a deliverable. A vendor is now required to use its best estimate of the selling price when Vendor Specific Objective Evidence or TPE of the selling price cannot be determined. In addition, the residual method of allocating arrangement consideration is no longer permitted.

In October 2009, the FASB issued ASU No. 2009-14, Software (ASC Topic 985), *Certain Revenue Arrangements That Include Software Elements, a consensus of the FASB Emerging Issues Task Force.* This guidance modifies the scope of ASC subtopic 965-605, *Software-Revenue Recognition,* to exclude from its requirements (a) non-software components of tangible products and (b) software components of tangible products that are sold, licensed or leased with tangible products when the software components and non-software components of the tangible product function together to deliver the tangible product's essential functionality.

ASU No. 2009-13 and ASU No. 2009-14 both require expanded qualitative and quantitative disclosures and are effective for fiscal years beginning on or after June 15, 2010. We have adopted these updates and they did not have a material impact on our financial statements.

In January 2010, the FASB issued ASU No. 2010-06, Fair Value Measurements and Disclosures (ASC Topic 820), *Improving Disclosures about Fair Value Measurements*. ASU No. 2010-06 enhances the disclosure requirements to include transfers in and out of Level 1 and 2 and the associated reasons, which was effective for fiscal years beginning on or after December 15, 2009. ASU No. 2010-06 also requires the disclosure of a disaggregated gross reconciliation of Level 3 fair value measurements, which is effective for fiscal years beginning on or after December 15, 2010. We have adopted these updates and they did not have a material impact on our financial statements.

In July 2010, the FASB issued ASU No. 2010-20, Receivables (ASC Topic 310), *Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses*. ASU No. 2010-20 enhances the disclosure requirements about the credit quality and related allowance for credit losses of financing receivables. We will be required to disclose the nature of the inherent risk of receivables, the methodology and analytics that support that assessment, and support any changes to the allowance for doubtful accounts. We will also be required to provide a rollforward of the allowance and disclose the accounts receivable on a disaggregated basis. This update is effective for fiscal years beginning on or after December 15, 2010. We have adopted this update and it did not have a material impact on our financial statements.

In December 2010, the FASB issued ASU No. 2010-29, Business Combinations (ASC Topic 805), *Disclosure of Supplementary Pro Forma Information for Business Combinations*. ASU No. 2010-29 amends the disclosure requirements for supplementary pro forma information for business combinations. This update addresses the diversity in practice about the interpretation of the pro forma revenue and earnings disclosure requirements for business combinations. The update specifies that if a public entity presents comparative financial statements, the entity should disclose revenue and earnings of the combined entity as though the business combination(s) that occurred during the current year had occurred as of the beginning of the comparable prior annual reporting period only. It also expands the supplemental pro forma disclosures to include a description of the nature and amount of material, nonrecurring pro forma adjustments directly attributable to the business combination included in the reported pro forma revenue and earnings. This update is effective prospectively for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2010. We have adopted this update and, with the acquisition of Direct EDI in May 2011, the required supplementary pro forma information is presented in Note B.

In September 2011, the FASB issued ASU No. 2011-08, Intangibles—Goodwill and Other (Topic 350)—*Testing Goodwill for Impairment*. ASU No. 2011-08 provides an entity with the option to perform a qualitative assessment of goodwill to determine whether further impairment testing is necessary. If an entity believes, as a result of its qualitative assessment, that it is more-likely-than-not that the fair value of a reporting unit is less than its carrying amount, the currently prescribed two step quantitative goodwill impairment test is required. Otherwise, no further testing is required. This update is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011 and earlier adoption is permitted. We are currently evaluating the early adoption option. We do not expect the adoption or early adoption of this update to have an impact on our financial statements.

| Line of Credit | 9 Months Ended Sep. 30, 2011 |
|---|---|
| **Line of Credit [Abstract]** | |
| Line of Credit | **NOTE D – Line of Credit**<br><br>On September 30, 2011, we entered into a revolving credit agreement with JPMorgan Chase Bank, N.A. The revolving credit agreement provides for a $20 million revolving credit facility that we may draw upon from time to time, subject to certain terms and conditions, and will mature on September 30, 2016. Proceeds from the credit facility are anticipated to be used for acquisitions and our capital needs.<br><br>Interest on amounts borrowed under the credit facility is based on (i) an Adjusted LIBO Rate (as defined in the revolving credit agreement) plus an applicable margin of 175 to 225 basis points based on our net working capital, or (ii) JPMorgan's prime rate (provided it is not less than the Adjusted One Month LIBO Rate (as defined in the revolving credit agreement)) plus an applicable margin of -25 to 25 basis points based on our net working capital. Interest is payable monthly in arrears. Availability under the credit facility is subject to a borrowing base equal to the sum of 250% of our eligible monthly recurring revenue (as defined in the revolving credit agreement) and all borrowings are due in full no later than the maturity date of the agreement.<br><br>The revolving credit agreement contains customary representations, warranties, covenants and events of default, including, but not limited to financial covenants requiring us to maintain a fixed charge coverage ratio of not less than 1.20 to 1.00, cash and cash equivalents of not less than $10 million and a minimum number of recurring revenue customers. If an event of default occurs, among other things, the applicable interest rate is subject to an increase of 2% and all outstanding obligations may become immediately due and payable.<br><br>There were no borrowings outstanding at September 30, 2011 and we were in compliance with all covenants under the revolving credit agreement as of that date. |

