

ELLIE MAE INC  
Form 10-K  
March 02, 2015

UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

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FORM 10-K

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(Mark One)

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

For the fiscal year ended December 31, 2014

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 001-35140

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ELLIE MAE, INC.

(Exact name of registrant as specified in its charter)

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Delaware

(State or other jurisdiction of incorporation or organization)

94-3288780

(I.R.S. Employer Identification No.)

4155 Hopyard Road, Suite 200

Pleasanton, California

(Address of principal executive offices)

(925) 227-7000

(Registrant's telephone number, including area code)

94588

(Zip Code)

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

Title of Each Class

Common Stock, par value \$0.0001 per share

Name of Each Exchange on Which Registered

New York Stock Exchange

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

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

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

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 Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes

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No

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer, or a smaller reporting company. See 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  Smaller reporting company

(Do not check if a 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 aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant as of June 30, 2014, the last business day of the registrant's most recently completed second fiscal quarter, was approximately \$834,971,000 (based on the last reported sale price of \$31.13 on June 30, 2014). 29,156,493 shares of the registrant's common stock, par value \$0.0001 per share, were outstanding as of February 27, 2015.

Documents Incorporated by Reference

Portions of the registrant's Proxy Statement for the registrant's 2015 Annual Meeting of Stockholders are incorporated by reference into Part III of this Form 10-K to the extent stated herein. The registrant intends to file the Proxy Statement within 120 days of the registrant's fiscal year ended December 31, 2014.

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 Form 10-K  
 For the Year Ended December 31, 2014  
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on-demand Software-as-a-Service, or SaaS, environment provides customers with the added benefits of lower up front implementation costs and reduced need for an infrastructure of servers, storage and network devices. Moreover, SaaS Encompass provides access to the most current version of software, including periodic upgrades and regulatory updates. We also host the Ellie Mae Network, a proprietary electronic platform that allows Encompass users to conduct electronic business transactions with investors and service providers they work with in order to process and fund loans.

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For mortgage originators, Encompass is a comprehensive mortgage management system that handles key business and management functions involved in running a mortgage origination business. Mortgage originators use Encompass as a single tool for loan processing, marketing and customer communication and to interact electronically with lenders, investors and service providers over the Ellie Mae Network. We also offer Encompass users a variety of other on-demand software services, including: Encompass Compliance Service, which automatically checks for compliance with federal, state and local regulations throughout the origination process; Encompass Docs Solution, which automatically prepares the disclosure and closing documents necessary to fund a mortgage; Encompass CenterWise, a bundled offering of electronic document management, or EDM, and websites used for customer relationship management; Total Quality Loan, or TQL, which offers a suite of fraud detection, valuation, validation and risk analysis services; tax transcript services which provide income verification capability; services for ordering and managing appraisals; Encompass CRM, a suite of tools for managing contacts, leads and marketing campaigns; Encompass Product and Pricing Service, which allows Encompass users to compare loans offered by different lenders and investors to determine appropriate mortgage programs available to a particular borrower; Encompass Flood Service, which allows Encompass users to order and transfer flood zone certifications; and services under the AllRegs brand, which include research and reference, education, documentation and data and analytics products relating to the mortgage industry.

For the lenders, investors and service providers on the Ellie Mae Network, we provide electronic connectivity that allows them to do business with a significant percentage of the mortgage origination professionals in the United States.

Mortgage originators pay for SaaS Encompass in one of two models: recurring monthly subscription fees or monthly fees based on the number of licensed users and mortgages funded. Our additional services are paid on a subscription or transaction basis. Lenders and service providers participating in the Ellie Mae Network also pay us fees, generally on a per transaction basis, for transactions processed through the Ellie Mae Network from Encompass users.

Under the AllRegs brand, our research and reference products include single and multifamily underwriting & insuring guidelines as well as libraries of federal and state laws and regulations, and we are the exclusive electronic publisher of the Fannie Mae and Freddie Mac Single and Multi-Family Seller/Service Guides and The Federal Home Loan Banks' MPF Program Guidelines. Our educational division, AllRegs Academy, offers courses related to the mortgage industry, including self-paced training, instructor-led online courses, webinars or live classroom training and certified continuing education classes for state licensed mortgage originators. In addition, through the AllRegs brand, we offer documentation and learning management solutions to facilitate our customer's mortgage lending compliance, as well as data and analytics services relating to investor loan products.

#### Corporate Information

Founded in 1997 as a California corporation, Ellie Mae was reincorporated as a Delaware corporation in November 2009 and completed its initial public offering of its common stock in April 2011. Our mailing address and executive offices are located at 4155 Hopyard Road, Suite 200 Pleasanton, California 94588 and our telephone number at that address is (925) 227-7000. We are subject to the information and periodic reporting requirements of the Securities Exchange Act of 1934, or Exchange Act, and, in accordance therewith, file periodic reports, proxy statements and other information with the Securities and Exchange Commission, or SEC. Such periodic reports, proxy statements and other information are available for inspection and copying at the SEC's Public Reference Room at 100 F Street, NE., Washington, DC 20549 or may be obtained by calling the SEC at 1-800-SEC-0330. In addition, the SEC maintains a website at <http://www.sec.gov> that contains reports, proxy statements and other information regarding issuers that file electronically with the SEC. We also post on the Investor Relations page of our Website, [www.elliemae.com](http://www.elliemae.com), a link to our filings with the SEC, our Corporate Governance Guidelines and Code of Business Conduct and Ethics, which applies to all directors and all our employees, and the charters of our Audit, Compensation and Nominating and Corporate Governance committees of our board of directors. Our filings with the SEC are posted on our Website and are available free of charge as soon as reasonably practical after they are filed electronically with the SEC. Please note that information contained on our Web site is not incorporated by reference in, or considered to be a part of, this report. You can also obtain copies of these documents free of charge by writing to us at: Corporate Secretary, Ellie Mae, Inc., 4155 Hopyard Road, Suite 200, Pleasanton, CA 94588, or emailing us at: [ir@elliemae.com](mailto:ir@elliemae.com).

#### Mortgage Industry Overview

Overview of Mortgage Origination Market

Mortgage originators typically advise borrowers, process loan files, collect and verify the property and borrower data upon which lending decisions are based and, in the majority of cases, fund and close the mortgage loan. According to NMLS, which is the sole system of licensure for mortgage companies for 57 state agencies and the sole system of licensure for mortgage originators for 60 state and territorial agencies, there were approximately 516,700 state licensed or federally registered individuals and 26,300 licensed companies or federal institutions engaged in originating residential mortgages across the United States at September 30,

2014.<sup>1</sup> Mortgage originators typically fall into one of three categories: mega lenders, other mortgage lenders and mortgage brokerages.

**Mega Lenders.** Mega lenders are large commercial banks that have both a retail channel in which they work directly with borrowers to originate loans and a wholesale channel in which they buy loans originated by other mortgage originators, such as mortgage banks, smaller lenders, credit unions and mortgage brokerages.

**Mortgage Lenders.** Mortgage lenders other than mega lenders include non-depository mortgage banks, smaller commercial banks, thrifts and credit unions. These companies source and fund loans and generally sell most of these funded loans to mega lenders or other investors.

**Mortgage Brokerages.** Mortgage brokerages are independent sales companies that originate loans for multiple mortgage lenders. They process and submit loan files to mortgage lenders or mega lenders that, in turn, fund the loans.

Based on estimates provided by the Mortgage Bankers Association, there were \$1.1 trillion<sup>2</sup>, \$1.8 trillion, \$2.0 trillion, \$1.4 trillion and \$1.7 trillion<sup>3</sup> in loans originated for 1- to 4-family homes during the years ended December 31, 2014, 2013, 2012, 2011 and 2010, respectively.

Based on information provided by Inside Mortgage Finance, 36.4% of mortgages originated nationwide during the nine months ended September 30, 2014 were funded directly through the retail channels of mega lenders and the remaining 63.6% were funded through other wholesale channels, mortgage lenders and brokerages.<sup>4</sup> For the years ended 2013 and 2012, this split was 39.0% / 61.0%<sup>5</sup> and 43.5% / 56.5%<sup>6</sup>, respectively.

#### The Mortgage Origination Process

Originating a residential mortgage involves multiple parties and requires a complex series of data-laden transactions that must be handled accurately under tight time constraints. By the time a mortgage has been funded, the typical loan package contains over one thousand pages of documents that come from over a dozen different entities, usually operating on disparate technology systems and databases. Traditionally, much of the data used to prepare these documents has been gathered manually, rather than electronically, with documents exchanged among the many participants by facsimile, courier or mail. The entire process results in significant duplicative efforts, time delays, errors, costs and redundant paper documentation, and often exposes borrower data to potential privacy and security breaches.

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1 NMLS, Mortgage Industry Report (2014 Quarter 3), Released December 12, 2014.

2 Mortgage Bankers Association, MBA Mortgage Finance Forecast as of February 20, 2015. Copyright 2015.

3 Mortgage Bankers Association, MBA Quarterly Origination Estimates as of January 14, 2014. Copyright 2014.

4 Inside Mortgage Finance, November 28, 2014, p.5, Top Retail Originators: 9M2014, Copyright 2014

5 Inside Mortgage Finance, February 28, 2014, p. 5, Top Retail Originators: 12M2013, Copyright 2014.

6 Inside Mortgage Finance, February 22, 2013, p. 5, Top Wholesale/Correspondent Channels: 12M2012, Copyright 2013.





The following diagram of the mortgage origination process provides a framework for understanding the complexity and inefficiency of the process and the need for automated solutions.

In addition to the challenges involved in processing loans, mortgage originators must satisfy a multitude of federal, state and local regulations and address basic business needs, including marketing, sales, product fulfillment, customer support, reporting and general management functions. Historically, most mortgage originators have operated their businesses using separate task-specific software applications that were interconnected, if at all, through customized integrations. This often resulted in constraints on effective collaboration among operating departments, limited ability to monitor the business comprehensively, increased risk of error due to inconsistent data, failure to incorporate current regulations into work flows, inadequate security and control over the process and expensive technical integration and maintenance costs.

#### Recent Mortgage Industry Trends and Developments

The residential mortgage industry continues to evolve and undergo significant changes. There are five major trends that are currently impacting the residential mortgage industry.

##### Increased Regulation Affecting Lenders and Investors

Many regulatory reforms have been introduced or proposed in recent years to ensure meaningful disclosures by lenders to borrowers, increased transparency and objectivity of settlement services and greater accountability of lenders and mortgage originators. Many of the significant changes in regulations were issued in 2013 and 2014, including material changes to:

Regulation Z of the Truth in Lending Act of 1968, as amended, or TILA, by the Consumer Financial Protection Bureau, or CFPB, with an effective date for applications taken on or after January 10, 2014, in which the CFPB implemented amendments to TILA made by the Dodd-Frank Wall Street Reform and Consumer Protection Act, or Dodd-Frank Act, to require that creditors determine a consumer's ability to repay a mortgage before making a loan and to establish both minimum mortgage underwriting standards and standards for complying with the ability to repay requirement by defining a "qualified mortgage."

both Regulation X of the Real Estate Settlement Procedures Act of 1974 as amended, or RESPA, and Regulation Z of TILA, with an effective date for applications taken on or after January 10, 2014, in which the CFPB implemented amendments to RESPA and TILA made by the Dodd-Frank Act to expand the types of mortgage loans that are subject to the protections of the Home Ownership and Equity Protection Act of 1994, or HOEPA, by revising and expanding the triggers for coverage under HOEPA, and to impose additional restrictions on HOEPA mortgage loans, including a pre-loan counseling requirement.

both Regulation X of RESPA and Regulation Z of TILA, with an effective date for applications taken on or after August 1, 2015, in which the Dodd-Frank Act directs the CFPB to issue proposed rules and forms that combine certain disclosures that consumers receive in connection with applying for and closing on a mortgage loan. In addition to combining the

existing disclosure requirements and implementing new requirements in the Dodd-Frank Act, the final rule provides extensive guidance regarding compliance with those requirements.

section 15G of the Exchange Act (15. U.S.C. 78o-11), as added by the Dodd-Frank Act, with an effective date one year from publication in the Federal Register, in which the Federal Reserve Board, the SEC, and the Department of Housing and Urban Development implement credit risk retention requirements for asset-backed securities. The final rule generally requires securitizers in both public and private securitization transactions to retain not less than 5% of the credit risk of the assets collateralizing any asset-backed security issuance. The final rule includes a variety of exemptions from these requirements, including an exemption for asset-backed securities that are collateralized exclusively by residential mortgages that qualify as "qualified residential mortgages." The final rule's definition of "qualified residential mortgage" is the same as the definition of "qualified mortgage" under the CFPB's ability-to-repay rules.

Regulation C to implement amendments to the Home Mortgage Disclosure Act with a comment period ending October 29, 2014, in which the Dodd-Frank Act directs the CFPB to add several new reporting requirements and to clarify several existing requirements. The CFPB is also proposing changes to institutional and transactional coverage under Regulation C.

In addition to the regulatory reforms that have been introduced or proposed, other significant changes in regulations have been implemented since 2008 that are subject to regulatory enforcement, including material changes to Regulation Z of TILA by the Federal Reserve Board to protect consumers in the mortgage market from unfair or abusive lending practices that could arise from certain loan originator compensation practices by prohibiting payments to loan originators based on the terms or conditions of the transaction other than the amount of credit extended. These regulatory reforms further complicate the process and increase the amount of documentation required to originate and fund residential mortgages.

#### Increased Quality Standards Imposed by Regulators, Lenders and Investors

Lenders have eliminated many high-risk loan product offerings and significantly tightened underwriting and processing requirements. Similarly, investors seek higher-quality, lower-risk loans in which to invest. Consistent with these tightened standards and expectations, lenders and investors are demanding increased levels of documentation of the data upon which a lending decision will be based, increased use of third-party services to obtain unbiased and independent verification of borrowers' creditworthiness, greater proof of the adequacy of the collateral securing mortgages and strict compliance with regulatory requirements. This trend further increases the amount of documentation and number of services required to originate and fund residential mortgages. Increased enforcement by federal and state regulators continues to encourage mortgage originators to explore technology solutions that provide adequate controls and policy enforcement to facilitate originating compliant loans.