| Stock-Based Compensation | 9 Months Ended<br>Sep. 30, 2011 |
|---|---|
| **Stock-Based Compensation [Abstract]** | |
| Stock-Based Compensation | |

**NOTE E – Stock-Based Compensation**

Our equity compensation plans provide for the grant of incentive and nonqualified stock options, as well as other stock-based awards, to employees, non-employee directors and other consultants who provide services to us. Stock options generally vest over three to four years and have a contractual term of ten years from the date of grant. At September 30, 2011, there were approximately 667,000 shares available for grant under approved equity compensation plans.

We recorded stock-based compensation expense of $487,000 and $232,000 for the three months ended September 30, 2011 and 2010, respectively. We recorded stock-based compensation expense of $1.3 million and $458,000 for the nine months ended September 30, 2011 and 2010, respectively. This expense was allocated as follows (in thousands):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2011 | 2010 | 2011 | 2010 |
| Cost of revenues | $68 | $31 | $186 | $ 65 |
| Operating expenses: | | | | |
| Sales and marketing | 121 | 64 | 347 | 129 |
| Research and development | 18 | 7 | 41 | 12 |
| General and administrative | 280 | 130 | 712 | 252 |
| Total stock-based compensation expense | $ 487 | $ 232 | $ 1,286 | $ 458 |

As of September 30, 2011, there was approximately $4.7 million of unrecognized stock-based compensation expense under our equity compensation plans, which is expected to be recognized on a straight line basis over a weighted average period of approximately two years.

Our stock option activity was as follows:

| | Options (#) | Weighted Average Exercise Price ($/share) |
|---|---|---|
| Outstanding at December 31, 2010 | 1,549,344 | $ 4.59 |
| Granted | 420,843 | 16.97 |
| Exercised | (130,529 ) | 2.60 |
| Forfeited | (19,129 ) | 10.80 |
| Outstanding at September 30, 2011 | 1,820,529 | 7.53 |

The weighted average fair value per share of options granted during the first nine months of 2011 was $8.11 and this was estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions:

| | |
|---|---|
| Weighted-average volatility | 45.0% |
| Expected dividend yield | 0% |
| Expected life (in years) | 6.25 |
| Weighted-average risk-free interest rate | 2.05%- 3.05% |

| Income Taxes | 9 Months Ended Sep. 30, 2011 |
|---|---|
| **Income Taxes [Abstract]** | |
| Income Taxes | **NOTE F – Income Taxes** |

**NOTE F – Income Taxes**

We recorded a provision for income taxes of $81,000 for the three months ended September 30, 2011 and a benefit for income taxes of $7,000 for the three months ended September 30, 2010. We recorded a provision for income taxes of $188,000 and $96,000 for the nine months ended September 30, 2011 and 2010, respectively. We record our interim provision for income taxes based on our estimated annual effective tax rate for the year. Our provision for income taxes includes estimated federal alternative minimum taxes and state income taxes, as well as deferred tax expense resulting from the book and tax basis difference in goodwill from asset acquisitions.

As of December 31, 2010, and updated for the filing of our tax returns in September 2011, we had net operating loss carryforwards of $50.8 million for U.S. federal tax purposes and $30.2 million for state tax purposes. These loss carryforwards expire between 2011 and 2029. Section 382 of the U.S. Internal Revenue Code generally imposes an annual limitation on the amount of net operating loss carryforwards that might be used to offset taxable income when a corporation has undergone significant changes in stock ownership. We have performed a Section 382 analysis for the time period from our inception through December 8, 2010. During this time period it was determined that we had six separate ownership changes under Section 382. We believe that approximately $17.6 million of federal losses and $15.4 million of state losses will expire unused due to Section 382 limitations. This limitation could be further restricted if ownership changes occur in future years. In addition, the state limitation will vary depending on future apportionment factors. Our deferred tax asset is reported net of this limitation.

Realization of our net operating loss carryforwards and other deferred tax temporary differences are contingent upon future taxable earnings. Our net deferred tax assets have been reduced fully by a valuation allowance, as realization is not considered to be likely based on an assessment of the history of losses and the likelihood of sufficient future taxable income. Our deferred tax liability relates to goodwill created in a prior asset acquisition which is deductible for tax purposes.

We are subject to income taxes in the U.S. federal jurisdiction and various state jurisdictions. As of September 30, 2011, we are generally subject to U.S. federal and state tax examinations for all tax years 2010 and prior due to net operating loss carryforwards.

As of September 30, 2011, we do not have any unrecognized tax benefits. It is our practice to recognize interest and penalties accrued on any unrecognized tax benefits as a component of income tax expense. We do not expect any material changes in our unrecognized tax positions over the next 12 months.

| Condensed Consolidated Statements of Cash Flows (Unaudited) (USD $) In Thousands | 9 Months Ended | |
|---|---|---|
| | Sep. 30, 2011 | Sep. 30, 2010 |
| **Cash flows from operating activities** | | |
| Net income | $ 560 | $ 2,443 |
| **Reconciliation of net income to net cash provided by operating activities** | | |
| Depreciation and amortization of property and equipment | 1,436 | 1,148 |
| Amortization of intangible assets | 383 | |
| Provision for doubtful accounts | 245 | 225 |
| Stock-based compensation | 1,286 | 458 |
| Change in carrying value of preferred stock warrants | | 27 |
| Other | | 1 |
| **Changes in assets and liabilities, net of effect of acquisition** | | |
| Accounts receivable | (2,265) | (975) |
| Prepaid expenses and other current assets | (264) | 450 |
| Other assets | | (18) |
| Deferred costs | (1,219) | (724) |
| Accounts payable | 389 | (287) |
| Deferred revenue | 1,323 | 866 |
| Accrued compensation and benefits | 1,612 | 714 |
| Accrued expenses and other current liabilities | 60 | (256) |
| Net cash provided by operating activities | 3,546 | 4,072 |
| **Cash flows from investing activities** | | |
| Acquisition of Direct EDI | (10,865) | |
| Purchases of property and equipment | (1,716) | (1,230) |
| Net cash used in investing activities | (12,581) | (1,230) |
| **Cash flows from financing activities** | | |
| Borrowings on line of credit | | 4,450 |
| Payments on line of credit | | (5,950) |
| Payments on equipment loans | | (732) |
| Payments of capital lease obligations | (122) | (338) |
| Net proceeds from initial public offering | | 32,902 |
| Stock offering costs | (108) | |
| Net proceeds from exercise of options to purchase common stock | 338 | 8 |
| Net cash provided by financing activities | 108 | 30,340 |
| Net increase (decrease) in cash and cash equivalents | (8,927) | 33,182 |
| Cash and cash equivalents at beginning of period | 40,473 | 5,931 |
| Cash and cash equivalents at end of period | $ 31,546 | $ 39,113 |

| Acquisition of Direct EDI | 9 Months Ended Sep. 30, 2011 |
|---|---|

**Acquisition of Direct EDI [Abstract]**

Acquisition of Direct EDI

**NOTE B – Acquisition of Direct EDI**

On May 17, 2011, we entered into an asset purchase agreement with Direct EDI LLC, a privately-held provider of cloud-based integration solutions for electronic data interchange, and we completed the asset purchase on May 18, 2011. Under the asset purchase agreement, we purchased and acquired substantially all of the assets of Direct EDI for $10.9 million in cash and assumed certain liabilities of Direct EDI. The acquisition of Direct EDI allows us to expand our base of recurring revenue customers.

*Purchase Price Allocation*

We accounted for the acquisition as a business combination. We allocated the purchase price to the tangible and identifiable intangible assets acquired and liabilities assumed based on their estimated fair values as of the acquisition date. We engaged an independent third-party valuation firm to assist us in the determination of the value of the purchased intangible assets. The excess of the purchase price over the fair value of net tangible and identifiable intangible assets acquired was recorded as goodwill. Goodwill is attributed to a trained workforce and other buyer-specific value resulting from expected synergies, including long-term cost savings, that are not included in the fair values of assets. Goodwill will not be amortized; however it is deductible for tax purposes. Although we believe the purchase price allocation is substantially complete, it is considered preliminary and the finalization of the valuation of the net tangible and intangible assets acquired and liabilities assumed could result in a future adjustment to the purchase price allocation.