#### Greater Focus on Operational Efficiencies

Mortgage originators experienced a \$2,263 increase in the average total production cost per loan, from \$3,685 in 2009 to \$5,948 in 2013.<sup>1</sup> During the third quarter of 2014, the average total production cost per loan was \$6,769<sup>2</sup> and we expect costs to continue to be a significant consideration for mortgage originators due to continued increased regulation and heightened quality standards. As a result, mortgage originators have sought to increase their efficiency and reduce fixed expenses, leading them to explore technology solutions to automate their business processes as well as methods to avoid or reduce expenses that are not tied to revenue generating activities.

#### Customers Adopting Multi-Channel Strategies

Customers are developing multi-channel strategies beyond a single retail, correspondent or wholesale mortgage lending channel in order to grow their businesses. The requirements of these different channels vary and in order to maintain a single operating system, customers must use a robust system with customizable functionality.

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<sup>1</sup> Mortgage Bankers Association, Annual Mortgage Bankers Performance Report 2013 Data, Net Loan Production Income and Expense, \$ per loan, Copyright May 2014.

Mortgage Bankers Association, Independent Mortgage Bankers Profits Drop Slightly Despite Higher Volume in the Third Quarter of 2014, December 4, 2014.

Greater focus by customers and regulators on data security and consumer privacy.

Recent high-profile data security incidents affecting banking institutions and cloud-service software providers have resulted in an increased focus on data security by our customers and our customers' regulators. We expect the industry focus on data security to continue to increase as companies generate greater amounts of data and as future data security incidents occur.

#### Our Strategy

Our mission is to be the industry standard platform for residential mortgage origination in the United States. Key elements of our strategy include:

**Increase the number of Encompass users.** We continue to focus our marketing and sales efforts and product development to increase the number of mortgage lenders, commercial banks, thrifts and credit unions using Encompass and the available add-on services. Mortgage lenders typically require software with comprehensive functionality to meet their various needs and generally order most of the settlement and other services available on the Ellie Mae Network in the process of funding loans. We continue to grow our sales department as we expect an increased number of mortgage lenders to assess new platform options and replace their legacy systems in response to the increased quality standards and compliance mandates affecting the industry. As we have experienced success in securing and supporting the largest, or enterprise lenders, we will continue to focus on all segments, including the enterprise segment, of the lending industry.

**Encompass as Software-as-a-Service (SaaS).** Our strategy is to sell Encompass as an on-demand offering, in contrast to our legacy on-premise license model, for which we will no longer provide software releases or technical support beginning in May 2016. With our Encompass on-demand offering, or SaaS Encompass, the customer does not pay the significant up-front licensing fee associated with our on-premise license software but rather pays a monthly base fee plus additional fees based on the number of loans they fund, or success basis, which we refer to as Success-Based Pricing. We believe the Success-Based Pricing model is particularly attractive in the present residential mortgage origination market as it aligns customers' payments for our software solutions with their own receipts of revenues. This business model also increases the efficiency of our sales and marketing efforts by allowing us to sell multiple products and services, including our SaaS version of Encompass, Encompass CenterWise, Encompass Docs Solution, Encompass Compliance Service and Encompass Product and Pricing Service, to our mortgage lender customers in a single sales effort.

**Sell additional products and services to Encompass users.** By utilizing our comprehensive suite of bundled products and services, customers avoid the risk and effort of cobbling together two or more solutions from our competing vendors. To the extent users do not subscribe to our bundled offering, we intend to encourage use of more of the Encompass services we currently offer, such as document preparation, EDM, compliance services, product and pricing services, flood services and website hosting. As our customers opt for supplemental on-demand software and services, we generate additional revenues. These are services the lender must use to originate loans and by encouraging our customers to use these through the Encompass platform we can help offer the lender greater efficiency and cost savings and continue to drive additional revenue per user. We also intend to develop additional products and services to sell to our Encompass users.

**Expand the use of settlement services on the Ellie Mae Network.** The Ellie Mae Network provides mortgage originators electronic access to many of the investors and mega lenders, and most of the service providers, that they need to interact with in order to process and fund loans. During 2014 and 2013, Encompass users employed the Ellie Mae Network to process on average approximately six transactions per loan file. These transactions included electronic ordering of credit reports and accessing the automatic underwriting systems of Fannie Mae and Freddie Mac. Electronic interaction over the Ellie Mae Network is less frequent with other service providers, such as appraisers and title and flood reporting companies. We believe this usage is lower in part because customers believe that the electronic solutions provided by settlement service entities do not offer electronic solutions superior to traditional processes. We intend to encourage providers of settlement services, such as title reports and appraisals, to deliver these services electronically through the Ellie Mae Network as such solutions improve over traditional processes.

**Sell enhanced Ellie Mae Network offerings to investors, lenders and service providers.** We intend to continue to add functionality and services to the Ellie Mae Network so investors, lenders and service providers can more effectively

do business with mortgage originators using Encompass. We introduced our TQL program in 2011 and continue to work to add more of our lender and investor customers to this program. Investors and lenders can populate mortgage originators' Encompass software with specific compliance, underwriting and documentation requirements for loans prior to delivery in order to screen loans for quality and regulatory compliance.

Acquisitions. Our industry is highly fragmented, and we believe there are strategic opportunities available to acquire competing software companies or software providers that offer related mortgage origination functionality that will complement and increase the attractiveness of our solutions. For example, in October 2014, we acquired substantially all the assets of Mortgage

Resource Center, Inc., dba AllRegs, a provider of research and reference, education, documentation and data and analytics products relating to the mortgage industry. The assets that we acquired from AllRegs will allow us to strengthen our products through product integration and introduce new products related to training, compliance management systems and loan product eligibility. Additionally, in January 2014, we acquired substantially all the assets of ARG Interactive, LLC (dba MortgageCEO), or MortgageCEO, a SaaS company specializing in customer relationship management and marketing solutions for the residential mortgage industry.

**Investment in our Business.** We are investing aggressively in initiatives that we believe will help us continue to grow our business, improve our products and services and strengthen our competitive advantage while bringing sustainable, long-term value to our customers. During 2014, we increased our investments in our sales and client services capabilities, research and development and technology infrastructure to support our user additions and overall business growth. These investments include expanding our talent across the organization by hiring additional personnel. To support customers and further differentiate ourselves, we currently anticipate that throughout 2015 we will continue to increase our investment in key areas such as research and development, enterprise sales, services, technical support, security and data center infrastructure. We currently anticipate that this investment will include development of our next generation Encompass platform, which will be incrementally introduced over the coming quarters and throughout 2016. We expect the costs associated with these investments to increase our cost of revenues and operating expenses as a percentage of our revenues in 2015.

**Products and Services**

**Encompass**

Encompass is our proprietary, comprehensive mortgage management software solution that combines loan origination and enterprise management software for mortgage originators into an all-in-one system, and also provides seamless access to the investors, lenders and service providers on the Ellie Mae Network. Encompass helps users structure and streamline their mortgage origination process and facilitates collaboration among internal departments of a mortgage origination company. It supports efficiency in gathering, reviewing and verifying mortgage related data and in producing accurate documentation. It also enables enforcement of rules and business practices designed to ensure loan quality, adherence to processing standards and regulatory compliance.

Encompass provides the following features and benefits:

Feature	Benefits
Customer Acquisition and Relationship Management	<ul style="list-style-type: none"> <li>• Sales and marketing tools to help acquire and grow new business and pre-qualify prospective borrowers, while also allowing users to manage contacts, leads and marketing campaigns.</li> <li>• Integration to custom branded websites to help attract new borrowers and create new loans through an online application that flows directly into the Encompass loan pipeline.</li> <li>• Integration to a self-service portal where borrowers can research and apply for a loan online. Automatic lead follow-up and customer retention through campaign management capabilities that allow design and execution of multi-step marketing campaigns.</li> <li>• Pre-qualification tools to start loan applications, access integrated pricing engines and easily find appropriate loan products and prices for a borrower.</li> <li>• Automatic status updates posted to a branded website to keep customers and their real estate and other designated agents informed throughout the loan process.</li> <li>• Tools used to track the effectiveness of marketing and relationship building activities.</li> </ul>
Processing	<ul style="list-style-type: none"> <li>• Configurable pipeline, forms and workflow enable faster loan processing, reduced errors and more efficient business operations.</li> <li>• Support for multiple business channels using configurable workflows.</li> <li>• “Alert” management allows focus on urgent and relevant issues.</li> <li>•</li> </ul>

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Collaboration tools keep stakeholders informed and reduce need to manually notify other employees, partners and borrowers.

- Seamless access to EDM simplifies document handling and increases data security.



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Feature	Benefits
Risk Management and Business Reporting	<ul style="list-style-type: none"><li>• Centralization of all business data and electronic images.</li><li>• Built-in rules and safeguards to set and enforce business practices.</li><li>• Management dashboards highlighting key performance indicators.</li><li>• Predefined reports provide out-of-the-box intelligence and can be modified with a custom report writer.</li></ul>
Connectivity, Personalization and Integration	<ul style="list-style-type: none"><li>• Seamless and secure connections to thousands of service providers and investors on the Ellie Mae Network.</li><li>• Workflow management to define customer-specific business processes.</li><li>• User-defined experience through a personalized homepage.</li><li>• Integration with third-party applications through a software development kit to leverage existing technology investments.</li></ul>
Underwriting	<ul style="list-style-type: none"><li>• Ability to collaborate with all origination team members and respond effectively to underwriting requests and track underwriting conditions.</li><li>• Ability to communicate loan conditions, request and receive mortgage documents and track conditions and documents in a single system.</li><li>• Access to electronic copies of borrower documents within the loan file and compare them with actual loan data to reduce risk of data inconsistencies.</li></ul>
Secondary Marketing and Trade Management	<ul style="list-style-type: none"><li>• Ability to manage lock requests and accurately track buy-side and sell-side pricing.</li><li>• Ability to allocate loans that qualify for trades, track progress and capture key trade details.</li><li>• Ability to receive deadline-notification alerts to help avoid late-delivery fees.</li></ul>
Closing and Funding	<ul style="list-style-type: none"><li>• Ability to enter closing data, perform audits and order closing documents all within a single loan file.</li><li>• Automatic population of closing data on funding worksheets, helping to reduce errors and enable faster funding.</li></ul>
Post-Closing, Shipping and Delivery	<ul style="list-style-type: none"><li>• Comprehensive tracking, fulfillment and shipping of loan package.</li><li>• Tools to manage interim servicing before selling loans to investors.</li></ul>
Advanced Customization and Business Rule Management	<ul style="list-style-type: none"><li>• Enterprise-level functionality for higher level security, more granular control of processes and flexible customization of the software.</li><li>• Comprehensive control over workflow, business rules, processes and user groups.</li></ul>

Mortgage originators subscribe to SaaS Encompass, an on-demand solution that we host and which the customer accesses through the Internet. Mortgage originators using SaaS Encompass pay monthly per-user subscription fees or fees based on their monthly loan volume, either separately or as a bundled package, subject to monthly base fees. This Success-Based Pricing model also includes our Encompass Docs Solution and Encompass Compliance Service. Historically, we offered an on-premise version of Encompass. However, effective May 1, 2016, we will no longer provide software releases or technical support for the on-premise version of Encompass.

### Encompass Solutions and Services

Solutions offered within our on-demand platform include the Ellie Mae Total Quality Loan Program, Encompass CenterWise, Encompass TPO WebCenter, Encompass Docs Solution, Encompass Compliance Service, Encompass Product and Pricing Service, Encompass 4506-T Service, Encompass Appraisal Service, Encompass Flood Service

and Encompass CRM. We launched a new product in July 2014, Encompass Consumer Direct.

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**Ellie Mae Total Quality Loan Program:** The Ellie Mae Total Quality Loan Program, or TQL, is a centralized platform of services within Encompass that facilitates improved consistency, efficiency and loan quality. TQL enables the ordering of multiple necessary services, such as compliance, income verification, fraud checks, collateral risk, and flood certification, from one tool. If selling mortgages to investors, TQL also aligns the ordered services with those required by the specific investor to help expedite the sales process for both lender and investor.

**Encompass CenterWise:** Encompass CenterWise is a bundled offering of Encompass WebCenter and Encompass Electronic Document Management (EDM).

**Encompass WebCenter.** Encompass WebCenter provides the ability to create and customize professional websites for lender headquarters, branches and/or loan officers. Encompass WebCenter helps facilitate the interaction of Encompass users with borrowers, allowing prospective borrowers to initiate loan applications online. If an application is initiated online, it is fed into the loan originator's Encompass loan processing pipeline. Encompass WebCenter provides borrowers and their real estate agents real-time 24/7 loan status updates.

**Encompass Electronic Document Management.** Encompass EDM gives Encompass users the ability to go paperless and receive, store, manage documents, as well as deliver any documents electronically and securely to borrowers, real estate agents, lenders and settlement service providers. Encompass EDM creates virtual loan folders, or eFolders, containing all documents involved in the loan process including those generated by the Encompass software, documents received electronically and paper documents that are digitized using facsimile, document recognition and scanner technology. Encompass EDM gives borrowers the option to eSign or wet sign disclosures. Once a loan is funded, Ellie Mae servers retain the virtual loan folder for long-term storage and compliance.

**Encompass TPO WebCenter:** Encompass TPO WebCenter is a web-based extension of Encompass that enables loan level interaction between a third-party originator, or TPO, and a lender. Encompass TPO WebCenter provides a secure, synchronized web-based environment for the TPO to upload loan files and supporting documentation directly to the Encompass software used by the lender. As the lender confirms locks, changes milestones and adds conditions, the TPO sees what is happening in real-time through the Encompass TPO WebCenter, eliminating back and forth emails and faxes.

**Encompass Docs Solution:** Encompass Docs Solution is an integrated, comprehensive initial disclosure and closing document preparation solution that electronically generates the dozens of documents a borrower must receive and sign prior to the funding of a loan. Unlike other third-party document preparation services, mortgage originators using Encompass Docs Solution do not have to move loan data from their loan origination system to a separate closing system. The data, calculations and compliance tests are all within Encompass. As a result, Encompass Docs Solution increases the accuracy and efficiency of the document preparation to closing process.

**Encompass Compliance Service:** Encompass Compliance Service analyzes mortgage loan data for compliance with consumer protection laws and institutionally mandated compliance policies. Encompass Compliance Service can automatically run loan file checks multiple times during processing, underwriting, closing or funding a loan to check against a comprehensive set of federal and state laws and regulations. Quick results analysis and review capabilities help identify compliance problems or data that need correcting. Encompass Compliance Service is integrated with Encompass but can be used with other loan origination software as well.

**Encompass Product and Pricing Service:** Encompass Product and Pricing Service allows Encompass users to automatically compare qualified loan products with current pricing and easily pinpoint the best program for a borrower. Seamless two-way workflow sends information directly from the loan file to the product and pricing engine and adjustment information directly back into Encompass, incorporating loan officer compensation compliance rules into loan pricing.

**Encompass 4506-T Service:** Encompass 4506-T Service, which we license from a third party, is an integrated income verification solution that allows users to electronically order tax return data from the Internal Revenue Service, quickly receive reports back, and compare and validate the income stated on the loan application with the borrower's actual tax returns.

**Encompass Appraisal Service:** Encompass Appraisal Service, which we license from a third party, enables Encompass users to seamlessly order, track and retrieve appraisal reports from within Encompass. Users can manage their own panel of independent appraisers or work with one of Ellie Mae's integrated appraisal management companies.

Encompass Flood Service: Encompass Flood Service, which we license from a third party, allows Encompass users to order and transfer basic and life-of-loan flood zone determination electronically. Documentation and data are stored automatically for review and investor delivery.

**Encompass CRM:** Encompass CRM, which we acquired in connection with the MortgageCEO acquisition, includes a suite of sales and marketing tools that allows users to manage contacts, leads and marketing campaigns within Encompass. It also provides reporting and controls for marketing and sales efforts. We plan to introduce functionality and expand the capabilities of Encompass CRM over time.

**Encompass Consumer Direct:** Encompass Consumer Direct, which was first made available to SaaS Encompass users in July 2014, is a storefront for mortgage originators, providing a self-service model for borrowers. Prospective borrowers will have around the clock access to individualized rates, be able to request more information or be able to complete a guided, interactive mortgage application. Lenders receive fully complete, quality mortgage applications directly in Encompass with a high likelihood of closing. Encompass Consumer Direct keeps borrowers informed throughout the loan process of the loan status, and provides a secure portal for sending and receiving documentation.

The Ellie Mae Network

A key component of our SaaS version of Encompass is the Ellie Mae Network, which enables mortgage originators to choose from, and connect to, a broad array of investors, mega lenders and third-party service providers essential to the processing and funding of loans. Key functions of the Ellie Mae Network include the following:

- Mortgage originators can electronically and securely submit loan files to the investors and mega lenders to whom they intend to sell them, in order to have the loans underwritten and priced and to have loan rates locked.

- Mortgage originators can electronically order settlement services, including credit, title, appraisal, flood, compliance, mortgage insurance, fraud detection and other reports.

Investors, mega lenders and settlement service providers can gain instant electronic access to a large number of mortgage originators, potentially increasing their revenue opportunities and lowering their marketing, loan processing and customer support costs.

- Investors, mega lenders and service providers can access electronic and real-time marketing and quality enforcement services that facilitate business interactions with mortgage originators.

Investors, mega lenders and service providers enter into contracts with us that allow their proprietary operating systems to inter-operate with the Ellie Mae Network. Lenders and service providers generally pay us fees on a per transaction basis when the mortgage originator orders these services through the Ellie Mae Network. The table below describes some of the services that mortgage originators may order during the mortgage origination process.

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Type	Description
Credit Report	A report verifying a loan applicant's credit standing to statistically predict the likelihood of the applicant repaying future debts.
Product Eligibility and Pricing Engine	A service that allows a mortgage originator to compare loans offered by different lenders and investors to determine the best product and price available to a particular borrower.
Automated Underwriting	A service provided by Fannie Mae and Freddie Mac that analyzes and determines whether a loan meets their acquisition requirements.
Data Transmission to and from Lenders and Investors	Mortgage originators transmit data for loan underwriting, pricing and registration prior to delivery of the loan package to the lender.
Appraisal Report	An estimate of the value of the property securing the mortgage conducted by a licensed appraiser and used by the lender to determine whether the loan is adequately collateralized.
Title Report; Insurance	A report ordered on the property to examine public records to ensure that no one except the seller or borrower has a valid claim on the property and to disclose past and current facts regarding ownership of and liens on the property; title insurance protects the insured against any loss caused by defect of title to the property.
Flood Certification	A report that determines whether the property is located in a flood hazard area based on federal flood regulations and whether the lender or investor will require flood insurance on the property.
Compliance Review	A service that reviews a loan file to confirm whether a loan complies with federal, state and local regulations.
Fraud Detection	A service that searches through a number of data fields on a loan application, identifies inaccurate or inconsistent data or suspicious circumstances and delivers a fraud filter score report.
Document Preparation	A service that automates the process of preparing the legal documents required for closing a loan.
Mortgage Insurance	Insurance that protects mortgage lenders against loss in the event of default by the borrower, which can allow lenders to originate loans with lower down payments.
Income, Identity and Employment Verifications	Services that automate the verification of each of a borrower's income, identity and employment through a variety of sources, including the Internal Revenue Service, Social Security Administration and other third parties.

AllRegs

Our AllRegs product line is classified into four categories as follows.

AllRegs Academy: Through AllRegs Academy, we offer courses related to the mortgage industry. Customers can choose from a variety of delivery options, including self-paced training, instructor-led online courses, webinars, or live classroom training. Our courses allow our customers to meet continuing education requirements for state-licensed mortgage loan originators, as well as certification programs for mortgage industry professionals.

AllRegs Professional Services: We offer standard and custom documentation services that allow our customers to manage internal mortgage lending compliance. We also manage our customers' document and guideline publishing with private label branding and provide custom training and learning management solutions.

Data & Analytics: We track and make available information regarding investor loan products from many different mortgage investors. Our product AllRegs Market Clarity® enables mortgage originators to search across these numerous loan products, allowing them to select appropriate loan programs for their borrowers.

Research & Reference: We offer access to a comprehensive online database consisting of thousands of government and conventional lending guidelines and forms, as well as federal and state laws and regulations. We also provide access to federal disclosures and forms and state compliance resources including pending legislation and email updates and we are the exclusive electronic publisher of the Fannie Mae and Freddie Mac Single and Multi-Family Seller/Service Guides and the Federal Home Loan Banks' MPF Program Guidelines.

### Sales, Marketing and Customer Support

Our sales force consists of four distinct teams who are deployed across the country in Sales Development, New Account Acquisition, Solution Engineering and Account Management. These teams manage our customer accounts and focus on continuing to expand the customer base. They encourage adoption of the Ellie Mae Network, manage new product introductions and cross sell solutions added to our portfolio as a result of acquisitions.

To build brand awareness and generate sales leads, we conduct direct marketing campaigns, web-based workshops, public relations campaigns and media advertising. We attend and sponsor many mortgage and banking industry conferences and host our own user summit to strengthen our brand and broaden the business within our customer base. Our implementation and support teams promote best practices-based implementations to allow customers to support their preferred work flows and integrate with other critical systems while improving productivity and ensuring that they remain compliant. Our support and training teams offer live and online technical support and product training. Our product training catalog includes a variety of training programs including product certification programs, in-field custom seminars for larger groups of customers, live or recorded on-line webinars to assist customers in conducting a mortgage business in general and in using our products in particular, and in-product and training videos to allow training on demand.

### Technology

Our technology infrastructure supports all of our on-demand products and services.

#### Data Centers and Network Access

Our primary data centers are hosted by a leading SOC 1/SSAE-16 Type II certified provider of hosting services in Santa Clara, California and Chicago, Illinois. All applications provided by Ellie Mae will run actively in either of these two sites at any time. During 2012, we performed a complete refresh of our data centers and infrastructure to increase reliability, meet future scalability needs and support the product roadmap going forward. This effort significantly increased overall systems capacity while adopting industry standard certified design which is independently audited for security and scalability. We continued to add servers and storage capacity during 2013 and 2014 and we have significant updates planned for both data centers during 2015.

The data centers host all of the Ellie Mae Network services and SaaS versions of Encompass. The data centers are designed with fault tolerance protection for all layers of the platform and infrastructure, including routers, switches, load balancers and firewalls, as well as the web and application services and backend database connections. In the event of a complete site failure, such as may occur in the event of a regional natural disaster, all of the services in a site can be recovered to the other site as a part of our disaster recovery strategy.

#### Network Security

All sensitive data transmitted over public networks is encrypted using industry standard encryption protocols in order to protect sensitive data against third-party disclosure in transit. Servers and network components are secured with access control mechanisms and protected by hardened industry standard firewalls, virus protection and intrusion prevention/detection systems. Security services are monitored and updated in order to address emerging vulnerabilities. Even with our robust security monitoring and detection systems, we cannot guarantee that our security measures will prevent security breaches and we may need to expend significant resources to protect against and remedy any potential security breaches and their consequences. New threats and vulnerabilities are identified frequently and there are often time lags before our vendors deploy mitigations.

#### Research and Development

We devote substantial resources to enhance the features and functionality of our offerings as well as developing new products and services. We are developing the next generation Encompass platform, mobile applications and other products, and we are investing in the Encompass CRM and Encompass Consumer Direct solutions. In 2015, we currently anticipate that a portion of our research and development expenditures will be targeted towards preparation for TILA-RESPA Integrated Disclosure rule changes which take effect in August 2015.

Our research and development expenses totaled \$28.2 million, \$24.7 million and \$18.1 million in 2014, 2013 and 2012, respectively.



## Intellectual Property

Our success depends in large part on our proprietary products and technology for which we seek protection from a combination of patent, copyright, trademark and trade secret laws and other agreements with employees and third parties. We require our officers, employees and consultants to enter into standard agreements containing provisions requiring confidentiality of proprietary information and assignment to us of all inventions made during the course of their employment or consulting relationship. We also enter into nondisclosure agreements with our commercial counterparties and limit access to, and distribution of, our confidential information.

We are committed to developing and protecting our intellectual property and, where appropriate, file patent applications to protect our technology. We currently hold nine United States, or U.S., patents, with five patent applications pending. The term of any issued patent in the United States is generally 20 years from its filing date and if our applications are pending for a long time period, we may have a correspondingly shorter term for any patent that may issue. U.S. Patent Nos. 8,364,579 and 7,444,302, which apply to the Internet or cloud-based transaction platforms that connect our customers to lenders, vendors and Government Sponsored Enterprises in the Ellie Mae Network within the Encompass Loan Origination System, expire in 2024 and 2025, respectively. U.S. Patent Nos. 8,126,920, and 8,762,357, which apply to the enterprise security management system of the Encompass Loan Origination System, expire in 2029 and 2024, respectively. U.S. Patent Nos. 7,472,089 and 8,117,117, which apply to web integration of Loan Origination Software interfaces used in lender and vendor connections in the Ellie Mae Network, both expire in 2024. U.S. Patent No. 8,600,798, which applies to the loan screening in the Ellie Mae Network, expires in 2030. U.S. Patent Nos. 7,412,417 and 7,752,124, which apply to the Mavent rule-based validation engine and its automation used in our Encompass Compliance Service, both expire in 2020. Our present and future patents may provide only limited protection for our technology and may not be sufficient to provide competitive advantages to us. Furthermore, we cannot guarantee any patents will be issued as a result of our patent applications.

We hold a number of registered and unregistered trademarks, service names and domain names that are used in our business in the United States.

## Competition

The mortgage origination software market is highly competitive. There are many software providers catering to mortgage brokerages and mortgage lenders. Our current principal software competitors include: Byte Software Inc., a subsidiary of CBCInnovis; Calyx Technology, Inc.; DH Corporation; Mortgage Builder Software, Inc., a subsidiary of Altisource Portfolio Solutions SA; Black Knight Financial Services, LLC, a subsidiary of Fidelity National Financial, Inc.; Mortgage Cadence LLC, a subsidiary of Accenture PLC; and Wipro Gallagher Solutions, which is owned by Wipro, Ltd. Some of these software providers, including Calyx Technology, Inc., also provide connectivity between their software users and lenders and service providers.

## Competition with Software Providers

We compete against software providers based on our ability to provide:

- a comprehensive software solution that provides all business-critical functions including customer acquisition, loan processing, task management, communication with borrowers and other mortgage origination participants, reporting, regulatory compliance and general enterprise management;
- solutions that create efficiencies in gathering, reviewing and verifying mortgage-related data and producing accurate documentation;
- on-demand solutions that reduce the need for IT infrastructure and overhead while providing the ability to update capabilities and adopt new regulations in a timely manner;
- customizable business rules to automate processes, promote accountability and enforce business practices that help assure loan quality and regulatory compliance;
- a database architecture designed to reduce data errors and facilitate collaboration among departments within a mortgage origination company and comprehensive monitoring of the business of the entire enterprise;
- attractive pricing options, such as our Success-Based Pricing model, allowing customers to time payments to cash flow;
- an integrated network to submit loan files electronically and securely to lenders and electronically order all of the services necessary to originate a loan; and

security, reliability and data security.

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#### Competition with Service Providers

We only offer our other Encompass software services to Encompass users. There are many other service providers that also offer our Encompass users competing software services, including:

**Borrower-facing Websites.** We compete against providers of borrower-facing websites for mortgage originators, including: a la mode, inc.; DH Corporation and Mortgage Internet Technologies, Inc. (dba vLender.Com).

**Document Preparation Services.** We compete against document preparation service providers, including: DigitalDocs, Inc.; DocMagic Inc.; LenderLive Network, Inc.; MRG Document Technologies; Mortgage Banking Systems, Inc.; and Wolters Kluwer Financial Services, Inc.