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the acquisition date (in thousands):

| | |
|---|---|
| Current assets | $195 |
| Property and equipment | 42 |
| Intangible assets | 6,120 |
| Goodwill | 4,712 |
| Current liabilities | (204) |
| Total purchase price | $ 10,865 |

*Purchased Intangible Assets*

The following table summarizes the estimated fair value of the purchased intangible assets and their estimated useful lives:

| Purchased Intangible Assets | Estimated Fair Value (in thousands) | Estimated Life (in years) |
|---|---|---|
| Subscriber relationships | $ 5,250 | 7 |

| | | |
|---|---|---|
| Non-competition agreements | 870 | 3 |
| Total | $ 6,120 | |

The purchased intangible assets are being amortized on a straight-line basis over their estimated useful lives. Amortization expense related to these intangible assets was $260,000 and $383,000 for the three and nine months ended September 30, 2011.

*Acquisition-Related Costs and Post-Acquisition Operating Results*

Acquisition-related costs were approximately $232,000 and are included in our condensed consolidated statements of operations for the nine months ended September 30, 2011. Acquisition-related costs were recorded as general and administrative expense in accordance with the current accounting guidance for business combinations. The operating results of Direct EDI have been included in our condensed consolidated financial statements from May 18, 2011, the date of the acquisition. For the three and nine months ended September 30, 2011, approximately $1.1 million and $1.6 million of our revenues were derived from Direct EDI customers. The amount of operating income or loss from Direct EDI was not separately identifiable due to our integration.

*Unaudited Pro Forma Financial Information*

The unaudited pro forma financial information in the table below presents the combined operating results of SPS Commerce and Direct EDI as if the acquisition had occurred on January 1, 2010. The unaudited pro forma information includes the historical operating results of each company and certain pro forma adjustments, including annual amortization expense for purchased intangible assets of approximately $1.0 million and additional annual compensation expense of approximately $280,000 related to employment arrangements entered into as part of the acquisition.

| | **Three Months Ended September 30,** | | **Nine Months Ended September 30,** | |
|---|---|---|---|---|
| **(in thousands, except per share data)** | **2011** | **2010** | **2011** | **2010** |
| Pro forma total revenue | $ 15,529 | $ 12,553 | $ 43,961 | $ 35,593 |
| Pro forma net income | $177 | $748 | $433 | $1,945 |
| Pro forma net income per share | | | | |
| Basic | $0.01 | $0.06 | $0.04 | $0.29 |
| Diluted | $0.01 | $0.06 | $0.03 | $0.17 |

The unaudited pro forma financial information is presented for informational purposes only and is not necessarily indicative of the results of operations that would have actually been reported had the acquisition occurred on January 1, 2010, nor is it necessarily indicative of our results of operations for any future periods.

| Condensed Consolidated Balance Sheets (Unaudited) (USD $) In Thousands | Sep. 30, 2011 | Dec. 31, 2010 |
|---|---|---|
| **CURRENT ASSETS** | | |
| Cash and cash equivalents | $ 31,546 | $ 40,473 |
| Accounts receivable, less allowance for doubtful accounts of $212 and $209, respectively | 7,695 | 5,574 |
| Deferred costs, current | 5,486 | 4,720 |
| Prepaid expenses and other current assets | 1,233 | 874 |
| Total current assets | 45,960 | 51,641 |
| PROPERTY AND EQUIPMENT, net | 3,082 | 2,760 |
| GOODWILL | 5,877 | 1,166 |
| INTANGIBLE ASSETS, net | 6,027 | 290 |
| **OTHER ASSETS** | | |
| Deferred costs, net of current portion | 2,396 | 1,943 |
| Other non-current assets | 80 | 80 |
| Total assets | 63,422 | 57,880 |
| **CURRENT LIABILITIES** | | |
| Capital lease obligations, current | 0 | 122 |
| Accounts payable | 1,387 | 998 |
| Accrued compensation and benefits | 5,189 | 3,577 |
| Accrued expenses and other current liabilities | 1,126 | 807 |
| Deferred revenue, current | 3,806 | 3,585 |
| Total current liabilities | 11,508 | 9,089 |
| **OTHER LIABILITIES** | | |
| Deferred revenue, less current portion | 6,104 | 5,002 |
| Other non-current liabilities | 225 | 281 |
| Total liabilities | 17,837 | 14,372 |
| COMMITMENTS and CONTINGENCIES | | |
| **STOCKHOLDERS' EQUITY** | | |
| Preferred stock, $0.001 par value; 5,000,000 shares authorized; 0 shares issued and outstanding | | |
| Common stock, $0.001 par value; 55,000,000 shares authorized; 11,980,101 and 11,849,572 shares issued and outstanding, respectively | 12 | 12 |
| Additional paid-in capital | 107,781 | 106,264 |
| Accumulated deficit | (62,208) | (62,768) |
| Total stockholders' equity | 45,585 | 43,508 |
| Total liabilities and shareholder's equity | $ 63,422 | $ 57,880 |