**Compliance Services.** We compete against compliance software service providers, including: Interthinx, Inc., a subsidiary of First American Financial Corporation; LogicEase Solutions Inc., an investee of Corelogic, and Wolters Kluwer Financial Services, Inc.

**Product and Pricing Services.** We compete against product and pricing service providers, including: Insight Lending Solutions, Inc.; Mortech, Inc., a Zillow business; LoanLogics formerly NYLX, Inc. and Optimal Blue, LLC.

**Electronic Document Management.** We compete against EDM providers, including: Encomia LP; SigniaDocs, Inc.; VirPack Corporation and Xerox Mortgage Services, Inc.

We compete against these providers not only based on the quality of the service we offer, but also on integration of each specific service provided within Encompass's overall workflow. This enhances mortgage originators' control over the mortgage origination process and reduces errors and costs through the seamless exchange of data across applications and services.

#### Competition Regarding the Ellie Mae Network

The Ellie Mae Network is only available to mortgage originators using Encompass. The principal competition to the use of the Ellie Mae Network remains traditional methods of exchanging data and documents among mortgage industry participants by email, facsimile, phone, courier and mail. In addition, competition comes from mortgage originators using a standalone web browser to go individually to each investor, lender, or service provider's website and then manually upload loan data or enter information into the website. Mortgage originators may continue to use these methods due to habit, personal business relationships or for other reasons, despite the disadvantages of duplicative efforts, time delays, errors and costs, redundant paper documentation and potential privacy and security breaches.

Lenders and service providers, including those who participate on the Ellie Mae Network, can and do connect with mortgage originators that are not Encompass users in a variety of ways, including through other networks between mortgage originators and lenders and service providers such as Black Knight Financial Services, LLC, a subsidiary of Fidelity National Financial, Inc.

We compete with respect to the Ellie Mae Network based on offering mortgage originators accessibility to a critical mass of investors, lenders and service providers and enabling mortgage originators to transact all aspects of the mortgage origination process over the network. In addition, we compete with respect to the Ellie Mae Network by providing investors, lenders and service providers with greater access to the mortgage origination community, which enables them to increase their revenue opportunity and lower the cost of marketing and customer support.

We believe we generally compete favorably with our competitors; however, some of our actual and potential competitors enjoy substantial competitive advantages over us, such as longer operating histories and significantly greater financial, technical, marketing and other resources.

#### Government Regulation

The U.S. mortgage industry is heavily regulated. Mortgage originators, lenders, investors and service providers with which we do business are subject to federal, state and local laws that regulate and restrict the manner in which they operate in the residential mortgage industry, including Regulation X of RESPA, Regulation Z of TILA, the Mortgage Disclosure Improvement Act, and the Secure and Fair Enforcement for Mortgage Licensing Act of 2008, as amended. In addition, the passage of the Dodd-Frank Act has increased, and will continue to increase, regulation of the mortgage industry, including: generally prohibiting lenders from making residential mortgage loans unless a good faith determination is made of a borrower's creditworthiness based on verified and documented information; requiring the CFPB to enact regulations to help assure that consumers are provided with timely and understandable information about residential mortgage loans that protect them against unfair, deceptive and abusive practices; and requiring

federal regulators to establish minimum national underwriting guidelines for residential mortgages that lenders will be

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allowed to securitize and sell to third-party investors without retaining any of the loans' default risk. Although we are not directly subject to these laws and regulations, changes to these laws and regulations could broaden the scope of parties or activities subject to regulation and require us to comply with their restrictions, and new products and services developed by us may be subject to, or have to reflect, these laws or regulations.

In addition, we are subject to general business laws and regulations, regulations governing federal contractors and laws and regulations specifically governing the Internet, such as those covering taxation, tariffs, user privacy, data protection, pricing, content, copyrights, distribution, electronic contracts and other communications, consumer protection, broadband residential Internet access and the characteristics and quality of services.

#### Employees

At December 31, 2014, we had 640 full-time employees, including 110 in sales and marketing, 453 in research and development and technology and 77 in general and administrative functions. None of our employees are covered by a collective bargaining agreement.

#### Facilities

Our corporate headquarters are located in Pleasanton, California, in two facilities totaling 54,000 square feet, under subleases expiring in April 2015. We also have field-based staff operating in several areas around the country, primarily based in Irvine, California; Calabasas, California; San Diego, California; Eagan, Minnesota; Omaha, Nebraska; and Parsippany, New Jersey. In July 2014, we entered into a lease agreement for 105,000 square feet of office space in Pleasanton, California that will serve as our future corporate headquarters. The term of the lease commences on April 1, 2015 and has an initial term of 117 months ending December 31, 2024.

#### ITEM 1A. RISK FACTORS

You should carefully consider the risks described below and the other information in this report. If any of the following risks materialize, our business could be materially harmed, and our financial condition and results of operations could be materially and adversely affected. The risks described below are not the only ones facing us. Additional risks not currently known to us or that we currently believe are immaterial may also impair our business, results of operations, financial condition and liquidity.

We experienced a system outage in March 2014 that prevented some of our customers from being able to access certain of our services. This system interruption and future system interruptions that impair access to the Ellie Mae Network or SaaS Encompass could damage our reputation and brand and may substantially harm our business.

The satisfactory performance, reliability and availability of SaaS Encompass, the Ellie Mae Network, our website, our services, including our Encompass Compliance Service, and our network infrastructure are critical to our reputation and our ability to attract and retain Ellie Mae Network participants and Encompass users. Because our service is complex and incorporates a variety of hardware and proprietary and third-party software, our service may have errors or defects that could result in unanticipated downtime for our subscribers. Internet-based services frequently contain undetected errors when first introduced or when new versions or enhancements are released, and we have from time to time found defects in our service and new errors in our service may be detected in the future. In addition, our customers may use our service in unanticipated ways that may cause a disruption in service for other customers attempting to access their data.

Moreover, we have experienced and may in the future continue to experience temporary system interruptions, either to the Ellie Mae Network or to SaaS Encompass hosting locations, for a variety of reasons, including network failures, power failures, software errors, problems with Encompass and other third-party firmware updates, as well as an overwhelming number of Ellie Mae Network participants and Encompass users trying to access our network during periods of strong demand. For example, on March 31, 2014, we experienced a system outage that prevented some of our customers from being able to access certain of our services until the system was restored on April 1, 2014. Since our customers use our service for important aspects of their business, any errors, defects, disruptions in service or other performance problems could result in negative publicity, damage our reputation and brand, reduce our revenue, increase our operating expenses, negatively impact our ability to run our business, hinder our ability to enroll new customers and cause us to lose current customers, all of which could substantially harm our business and operating results.

In addition, our two primary data centers, located in Santa Clara, California and Chicago, Illinois, are hosted by a third-party service provider over which we maintain regular oversight but have little direct control. We depend on this

third-party service provider to provide continuous and uninterrupted access to the Ellie Mae Network and SaaS Encompass. If for any reason our relationship with this third party were to end unexpectedly, it could require a significant amount of time to transition the hosting

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of our data centers to a new third-party service provider. We are also subject to interruptions beyond our and our third-party service provider's control, such as disruptions or congestion in the portions of the Internet linking us to our customers. Since we are dependent on third parties for the implementation and maintenance of certain aspects of our systems and because some of the causes of system interruptions may be outside of our control, we may not be able to remedy such interruptions in a timely manner.

Our future performance will be highly dependent on our ability to continue to attract SaaS Encompass customers and grow revenues from new on-demand services.

To maintain or increase our revenues, we must increase the number of users of our software and the percentage of our software users who choose our on-demand SaaS Encompass offering, from which we generate greater revenues than from our on-premise license offering for which we will no longer provide software releases or technical support beginning in May 2016. We cannot guarantee our on-demand SaaS strategy, including our Success-Based Pricing model, will continue to be successful. If we are unable to increase the number of SaaS Encompass customers, our business may be materially adversely affected.

Our success will depend, to a large extent, on the willingness of mortgage lenders to continue to accept the SaaS model for delivering software applications that they view as critical to the success of their business. Our success will substantially depend on our ability to convince enterprises using on-premise enterprise software solutions to invest significant personnel and financial resources to migrate to our SaaS offering. It is difficult to predict customer adoption rates and demand for our services, the future growth rate and size of the SaaS market or the entry of competitive applications. The growth of the SaaS market depends on a number of factors, including the cost, performance and perceived value associated with SaaS offerings, as well as the ability of SaaS companies to address security and privacy concerns. If other SaaS providers experience security incidents, loss of customer data, disruptions in delivery or other problems, the market for SaaS applications as a whole, including our own products and services, may be negatively affected. If there is a reduction in demand for SaaS caused by technological challenges, weakening economic conditions, security or privacy concerns, competing technologies and products, decreases in corporate spending or otherwise, it could result in decreased revenues and our business could be adversely affected.

In order to grow our business, we must expand the use of settlement services on, and increase the number of transactions effected through, the Ellie Mae Network.

To grow our base of Ellie Mae Network participants, we and settlement service providers must continue to enhance the features and functionality of offerings to them. In addition, increasing the number of settlement service transactions effected through the Ellie Mae Network will depend, in part, on settlement service providers enhancing their technical capabilities, which is largely beyond our control.

We must also convince a variety of potential Ellie Mae Network participants, including mortgage lenders, originators, settlement service providers and mega lenders, of the benefits of electronic origination and network participation as compared to traditional mortgage origination methods including paper, facsimile, courier, mail and email.

We cannot guarantee that our Ellie Mae Network and other service offerings will achieve market acceptance. In the event these efforts are not successful, our business and growth prospects would be adversely affected.

Our failure to protect the confidential information of our Encompass users, our Ellie Mae Network participants and their respective customers could damage our reputation and brand and substantially harm our business.

Certain confidential information relating to our Encompass users, our Ellie Mae Network participants and their respective customers resides on our third-party hosted data center servers and is transmitted over our network. We rely on encryption as well as authentication technology licensed from third parties to effect secure transmission of confidential information over public networks, including personal information and credit card numbers. These security measures may be breached as a result of third-party action, including intentional misconduct by computer hackers, service provider error, malfeasance or otherwise. Customer data or our confidential information may be lost as a result of employee error or malfeasance. Our servers may also be vulnerable to computer viruses, break-ins and similar disruptions from unauthorized tampering with our computer systems, which could result in someone obtaining unauthorized access to our customers' data or our data, including our intellectual property and other confidential business information, or our IT systems. Because the techniques used to obtain unauthorized access to, or to sabotage, systems change frequently and generally are not recognized until launched against a target, we may be unable to anticipate these techniques or implement adequate preventative measures. The possession and use of personal

information in conducting our business subject us to legislative and regulatory burdens that may require notification to customers in the event of a security breach, restrict our use of personal information and hinder our ability to acquire new customers or market to existing customers.



We cannot guarantee that our security measures will prevent security breaches. Any such compromise of our security could damage our reputation and brand and expose us to a risk of loss or litigation or regulatory actions and potential liability, which would substantially harm our business and operating results. We may need to expend significant resources to protect against and remedy any potential security breaches and their consequences.

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

Our customers have no obligation to renew their subscriptions for our service after the expiration of their initial subscription period, which ranges from one to five years. They may also choose to renew their subscriptions at lower levels. In addition, in the first year of a subscription, customers often purchase a higher level of professional services than they do in renewal years. As a result, our ability to grow is dependent in part on customers purchasing additional subscriptions and services after the initial subscription term. We cannot accurately predict renewal rates given our varied customer base and the number of multi-year subscription contracts. Our customers' renewal rates may decline or fluctuate because of several factors, including their satisfaction or dissatisfaction with our services, the prices of our services, the prices of services offered by our competitors or reductions in our customers' spending levels due to the macroeconomic environment or other factors. If our customers do not renew their subscriptions for our services, renew on less favorable terms or do not purchase additional subscriptions or services, our revenues may grow more slowly than expected or decline and our profitability and gross margin percentage may be harmed.

Mortgage lending volume was significantly lower in 2014 than in 2013, and may decrease further in 2015 and future years, which would materially adversely affect our business.

Mortgage lending volume was significantly lower in 2014 than in 2013, and may decrease further in 2015 and future years. Factors that adversely impact mortgage lending volumes include increasing mortgage interest rates, reduced consumer and investor demand for mortgages, more stringent underwriting guidelines, decreased liquidity in the secondary mortgage market, high levels of unemployment, high levels of consumer debt, lower consumer confidence, changes in tax and other regulatory policies, the number of existing mortgages eligible for refinancing and other macroeconomic factors.

Mortgage interest rates are influenced by a number of factors, including monetary policy. The Federal Reserve Bank may raise the federal funds rate, which would likely cause mortgage interest rates to rise. Increases in mortgage interest rates could reduce the volume of new mortgages originated, in particular the volume of mortgage refinancings. Additionally, because the ratio of applications to closed loans typically is greater with refinancings than with purchase loans, a continued decrease in refinancings would result in fewer mortgage applications per funded loan. Since we generate some Ellie Mae Network revenues during the application process, regardless of whether the loan is eventually funded, this may continue to negatively impact our transaction based revenue.

We currently estimate that approximately 30% to 40% of our revenues have some sensitivity to volume. To the extent there is an additional decrease in residential mortgage volumes in 2015 compared to 2014, we would need to increase our user base and/or our revenue per loan processed by our customers in order to maintain our financial performance. We cannot guarantee we will be successful in these efforts, which could materially adversely affect our business.

A significant decline in mortgage origination volume, such as the significant drop in mortgage volume that occurred in 2014, could also negatively impact our customers, resulting in a reduction of their Encompass users, consolidation with other lenders or cessation of operations. If any of these occurs, it could materially adversely affect our business. We expect a number of factors to cause our operating results to fluctuate on a quarterly and annual basis, which may make it difficult to predict our future performance.

Our revenues and operating results have in the past varied and could in the future vary significantly from quarter-to-quarter and year-to-year because of a variety of factors, many of which are outside of our control. As a result, comparing our operating results on a period-to-period basis may not be indicative of future operating results. In addition to other risk factors discussed in this section, factors that may contribute to the variability of our quarterly and annual results include:

- the number of Encompass users;
- the volume of mortgages originated by Encompass users, especially users on our Success-Based Pricing model;
- transaction volume on the Ellie Mae Network;
- fluctuations in mortgage lending volume;

the relative mix of purchase and refinance volume handled by Encompass users;  
the level of demand for our services;

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the timing of the introduction and acceptance of Ellie Mae Network offerings and new on-demand services; any write-downs in the value of our property and equipment or intangible assets as a result of our investment or acquisition activities;

costs associated with defending intellectual property infringement and other claims; and

changes in government regulation affecting Ellie Mae Network participants or our business.

Due to these and other factors, our future results may not reach our internal projections. In addition, our operating results in future periods may not meet the expectations of investors or public market analysts who follow our company, which could cause our stock price to decline rapidly and significantly. The results of any prior quarterly or annual periods should not be relied upon as indications of our future operating performance.

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

Part of our business strategy is to target larger mortgage lenders that handle greater volumes of loans. As we target more of our sales efforts at larger customers, we could face greater costs, longer sales cycles and less predictability in completing some of our sales. In this market, the customer's decision to use our products and services may be an enterprise-wide decision and, if so, this type of sale could require us to provide greater levels of education regarding the use and benefits of our products and services. In addition, larger customers may demand more customization, implementation services and features. As a result of these factors, these sales opportunities may require us to devote greater sales support and professional services resources to individual customers, driving up costs and time required to complete sales and diverting our own sales and professional services resources to a smaller number of larger transactions, while potentially requiring us to delay revenue recognition on some of these transactions until the technical or implementation requirements have been met.

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

We continue to experience significant growth in our customer base, which has placed a strain on our management and administrative, operational and financial infrastructure. Additional investments in our implementation capabilities and research and development and general and administrative spending will be required to scale our operations and increase productivity, address the needs of our customers, further develop and enhance our products and services and scale with the overall growth of our company.

In addition, professional services, such as implementation services, are a key aspect of on-boarding new customers.

The implementation process is complicated and we will need to scale our capabilities in this area to meet future revenue targets. If a customer is not satisfied with the quality of work performed by us or with the type of services or solutions delivered, then we could incur additional costs to address the situation, the profitability of that work might be impaired, and the customer's dissatisfaction with our products and services could damage our ability to obtain additional work from that customer. In addition, negative publicity related to our customer relationships, regardless of its accuracy, may further damage our business by affecting our ability to compete for new business with current and prospective customers.

Our business strategy will place significant demands on our management and our infrastructure and will require significant expenditures and resources.

Our strategy of growing our business has placed and may continue to place significant demands on our management and our administrative, operational and financial infrastructure. As our operations grow in size, scope and complexity, we will need to improve and upgrade our systems and infrastructure, including our data centers and financial reporting systems. These upgrades and improvements are necessary in order to offer an increasing number of customers enhanced solutions, features and functionality and to ensure continued adequate controls over financial reporting.

In addition, the expansion of our systems and infrastructure and improvements to our products will require us to commit substantial financial, operational and technical resources in advance of any anticipated increase in the volume of business, with no assurance that the volume of business or our revenues will actually increase. For example, during 2015, we currently anticipate that we will increase our investment in research and development, enterprise sales, services, technical support, security and our data center infrastructure, including in connection with the development of our next generation Encompass platform. Continued growth could also strain our ability to maintain reliable service

levels for our customers, develop and improve our operational, financial and management controls, enhance our reporting systems and procedures and recruit, train and retain highly skilled personnel.

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Managing our growth will require significant expenditures and allocation of valuable management resources. We have been aggressively hiring talent in all areas of our business, which has significantly increased our expenses. If we fail to achieve the necessary level of efficiency in our organization as it grows, our business would be harmed. We periodically upgrade and/or replace various software systems to support our growth, including our new enterprise resource planning, or ERP, system. Unanticipated problems impacting the implementation of these systems could significantly increase the expenditures and resources allocated to them, divert the attention of management and harm our business. If the implementations of new applications are delayed, or if we encounter unforeseen problem with our new systems or in migrating away from our existing applications and systems, our operations and our ability to manage our business could be negatively impacted.

Integrating future acquisitions could disrupt our business, harm our financial condition and operating results or dilute or adversely affect the price of our common stock.

Our success will depend in part on our ability to expand our solutions and services and to grow our business in response to changing technologies, customer demands and competitive pressures. In some circumstances, we may pursue growth through the acquisition of complementary businesses, solutions or technologies rather than through internal development. For example, in October 1, 2014, we acquired substantially all the assets of Mortgage Resource Center, Inc., dba AllRegs, a provider of research and reference, education, documentation and data and analytics products relating to the mortgage industry. In January 2014, we acquired substantially all the assets of ARG Interactive, LLC (dba MortgageCEO), a SaaS company specializing in customer relationship management and marketing solutions for the residential mortgage industry.

The identification of suitable acquisition candidates can be difficult, time-consuming and costly, and we may not be able to complete acquisitions successfully. Moreover, if such acquisitions require us to seek additional debt or equity financing, we may not be able to obtain such financing on terms favorable to us or at all. Acquisitions and investments involve numerous risks which may have a negative impact on our results of operations, including:

- write-offs of acquired assets or investments;
- potential financial and credit risks associated with acquired customers;
- unknown liabilities associated with the acquired businesses;
- unanticipated expenses related to acquired technology and its integration into existing technology;
- limitations to our ability to recognize revenue from acquired deferred revenue;
- depreciation and amortization of amounts related to acquired intangible assets, fixed assets and deferred compensation; and
- adverse tax consequences of any such acquisitions.

For example, during the fourth quarter of 2014, we recorded a non-cash impairment charge to intangible assets acquired from MortgageCEO.

Even if we successfully complete an acquisition, we may not be able to assimilate and integrate effectively the acquired business, technologies, solutions, assets, personnel or operations, particularly if key personnel of an acquired company decide not to work for us. We may encounter difficulty in incorporating acquired technologies into our service and maintaining the quality standards that are consistent with our brand and reputation. In addition, we may issue debt or equity securities to complete an acquisition, which could dilute our stockholders' ownership and adversely affect the price of our common stock.

Events similar to the extreme turmoil in the residential mortgage industry that occurred from 2007 to 2009 could adversely affect our business.

From 2007 to 2009, the worldwide credit market was severely disrupted by the global financial crisis due to the precipitous rise of sub-prime mortgage delinquencies and resulting failure of securities backed by mortgages, including these sub-prime mortgages. This crisis resulted in extreme turmoil in the residential mortgage industry and caused many mortgage originators and other mortgage industry participants to go out of business. If the residential mortgage industry were to experience another similar disruptive event, our business could be materially adversely affected.

The residential mortgage industry is heavily regulated and changes in current legislation or new legislation could adversely affect our business.

Changes in the regulations that govern our customers could adversely affect our business.

The U.S. mortgage industry is heavily regulated. Federal and state governments and agencies could enact legislation or other policies that could negatively impact the business of our Encompass users and other Ellie Mae Network participants. Any changes to existing laws or regulations or adoption of new laws or regulations that increase restrictions on the residential mortgage industry may decrease residential mortgage volume or otherwise limit the ability of our Encompass users and Ellie Mae Network participants to operate their businesses, resulting in decreased usage of our solutions.

Changes in current legislation or new legislation may increase our costs by requiring us to update our products and services.

Changes to existing laws or regulations or adoption of new laws or regulations relating to the residential mortgage industry could require us to incur significant costs to update our products and services. Our Encompass Compliance Service analyzes mortgage loan data for compliance with consumer protection laws and institutionally mandated compliance policies and must continually be updated to incorporate changes to such laws and policies. The Dodd-Frank Act has caused and will continue to cause us to make similar updates to Encompass, Encompass Product and Pricing Service, Encompass Docs Solution, TQL and the Ellie Mae Network to address, among other things, regulations that protect consumers against unfair, deceptive and abusive practices by lenders. For example, additional tools and product updates were recently required to address the Ability-to-Repay, or ATR, / Qualified Mortgage, or QM, and Federal and State High Cost rules that became effective in January 2014. In addition, we will be updating certain of our products to comply with the TILA-RESPA Integrated Disclosure rule changes that take effect in August 2015. These additions and updates have caused us to incur significant expense, and future updates will likely similarly cause us to incur significant expense. In addition, if our products and services fail to address relevant laws and regulations, we could be subject to claims by our customers that we have breached the warranty provisions in our customer contracts. Such claims could result in substantial costs and we could incur judgments or enter into settlements of claims that could have a material adverse effect on our business.

Potential structural changes in the U.S. residential mortgage industry, in particular plans to diminish the role of Fannie Mae and Freddie Mac, could disrupt the residential mortgage market and have a material adverse effect on our business.

Fannie Mae and Freddie Mac play a very important role in providing liquidity, stability and affordability in the current U.S. residential mortgage market. In particular, they participate in the secondary mortgage market by purchasing mortgage loans and mortgage-related securities for investment and by issuing guaranteed mortgage-related securities. In February 2011, the Obama administration delivered a report to Congress which proposed the winding down of Fannie Mae and Freddie Mac and shrinking the federal government's role in the housing market. This proposal includes the withdrawal of government guarantees currently available for certain residential loans and increasing the down payment requirements for borrowers, both of which could reduce mortgage lending volume. In February 2012, the Federal Housing Finance Agency sent Congress a strategic plan to wind down Fannie Mae and Freddie Mac over the next several years. This proposal includes building a new infrastructure for the secondary mortgage market, continuing to shrink Fannie Mae's and Freddie Mac's operations by eliminating the direct funding of mortgages and shifting mortgage credit risk to private investors and maintaining foreclosure prevention activities and credit availability. In August 2012, the U.S. Department of the Treasury announced it would require Fannie Mae and Freddie Mac to reduce their investment portfolios more quickly, at an annual rate of 15% versus the previous rate of 10%. In June 2013, the U.S. Senate introduced a bill to wind down Fannie Mae and Freddie Mac over five years. This legislation would replace Fannie Mae and Freddie Mac with a new Federal Mortgage Insurance Corporation that would continue to guarantee mortgages, but only after private capital absorbs the first 10% of any losses. In July 2013, the U.S. House of Representatives also unveiled draft legislation to similarly wind down Fannie Mae and Freddie Mac over a five year period. In 2014, four Fannie Mae and Freddie Mac reform measures were active in Congress: the Senate's Johnson-Crapo and Corker-Warner, and the House's PATH Act and HOME Forward Act. The effects of these proposals, the passage of either of these bills into law or any significant structural change to the U.S. residential mortgage industry may cause significant disruption to the residential mortgage market. If we are unable to react

effectively and quickly to changes in the residential mortgage industry, our business could be harmed.

We may be limited in the way in which we market our business or generate revenue by U.S. federal law prohibiting referral fees in real estate transactions, and if we are found to be in violation of such laws we would be subject to significant liability.

RESPA generally prohibits the payment or receipt of fees or any other thing of value for the referral of business related to a residential real estate settlement service and prohibits fee shares or splits or unearned fees in connection with the provision of such services. Encompass software and services and the Ellie Mae Network were designed with payment methods that are not currently prohibited by the restrictions under RESPA. Nonetheless, RESPA may restrict our ability to enter into marketing and distribution arrangements with third parties for existing or newly developed products and services, particularly to the extent that

such arrangements may be characterized as involving payments for the referral of residential real estate settlement service business. Additionally, any amendments to RESPA or court opinions interpreting the provisions of RESPA that result in restrictions on our current payment methods, or any determination that our payment methods have been and currently are subject to the restrictions under RESPA, could have a material adverse effect on our business. If we were found to be in violation of RESPA rules, we would be exposed to significant potential liability that could have a material adverse effect on our reputation and business.

We depend on key and highly skilled personnel to operate our business, and if we are unable to retain our current or hire additional personnel, our ability to develop and successfully market our business could be harmed.

We believe our future success will depend in large part upon our ability to attract and retain highly skilled managerial, technical, finance, creative and sales and marketing personnel. Moreover, we believe that our future success is highly dependent on the contributions of our named executive officers. All of our officers and other employees are at-will employees, which means they may terminate their employment relationship with us at any time, and their knowledge of our business and industry would be extremely difficult to replace. In addition, the loss of any key employees or the inability to attract or retain qualified personnel could delay the development and introduction of, and harm our ability to sell, our solutions and harm the market's perception of us. Competition for qualified personnel is particularly intense in the San Francisco Bay Area, where our headquarters are located. Qualified individuals are in high demand, and we may incur significant costs to attract them. We may be unable to attract and retain suitably qualified individuals who are capable of meeting our growing sales, operational and managerial requirements, or may be required to pay increased compensation in order to do so. If we are unable to attract and retain the qualified personnel we need to succeed, our business will suffer.

Volatility or lack of performance in our stock price may also affect our ability to attract and retain our key employees. Our named executive officers are vested in a substantial amount of stock options and performance share awards.

Employees may be more likely to leave us if the shares they own or the shares underlying their vested options have significantly appreciated in value relative to the original purchase prices of the shares or the exercise prices of the vested options, or if the exercise prices of the options that they hold are significantly above the market price of our common stock. If we are unable to retain our named executive officers or other key employees, our business will be harmed.

We operate in a highly competitive market, which could make it difficult for us to attract and retain Encompass users and Ellie Mae Network participants.

The mortgage origination software market is highly competitive. There are many software providers, such as: Byte Software Inc., a subsidiary of CBCInnovis; Calyx Technology, Inc.; DH Corporation; Mortgage Builder Software, Inc., a subsidiary of Altisource Portfolio Solutions SA; Mortgage Cadence LLC, a subsidiary of Accenture PLC; and Wipro Gallagher Solutions, which is owned by Wipro, Ltd., that compete with us by offering loan origination software to mortgage originators. Some software providers, including Calyx Technology, Inc., also provide connectivity between their software users and lenders and service providers. Other connectivity alternatives are provided by services such as Black Knight Financial Services, LLC, a subsidiary of Fidelity National Financial, Inc., which aggregate service providers to make available such services to mortgage lenders. We also compete with compliance and document preparation service providers that are more established than us. There is vigorous competition among providers of these services and we may not succeed in convincing potential customers using other services to switch to ours. Many service providers connect directly to mortgage originators without using any loan origination software. In addition, some of our competitors are consolidating which facilitates greater cross-selling of services, which could weaken our ability to differentiate our offering in the market. Some of our competitors also offer services on a per closed loan basis, which could adversely impact the effectiveness of our Success-Based Pricing strategy for increasing the number of SaaS Encompass customers. If we are unsuccessful in competing effectively by providing attractive functionality, customer service or value, we could lose existing Encompass users to our competitors and our ability to attract new Encompass users could be harmed.

We only offer our Encompass services to Encompass users. There are many other service providers that offer our Encompass users competing services, including borrower-facing websites, document preparation services, compliance services and EDM. We may be unsuccessful in continuing to differentiate our Encompass service offerings to the extent necessary to effectively compete in some or all of these markets.



The Ellie Mae Network is only available to mortgage originators using Encompass. The principal alternative to the use of the Ellie Mae Network by Encompass users remains traditional methods of exchanging data and documents among mortgage industry participants by email, facsimile, phone, courier and mail. In addition, mortgage originators may use standalone web browsers to go individually to each investor, lender or service provider's website and then manually upload loan data or enter information into the website. Mortgage originators may continue to use these methods due to habit, personal business relationships or otherwise. The success of the Ellie Mae Network depends on our ability to achieve and offer access to both the critical mass of investors, lenders and service providers necessary to attract and retain mortgage originators using Encompass on the Ellie Mae

Network and the critical mass of active mortgage originators necessary to attract and retain investors, lenders and service providers on our network.

Some of our actual and potential competitors have longer operating histories and significantly greater financial, technical, marketing and other resources than we do and, as a result, these companies may be able to respond more quickly to changes in regulations, new technologies or customer demands, or devote greater resources to the development, promotion and sale of their software and services than we can. In addition, we may face increased competition as a result of continuing industry consolidation, such as: Altisource Portfolio Solutions SA's acquisition of Mortgage Builder Software, Inc. in July 2014; Accenture PLC's acquisition of Mortgage Cadence LLC in August 2013; DH Corporation's acquisitions of Harland Financial Solutions in August 2013, Mortgagebot LLC in April 2011 and Avista Solutions, Inc. in May 2012; Optimal Blue, Inc.'s acquisition of LoanSifter, Inc. in December 2013 and Fidelity National Financial, Inc.'s acquisition of Lender Processing Services, Inc. in January 2014. We expect the mortgage origination market to continue to attract new competitors and there can be no assurance that we will be able to compete successfully against current or future competitors or that competitive pressures we face will not materially adversely affect our business.

Failure to adapt to technological changes may render our technology obsolete or decrease the attractiveness of our solutions to our customers.

If new industry standards and practices emerge, or if competitors introduce new solutions embodying new services or technologies, Encompass and the Ellie Mae Network technology may become obsolete. Our future success will depend on our ability to:

- enhance our existing solutions;
- develop and potentially license new solutions and technologies that address the needs of our prospective customers;
- and
- respond to changes in industry standards and practices on a cost-effective and timely basis.

We must continue to enhance the features and functionality of Encompass, other Encompass services and the Ellie Mae Network. The effective performance, reliability and availability of Encompass, Encompass services and the Ellie Mae Network infrastructure are critical to our reputation and our ability to attract and retain Encompass users and Ellie Mae Network participants. If we do not continue to make investments in product development and, as a result, or due to other reasons, fail to attract new and retain existing mortgage originators, lenders, investors and service providers, we may lose existing Ellie Mae Network participants, which could significantly decrease the value of the Ellie Mae Network to all participants and materially adversely affect our business.

Failure to adequately protect our intellectual property could harm our business.

The protection of our intellectual property rights, including our proprietary Encompass software and Ellie Mae Network technology, is crucial to the success of our business. We rely on a combination of patent, copyright, trademark and trade secret law and contractual restrictions to protect our intellectual property. Our present and future patents may provide only limited protection for our technology and may not be sufficient to provide competitive advantage to us. Furthermore, we cannot guarantee any patents will be issued to us as a result of our patent applications. We also rely in part on confidentiality and invention assignment agreements with our employees, independent contractors and consultants. Despite our efforts to protect our proprietary rights, unauthorized parties may attempt to copy aspects of our Ellie Mae Network and Encompass features and functionality or obtain and use information that we consider proprietary. Enforcing our proprietary rights is difficult and may not always be effective. We have registered "Ellie Mae," "Encompass" and "AllRegs" and certain of our other trademarks as trademarks in the United States. Competitors may adopt service names similar to ours, thereby impeding our ability to build brand identity and possibly leading to customer confusion. In addition, there could be potential trade name or trademark infringement claims brought by owners of other registered trademarks or trademarks that incorporate variations of the terms Ellie Mae, Encompass or our other trademarks.

Litigation or proceedings before the U.S. Patent and Trademark Office or other governmental authorities and administrative bodies in the United States and abroad may be necessary in the future to enforce our intellectual property rights, protect our patent and copyright rights, trade secrets and domain names and determine the validity and scope of the proprietary rights of others. Our efforts to enforce or protect our proprietary rights may be ineffective and could result in substantial costs and diversion of resources and could harm our business.



Assertions that we infringe third-party intellectual property rights could result in significant costs and substantially harm our business.

Other parties have asserted, and may in the future assert, that we have infringed their intellectual property rights. For example, on March 25, 2011, we were named a defendant in a patent infringement lawsuit filed by Industry Access Incorporated alleging that our Encompass loan management software system and related operations infringes a patent and on March 19, 2013, Industry Access filed a second patent infringement lawsuit against us alleging that our products and services infringe two additional patents. We settled this matter in the third quarter of 2014. See Note 8 of the Notes to Condensed Consolidated Financial Statements. In addition, we generally agree to indemnify our customers against legal claims that our software products infringe intellectual property rights of third parties and, in the event of an infringement, to modify or replace the infringing product or, if those options are not reasonably possible, to refund the cost of the software, as pro-rated over a period of years. We cannot predict whether assertions of third-party intellectual property rights or claims arising from such assertions will substantially harm our business and operating results. If we are forced to defend against any infringement claims, whether they are with or without merit or are determined in our favor, we may face costly litigation and diversion of technical and management personnel. Furthermore, an adverse outcome of a dispute may require us to: pay damages, potentially including treble damages and attorneys' fees if the infringement were found to be willful; cease providing solutions that allegedly incorporate the intellectual property of others; expend additional development resources to redesign or re-engineer our solutions and products, if feasible; and enter into potentially unfavorable royalty or license agreements in order to obtain the right to use necessary technologies. We cannot be certain of the outcome of any litigation. Any royalty or licensing agreement, if required, may not be available to us on acceptable terms or at all. Our failure to obtain the necessary licenses or other rights could prevent the sale or distribution of some of our products and services and, therefore, could have a material adverse effect on our business.

If we fail to maintain proper and effective internal controls, our ability to produce accurate financial statements could be impaired, which could result in a loss of investor confidence in our financial reports, significant expenses to remediate any internal control deficiencies and ultimately have an adverse effect on the market price of our common stock.

As a publicly-traded company, we are subject to compliance with, among other regulations, Section 404 of the Sarbanes-Oxley Act of 2002, or SOX, which requires that we test our internal control over financial reporting and disclosure controls and procedures. Ensuring that we have adequate internal financial and accounting controls and procedures in place so that we can produce accurate financial statements on a timely basis is a costly and time-consuming effort that needs to be re-evaluated frequently. Our compliance with SOX requires that we incur substantial expense and expend significant management time on compliance-related issues. If we fail to achieve and maintain an effective internal control environment, we could suffer material misstatements in our financial statements and fail to meet our reporting obligations, which would likely cause investors to lose confidence in our reported financial information. This could harm our operating results and lead to a decline in our stock price. Additionally, ineffective internal control over financial reporting could expose us to increased risk of fraud or misuse of corporate assets and subject us to potential delisting from the New York Stock Exchange, regulatory investigations, civil or criminal sanctions and class action litigation.

As a third-party technology service provider of mission-critical products and services to many financial institutions that are regulated by one or more member agencies of the Federal Financial Institutions Examination Council, or FFIEC, we are subject to an IT examination by the member agencies of the FFIEC. As a result, the FFIEC conducts recurring IT Examinations in order to identify existing or potential risks associated with our operations that could adversely affect the financial institutions to whom we provide products and services, evaluate our risk management systems and controls and determine our compliance with applicable laws that affect the products and services we provide to financial institutions. In addition to examining areas such as our management of technology, data integrity, information confidentiality and service availability, the reviews also assess our financial stability. In June 2014 the FDIC, a member agency of the FFIEC, completed its IT examination, and found that, while the services we provide to our client banks are satisfactory, several matters required further attention, some of which were repeat findings and recommendations from the FDIC's 2012 examination. Although management has developed a plan for addressing these matters, we cannot be assured that the plan will satisfy the FDIC or applicable law. A sufficiently unfavorable

review from the FFIEC in the future could have a material adverse effect on our business and financial condition. If one or more U.S. states or local jurisdictions successfully assert that we should have collected or in the future should collect additional sales or use taxes on our fees, we could be subject to additional liability with respect to past or future sales, and the results of our operations could be adversely affected.

We do not collect state and local sales and use taxes on all sales in all jurisdictions in which our customers are located, based on our belief that such taxes are not applicable. Sales and use tax laws and rates vary by jurisdiction and such laws are subject to interpretation. Jurisdictions in which we do not collect sales and use taxes may assert that such taxes are applicable, which could result in the assessment of such taxes, interest and penalties, and we could be required to collect such taxes in the future. This additional sales and use tax liability could adversely affect the results of our operations.

Our business is subject to the risks of earthquakes, fires, floods and other natural catastrophic events and to interruption by man-made problems such as terrorism.

Our systems and operations are vulnerable to damage or interruption from earthquakes, fires, floods, power losses, telecommunications failures, terrorist attacks, acts of war and similar events. For example, a significant natural disaster, such as an earthquake, fire or flood, could have a material adverse impact on our business, operating results and financial condition, and our insurance coverage may be insufficient to compensate us for losses that may occur. Our corporate offices and one of the facilities we lease to house our computer and telecommunications equipment are located in the San Francisco Bay Area, a region known for seismic activity. In addition, acts of terrorism, which may be targeted at metropolitan areas with higher population density than rural areas, could cause disruptions in our or our customers' businesses or the economy as a whole. We may not have sufficient protection or recovery plans in certain circumstances, such as natural disasters affecting the San Francisco Bay Area, and our business interruption insurance may be insufficient to compensate us for losses that may occur.

Our stock price is volatile and purchasers of our common stock could incur substantial losses.

The trading price of our common stock may be subject to wide fluctuations in response to various factors, some of which are beyond our control. In addition to the factors discussed in this "Risk Factors" section and elsewhere in our filings with the SEC, these factors include:

- our operating performance and the operating performance of similar companies;
- the overall performance of the equity markets;
- the number of shares our common stock publicly owned and available for trading;
- threatened or actual litigation;
- changes in laws or regulations relating to our solutions;
- any major change in our board of directors or management;
- publication of research reports about us or our industry or positive or negative recommendations or withdrawal of research coverage by securities analysts;
- large volumes of sales of our shares of common stock by existing stockholders; and
- general political and economic conditions.

In addition, the stock market in general has experienced extreme price and volume fluctuations. Securities class action litigation has often been instituted against companies following periods of volatility in the overall market and in the market price of a company's securities. This litigation, if instituted against us, could result in very substantial costs, divert our management's attention and resources and harm our business.

Our stock repurchase program may be suspended or terminated at any time, which may result in a decrease in the trading price of our common stock.

Our board of directors previously approved a stock repurchase program under which we are authorized to repurchase up to \$75.0 million of our common stock over a 36-month period, all of which remains available as of December 31, 2014. Such stock repurchases may be limited, suspended, or terminated at any time without prior notice. There can be no assurance that we will repurchase additional shares of our common stock under our stock repurchase program or that any future repurchases will have a positive impact on the trading price of our common stock or earnings per share. Important factors that could cause us to limit, suspend or terminate our stock repurchase program include, among others, unfavorable market conditions, the trading price of our common stock, the nature of other investment or strategic opportunities presented to us from time to time, the rate of dilution of our equity compensation programs, the availability of adequate funds, and our ability to make appropriate, timely, and beneficial decisions as to when, how, and whether to purchase shares under the stock repurchase program. If we limit, suspend or terminate our stock repurchase program, our stock price may be negatively affected.

If securities or industry analysts discontinue publishing research or publish inaccurate or unfavorable research about our business, our stock price and trading volume could decline.

The trading market for our common stock depends in part on the research and reports that securities or industry analysts publish about us or our business. If one or more of the analysts who cover us downgrade our stock or publish inaccurate or unfavorable research about our business, our stock price would likely decline. If one or more of these analysts cease coverage of our company or fail to publish reports on us regularly, demand for our stock could decrease, which might cause our stock price and trading volume to decline.



Certain provisions in our charter documents and Delaware law could discourage takeover attempts and lead to management entrenchment.

Our amended and restated certificate of incorporation and amended and restated bylaws contain provisions that could have the effect of delaying or preventing changes in control or changes in our board of directors. These provisions include:

- a classified board of directors with three-year staggered terms, which may delay the ability of stockholders to change the membership of a majority of our board of directors;
- no cumulative voting in the election of directors, which limits the ability of minority stockholders to elect director candidates;
- the exclusive right of our board of directors to elect a director to fill a vacancy created by the expansion of the board of directors or the resignation, death or removal of a director, which prevents stockholders from being able to fill vacancies on our board of directors;
- the ability of our board of directors to determine to issue shares of preferred stock and to determine the price and other terms of those shares, including preferences and voting rights, without stockholder approval, which could be used to significantly dilute the ownership of a hostile acquirer;
- a prohibition on stockholder action by written consent, which forces stockholder action to be taken at an annual or special meeting of our stockholders;
- the requirement that a special meeting of stockholders may be called only by the chairman of the board of directors, the chief executive officer, the president or the board of directors, which may delay the ability of our stockholders to force consideration of a proposal or to take action, including the removal of directors; and
- advance notice procedures that stockholders must comply with in order to nominate candidates to our board of directors or to propose matters to be acted upon at a stockholders' meeting, which may discourage or deter a potential acquirer from conducting a solicitation of proxies to elect the acquirer's own slate of directors or otherwise attempting to obtain control of us.

We are also subject to certain anti-takeover provisions under Delaware law. Under Delaware law, a corporation may not, in general, engage in a business combination with any holder of 15% or more of its capital stock unless the holder has held the stock for three years or, among other things, the board of directors has approved the transaction.

#### ITEM 1B. UNRESOLVED STAFF COMMENTS

Not applicable.

#### ITEM 2. PROPERTIES

The following table sets forth the location and approximate square footage of each of our principal properties. All properties are leased under operating leases that expire at various times through 2019.

Location	Primary Use	Approximate Square Footage
Pleasanton, CA	Headquarters	54,000
San Diego, CA	Branch office	4,880
Omaha, NE	Branch office	10,500
Irvine, CA	Branch office	3,384
Calabasas, CA	Branch office	2,880
Parsippany, NJ	Branch office	2,200
Eagan, MN	Branch office	5,000



In July 2014, we entered into a lease agreement for 105,000 square feet of office space in Pleasanton, California that will serve as our future corporate headquarters. The term of the lease commences on April 1, 2015 and has an initial term of 117 months ending December 31, 2024. In addition, we believe that our branch offices are adequate for our current needs and that suitable additional or substitute space will be available as needed to accommodate foreseeable expansion of our operations.

### ITEM 3. LEGAL PROCEEDINGS

Information pertaining to our legal proceedings is incorporated by reference from Note 8 of the Notes to Consolidated Financial Statements.

### ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

## PART II

### ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

#### Market Information for Common Stock

Our common stock has been traded on the New York Stock Exchange, or NYSE, under the symbol "ELLI." The following table sets forth the high and low sales prices of our common stock as reported on the NYSE for the periods indicated.

	Low	High
Year ended December 31, 2013		
First Quarter	\$18.61	\$30.59
Second Quarter	\$21.00	\$26.34
Third Quarter	\$21.96	\$32.61
Fourth Quarter	\$22.46	\$33.24
Year ended December 31, 2014		
First Quarter	\$23.90	\$32.27
Second Quarter	\$23.62	\$31.99
Third Quarter	\$27.85	\$36.22
Fourth Quarter	\$31.05	\$42.66

#### Holder of Our Common Shares

As of February 27, 2015, there were approximately 64 holders of record of our common stock. Because many of our shares are held by brokers and other institutions on behalf of stockholders, we are unable to estimate the total number of stockholders represented by these record holders.

#### Dividend Policy

We have never declared or paid, and do not anticipate declaring or paying, any cash dividends on our common stock. Any future determination as to the declaration and payment of dividends, if any, will be at the discretion of our board of directors and will depend on then existing conditions, including our financial condition, operating results, contractual restrictions, capital requirements, business prospects and other factors our board of directors may deem relevant.

#### Performance Graph

The following graph compares the total cumulative shareholder return on our common stock with the total cumulative return of the NYSE Composite Index, and the S&P 500 North American Technology-Software Index for the period from April 15, 2011 (the date our common stock commenced trading on the NYSE MKT) through December 31, 2014. The graph reflects the closing sales price of \$6.77 per share on April 15, 2011 as the initial value of our common stock.

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	4/15/2011	12/31/2011	12/31/2012	12/31/2013	12/31/2014
Ellie Mae, Inc.	100.00	83.46	409.90	396.90	595.57
NYSE Composite	100.00	90.64	105.13	132.74	141.70
S&P 500 North American Technology-Software	100.00	87.52	102.77	134.74	153.44

Assumes that \$100.00 was invested in our common stock and in each index at market closing prices on April 15, 2011, and that all dividends were reinvested. The graph assumes our closing sales price on April 15, 2011 of \$6.77 \* per share as the initial value of our common stock. No cash dividends have been declared on our common stock since our initial public offering. Stockholder returns over the indicated period should not be considered indicative of future share prices or stockholder returns.

This performance graph shall not be deemed “filed” for purposes of Section 18 of the Exchange Act of 1934, or incorporated by reference into any filing of Ellie Mae, Inc. under the Securities Act of 1933, as amended except as shall be expressly set forth by specific reference in such filing.

Recent Sales of Unregistered Securities

None.

Purchases of Equity Securities by the Issuer and Affiliated Purchasers

None.

## ITEM 6. SELECTED CONSOLIDATED FINANCIAL DATA

The consolidated statements of operations data for the years ended December 31, 2014, 2013 and 2012 and the consolidated balance sheets data as of December 31, 2014 and 2013 are derived from our audited consolidated financial statements included elsewhere in this report. The consolidated statements of operations data for the years ended December 31, 2011 and 2010 and the consolidated balance sheets data as of December 31, 2012, 2011 and 2010 are derived from our audited consolidated financial statements not included elsewhere in this report. Our historical results are not necessarily indicative of future performance. You should read the following selected consolidated financial data below in conjunction with “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and the consolidated financial statements, related notes and other financial information included elsewhere in this report. The selected consolidated financial data in this section are not intended to replace the consolidated financial statements and are qualified in their entirety by the consolidated financial statements and related notes included elsewhere in this report.

	Year ended December 31,				
	2014	2013 (2)	2012	2011	2010
	(in thousands, except share and per share data)				
<b>Consolidated Statements of Operations Data:</b>					
Revenues	\$161,537	\$128,481	\$101,845	\$55,494	\$43,234
Cost of revenues (1)	46,283	32,630	23,114	15,784	12,505
Gross profit	115,254	95,851	78,731	39,710	30,729
Operating expenses:					
Sales and marketing (1)	26,544	21,331	17,887	12,126	9,555
Research and development (1)	28,228	24,695	18,053	12,975	10,468
General and administrative (1)	39,361	30,853	21,601	12,900	9,823
Total operating expenses	94,133	76,879	57,541	38,001	29,846
Income from operations	21,121	18,972	21,190	1,709	883
Other income (expense), net	488	460	(43	) 76	119
Income before income taxes	21,609	19,432	21,147	1,785	1,002
Income tax provision (benefit)	6,786	6,114	1,683	(1,835	) 225
Net income	\$14,823	\$13,318	\$19,464	\$3,620	\$777
Net income per share of common stock:					
Basic	\$0.53	\$0.50	\$0.83	\$0.23	\$0.22
Diluted	\$0.50	\$0.47	\$0.76	\$0.18	\$0.05
Weighted average shares outstanding:					
Basic	27,858,828	26,581,962	23,523,222	15,618,053	3,495,731
Diluted	29,593,873	28,502,403	25,537,192	20,649,451	17,146,735
	December 31,				
	2014	2013 (2)	2012	2011	2010
	(in thousands)				
<b>Consolidated Balance Sheet Data:</b>					
Cash and cash equivalents	\$26,756	\$33,462	\$44,114	\$23,732	\$14,349
Short-term investments	\$49,352	\$46,325	\$16,243	\$1,933	\$2,556
Long-term investments	\$58,679	\$56,285	\$43,728	\$—	\$—
Property and equipment, net	\$28,694	\$12,869	\$9,494	\$5,539	\$2,710
Working capital	\$78,733	\$78,161	\$58,784	\$19,965	\$15,788
Total assets	\$290,120	\$229,603	\$185,615	\$99,771	\$62,956
Redeemable convertible preferred stock	\$—	\$—	\$—	\$—	\$82,672
Total stockholders’ equity (deficit)	\$252,884	\$207,927	\$166,862	\$78,858	\$(31,825

(1 ) Stock-based compensation included in the above line items:

	Year ended December 31,				
	2014	2013	2012	2011	2010
	(in thousands)				
Cost of revenues	\$1,579	\$745	\$271	\$103	\$192
Sales and marketing	1,562	1,041	467	201	303
Research and development	3,672	3,469	1,552	406	443
General and administrative	7,735	9,004	4,559	970	1,130
Total	\$14,548	\$14,259	\$6,849	\$1,680	\$2,068

The Consolidated Statement of Operations for the year ended December 31, 2013 and the Consolidated Balance Sheet as of December 31, 2013 have been revised, primarily to reflect an immaterial correction of the income tax provision related to the deductibility of compensation to our executive officers for income tax purposes under Section 162(m) of the Internal Revenue Code. The primary impact of the revision to 2013 was a decrease in the tax provision of \$0.6 million. See Note 2 to our consolidated financial statements for further discussion.

ITEM 7. **MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

You should read the following discussion of our financial condition and results of operations in conjunction with the financial statements and the notes thereto included elsewhere in this Annual Report on Form 10-K. The following discussion contains forward-looking statements that reflect our plans, estimates and beliefs. Our actual results could differ materially from those discussed in the forward-looking statements. Factors that could cause or contribute to these differences include those discussed below and elsewhere in this Annual Report on Form 10-K, particularly in “Risk Factors” and “Special Note Regarding Forward-Looking Statements.”

**Overview**

We are a leading provider of innovative on-demand software solutions and services for the residential mortgage industry in the United States. Our end-to-end Encompass mortgage management solution provides one system of record that allows banks, credit unions and mortgage lenders to originate and fund mortgages and improve compliance, loan quality and efficiency.

Mortgage originators use our Encompass software, a comprehensive mortgage management system that handles key business and management functions involved in running a mortgage origination business. Mortgage originators use Encompass as a single tool for loan processing, marketing and customer communication and to interact electronically with lenders, investors and service providers over the Ellie Mae Network. Our software also enables enforcement of rules and business practices designed to ensure loan quality, adherence to processing standards and regulatory compliance.

We also offer Encompass users a variety of other on-demand services, including Encompass Docs Solution, which automatically prepares the disclosure and closing documents necessary to fund a mortgage; Encompass CenterWise, a bundled offering of electronic document management, or EDM, and websites used for customer relationship management; TQL, which offers a suite of fraud detection, valuation, validation and risk analysis services using streamlined workflows and processing rules; Encompass Compliance Service, which automatically checks for compliance with federal, state and local regulations throughout the origination process; tax transcript services, which provide income verification capability to our customers; Encompass Product and Pricing Service, which allows Encompass users to compare loans offered by different lenders and investors to determine appropriate mortgage programs available to a particular borrower; Encompass Flood Service, which allows Encompass users to order and transfer flood zone certifications; Encompass CRM, which offers a suite of sales and marketing tools that allows users to manage contacts, leads and marketing campaigns; Encompass Consumer Direct, a web-based tool that allows borrowers to complete a loan application online; and services under the AllRegs brand, which include research and reference, education, documentation and data and analytics products relating to the mortgage industry. By the nature of our on-demand service, even with our robust security monitoring and detection systems, we cannot guarantee that our security measures will prevent security breaches and we may need to expend significant resources to protect against and remedy any potential security breaches and their consequences.

The Ellie Mae Network electronically connects the approximately 109,000 mortgage professionals using Encompass to the broad array of mortgage lenders, investors and third-party service providers integral to the origination and funding of residential mortgages. During the mortgage origination process, mortgage originators may order various services through the Ellie Mae Network, including credit reports; product eligibility and pricing services; automated underwriting services; appraisals; title reports; insurance; flood certifications and flood insurance; compliance reviews; fraud detection; document preparation; and verification

of income, identity and employment. Mortgage originators can also initiate secure data transmission to and from lenders and investors.

On October 1, 2014, we acquired substantially all the assets of Mortgage Resource Center, Inc., dba AllRegs, a provider of research and reference, education, documentation and data and analytics products relating to the mortgage industry. The write-down of acquired deferred revenue in accordance with applicable purchase accounting rules under generally accepted accounting principles in the United States, or U.S. GAAP, resulted in us realizing lower amounts of revenues from the AllRegs business in the fourth quarter of 2014 than would normally be expected and will result in lower amounts of revenues than would normally be expected from the AllRegs business in the first nine months of 2015. The write-down of deferred revenue will no longer impact the revenues from the AllRegs business starting in 2016. Operating costs generated by the AllRegs business and the amortization of acquired intangible assets increased our operating expenses in the fourth quarter of 2014 and will contribute to our operating expenses for the foreseeable future.

Our revenues consist of on-demand and on-premise revenues. On-demand revenues are generated primarily from software subscriptions we host that customers access through the Internet, including customers who pay fees based on the number of loans they fund, or success basis, subject to monthly base fees, which we refer to as Success-Based Pricing, and related professional services, such as consulting, implementation and training services. On-demand revenues also include software services that are sold transactionally; Ellie Mae Network transaction fees paid by lender-investors, service providers and certain government-sponsored entities participating on the Ellie Mae Network; education and training; and loan product and guideline data and analytics services that are provided under the AllRegs brand. On-premise revenues are generated from customer-hosted software licenses and related professional services and maintenance services. In February 2015, we announced that effective May 1, 2016, we will no longer provide software releases or technical support for the on-premise version of Encompass. We expect that this will decrease the amount of on-premise revenues in 2015 and we do not expect significant on-premise revenues after May 1, 2016. Our on-demand revenues typically, but not always, track the seasonality of the residential mortgage industry, with increased activity in the second and third quarters and reduced activity in the first and fourth quarters as home buyers tend to purchase their homes during the spring and summer in order to move to a new home before the start of the school year. Mortgage volumes are also impacted by other factors, such as interest rate fluctuations, home sale activity and general economic conditions, which can lead to departures from the typical seasonal pattern. For example, increases in mortgage interest rates could reduce the volume of new mortgages originated and, in particular, the volume of mortgage refinancings. We currently estimate that approximately 30% to 40% of our revenues have some sensitivity to volume.

We are investing aggressively in initiatives that we believe will help us continue to grow our business, improve our products and services and strengthen our competitive advantage while bringing sustainable, long-term value to our customers. During 2014, we increased our investments in our sales and client services capabilities, research and development and technology infrastructure to support our user additions and overall business growth. These investments include expanding our talent across the organization by hiring additional personnel. To support customers and further differentiate ourselves, we currently anticipate that throughout 2015 we will continue to increase our investment in key areas such as research and development, enterprise sales, services, technical support, security and data center infrastructure. We currently anticipate that this investment will include development of our next generation Encompass platform, which will be incrementally introduced over the coming quarters and throughout 2016. We expect the costs associated with these investments to increase our cost of revenues and operating expenses as a percentage of our revenues in 2015.

On March 31, 2014, we experienced a system outage that prevented some of our customers from being able to access certain of our services until the system was restored on April 1, 2014. In responding to this outage, we engaged forensics experts and other consultants, resulting in significant forensics and consulting fees incurred in the second and third quarters of 2014. We have increased our investments to bolster our infrastructure and enhance our system capacity, reliability and security, which costs we expect will be incurred throughout 2015 and the foreseeable future. In addition to our internal initiatives, our business strategy has evolved to address recent industry trends, including:

- increased quality standards imposed by regulators, lenders and investors;

increased regulation affecting lenders and investors;  
greater focus by our customers on operational efficiencies;  
customers adopting multi-channel strategies; and  
greater focus by customers and regulators on data security and consumer privacy

We are responding to these trends as follows:

Increased quality standards imposed by regulators, lenders and investors. Encompass is designed to automate and streamline the process of originating mortgages to, among other things, satisfy increased quality requirements of investors. Relevant features of Encompass include enabling customers' management to impose processing rules and formats, and providing milestone and

process reminders, automated population of forms with accurate data, and accurate and automated transmission of loan files and data from originators to investors and lenders. Our TQL program is designed to further enhance the quality, compliance and saleability of loans that are originated through Encompass. Additionally, TQL is intended to reduce the opportunities for errors in the process of transferring information from originator to investor and to give investors confidence in the accuracy and regulatory compliance of the information that is underlying loan files. In response to the increased quality standards and compliance mandates affecting the industry, we expect an increased number of mortgage lenders to assess new platform options and replace their legacy systems. We have increased the size of our customer acquisition, implementation and support teams by approximately 110% from 154 employees at December 31, 2012 to 324 employees at December 31, 2014 in order to address anticipated demand for our software solutions.

Increased regulation affecting lenders and investors. Regulatory reforms have significantly increased the complexity and importance of regulatory compliance. We devote considerable resources to continually upgrading software to help customers address regulatory changes. We offer Encompass Compliance Service, which analyzes mortgage loan data for compliance with consumer protection laws and institutionally mandated compliance policies and alerts users to possible violations of these laws and policies. In addition, we have a staff of attorneys and work with compliance experts who help ensure that documents prepared using our software and the processes recommended by the Encompass workflow comply with applicable rules and regulations. For example, additional tools and product updates were recently required to address the Ability-to-Repay, or ATR, / Qualified Mortgage, or QM, and Federal and State High Cost rules that became effective in January 2014. In addition, we will be updating certain of our products to comply with the TILA-RESPA Integrated Disclosure rule changes that take effect in August 2015. We believe we are also well-positioned to help our customers meet future Dodd-Frank Act requirements as they are published and become effective.

Greater focus on operational efficiencies. Mortgage originators experienced a \$2,263 increase in the average total production cost per loan, from \$3,685 in 2009 to \$5,948 in 2013.<sup>1</sup> During the third quarter of 2014, the average total production cost per loan was \$6,769,<sup>2</sup> and we expect costs to continue to be a significant consideration for mortgage originators due to continued increased regulation and heightened quality standards. By automating many of the functions of mortgage origination, we enable our users to comply with regulations and process quality loans more efficiently and effectively. This reduces the cost of originating a loan and lowers the risk of buy-back demands from investors resulting from poorly originated or documented loans or loans that fail to comply with applicable regulations. We continually address the changing needs of our customers by developing and enhancing tools to allow for simplified regulatory compliance, increased availability of information, and enhanced system functionality and performance.

With an eye towards providing customers with ever-improving tools to enhance efficiency, we currently anticipate that we will continue to develop new service offerings through the Ellie Mae Network and pursue adoption of our services through initiatives such as our TQL program. By integrating and expanding our current and new services, we aim to provide a more comprehensive benefit to our users.

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<sup>1</sup> Mortgage Bankers Association, Annual Mortgage Bankers Performance Report 2013 Data, Net Loan Production Income and Expense, \$ per loan, Copyright May 2014.



2 Mortgage Bankers Association, Independent Mortgage Bankers Profits Drop Slightly Despite Higher Volume in the Third Quarter of 2014, December 4, 2014.

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Customers adopting multi-channel strategies. Customers are developing multi-channel strategies beyond a single retail, correspondent or wholesale mortgage lending channel in order to grow their businesses. The requirements of these different channels vary and in order to maintain a single operating system, customers must use a robust system with customizable functionality. Encompass includes support for multi-channel workflows, allowing our customers to drive efficiencies and boost productivity by creating distinct workflows for each channel that map to our customers' business needs. Encompass users can customize workflows based on channel, loan purpose or specific loan criteria - all of which can vary between lending channels. Additionally, Encompass Consumer Direct gives our customers the ability to originate loans directly from borrowers by offering an online loan application that can be accessed by anyone with a web browser.

Greater focus by customers and regulators on data security and consumer privacy. Recent high-profile data security incidents affecting banking institutions and cloud-service software providers have resulted in an increased focus on data security by our customers and our customers' regulators. We are making significant investments in the security of the Encompass service, as well as our internal systems, processes and monitoring capabilities to protect our customers' data and minimize the risk of data security loss. We expect the industry focus on data security to continue to increase, and we anticipate that our investments in data security will increase substantially over time.

#### Acquisition Strategy

Our industry is highly fragmented, and we believe there are strategic opportunities available to acquire competing software companies or software providers that offer related mortgage origination functionality that will complement and increase the attractiveness of our solutions. In October 2014, we acquired substantially all the assets of Mortgage Resource Center, Inc. (dba AllRegs), or AllRegs, a provider of research and reference, education, documentation and data and analytics products relating to the mortgage industry. The assets that we acquired from AllRegs will allow us to strengthen our products through product integration and introduce new products related to training, compliance management systems and loan product eligibility. In January 2014, we acquired substantially all the assets of ARG Interactive, LLC (dba MortgageCEO), or MortgageCEO, a SaaS company specializing in customer relationship management and marketing solutions for the residential mortgage industry. We intend to continue pursuing additional strategic acquisitions.

#### Operating Metrics

We use certain operational metrics to evaluate our business, determine allocation of our resources and make decisions regarding corporate strategy. We focus on these metrics to determine our success in leveraging our user base to increase our revenues and to gauge the degree of our market penetration.

These metrics are defined below.

Contracted revenues. Contracted revenues are those revenues that are fixed by the terms of a contract and are not affected by fluctuations in mortgage origination volume. These revenues consist of the base fee portion of success-based SaaS Encompass revenues, monthly per-user subscription SaaS Encompass revenues, professional services revenues, on-premise revenues, revenues from sales of AllRegs services and subscription revenues paid for products other than Encompass.

SaaS Encompass revenues. SaaS Encompass revenues are those revenues earned from the customer's usage of the SaaS version of Encompass. These revenues consist of success-based SaaS Encompass revenues and subscription-based SaaS Encompass revenues.

Active Encompass users. An active Encompass user is a mortgage origination professional who has used Encompass at least once within a 90-day period preceding the measurement date. An Encompass user is a mortgage origination professional working at an Encompass mortgage lender, such as a mortgage bank, commercial bank, thrift or credit union, which sources and funds loans and generally sells these funded loans to investors; or a mortgage brokerage, which typically processes and submits loan files to a mortgage lender or mega lender that funds the loan.

Contracted SaaS users. A contracted SaaS user is a mortgage origination professional who has a license to use SaaS Encompass and has an obligation to pay for this license, but who is not necessarily an active user.

Active SaaS Encompass users. An active SaaS Encompass user is a mortgage origination professional who has used SaaS Encompass at least once within a 90-day period preceding the measurement date.

Average active Encompass users. Average active Encompass users during a period is calculated by averaging the monthly active Encompass users during a period.

Average active SaaS Encompass users. Average active SaaS Encompass users during a period is calculated by averaging the monthly active SaaS Encompass users during a period.

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Revenue per average active Encompass user. Revenue per average active Encompass user is calculated by dividing total revenues by average active Encompass users during a period.

SaaS Encompass revenue per average active SaaS Encompass user. SaaS Encompass revenue per average active SaaS Encompass user is calculated by dividing total SaaS Encompass revenues by average active SaaS Encompass users during the period.

The following table shows these operating metrics as of and for the years ended December 31, 2014, 2013 and 2012:

	Year ended December 31,				
	2014	2013	2012		
Revenues (in thousands):					
Total revenues	\$ 161,537	\$ 128,481	\$ 101,845		
Total contracted revenues	\$ 102,477	\$ 71,453	\$ 48,768		
Total SaaS Encompass revenues	\$ 98,260	\$ 75,783	\$ 47,940		
Users at end of period:					
Contracted SaaS users	126,346	95,044	60,187		
Active Encompass users	108,933	92,161	73,687		
Active SaaS Encompass users	84,905	63,695	41,458		
Active SaaS Encompass users as a percentage of active Encompass users	78	% 69	% 56	%	
Active SaaS Encompass users as a percentage of contracted SaaS Encompass users	67	% 67	% 69	%	
Average users during period:					
Active Encompass users	100,238	87,276	63,993		
Active SaaS Encompass users	74,168	55,421	33,203		
Active SaaS Encompass users as a percentage of active Encompass users	74	% 64	% 52	%	
Revenue per average user during period:					
Revenue per average active Encompass user	\$ 1,612	\$ 1,472	\$ 1,592		
SaaS Encompass revenue per average active SaaS Encompass user	\$ 1,325	\$ 1,367	\$ 1,444		

In February 2015, we announced that effective May 1, 2016, we will no longer provide software releases or technical support for the on-premise version of Encompass. Some on-premise Encompass users may not convert to SaaS Encompass, which could affect the number of active Encompass users in future periods.

#### Basis of Presentation

##### General

Our consolidated financial statements include the accounts of Ellie Mae, Inc. and its wholly owned subsidiaries. All significant intercompany accounts and transactions have been eliminated upon consolidation.

##### Revenue Recognition

We generate revenues primarily from transaction-based fees and fees for software and related services. Our software can be accessed either through a company-hosted subscription or a customer-hosted license. Accordingly, our revenues are described as on-demand and on-premise revenues. Sales taxes assessed by governmental authorities are excluded from revenue.

In the notes to the consolidated financial statements on our Annual Reports on Form 10-K for the years ended December 31, 2013 and 2012, we included all revenues from professional services in on-premise revenues in our disclosure related to revenues by type. For the year ended December 31, 2014, we included professional services revenues in either on-demand revenues or on-premise revenues as determined by the related service or software license revenue. We have retrospectively reclassified our disclosure of on-demand and on-premise revenues for the years ended December 31, 2013 and 2012 in order to conform to the current presentation.

#### On-demand Revenues

On-demand revenues are revenues generated from company-hosted software subscriptions that customers access through the Internet and revenues from customers that pay fees based on a per closed loan, or success, basis subject to monthly base fees, which we refer to as Success-Based Pricing. Additionally, on-demand revenues are comprised of software services sold transactionally; Ellie Mae Network transaction fees; education and training, loan product and guideline data and analytics services under the AllRegs brand; and professional services which include consulting, implementation and training services.

#### On-premise Revenues

On-premise revenues are revenues generated from maintenance services, sales of customer-hosted software licenses, and professional services.

#### Cost of Revenues and Operating Expenses

##### Cost of Revenues

Our cost of revenues consists primarily of: salaries and benefits, including stock-based compensation expense; expenses for document preparation, income verification and compliance services; customer support; data centers; depreciation on computer equipment used in supporting the Ellie Mae Network, SaaS Encompass and Encompass CenterWise offerings; amortization of acquired intangible assets such as developed technology and trade names; amortization of internal-use software; professional services associated with implementation of our software and allocated facilities costs. We expect that our cost of revenues will continue to increase in absolute dollars as our revenues increase, as we pursue additional strategic acquisitions, as we place new internal-use software into service and as we continue to hire additional personnel in our implementation and customer support departments to support new customers.

##### Sales and Marketing

Our sales and marketing expenses consist primarily of: salaries, benefits and incentive compensation, including stock-based compensation expense and commissions; allocated facilities costs; expenses for trade shows, public relations and other promotional and marketing activities; expenses for travel and entertainment; and amortization of acquired intangible assets such as customer relationships. We expect that our sales and marketing expense will continue to increase as we continue to hire additional sales personnel in order to address anticipated demand for our software solutions and as we pursue additional strategic acquisitions. We also intend to increase marketing activities focused on SaaS Encompass, our Ellie Mae Network offerings and our other Encompass services.

##### Research and Development

Our research and development expenses consist primarily of: salaries and benefits, including bonuses and stock-based compensation expense; fees to contractors engaged in the development and support of the Ellie Mae Network, Encompass software and other products; and allocated facilities costs. We expect that our research and development expenses will continue to increase in absolute dollars as we continue to invest in our products and services and related next-generation enhancements, including hiring additional engineering and product development personnel and as we pursue additional strategic acquisitions.

##### General and Administrative

Our general and administrative expenses consist primarily of: salaries and benefits, including bonuses and stock-based compensation expense for employees involved in finance, accounting, human resources, administrative, information technology and legal roles; consulting, legal, accounting and other professional services by third-party providers; and allocated facilities costs. General and administrative expenses recognized during the second and third quarters of 2014 also included forensic and consulting fees incurred in response to a service outage that occurred at the end of the first quarter and legal expenses in connection with the settlement of a legal claim. We expect general and administrative expenses to continue to increase in absolute dollars as we make additional and accelerated investments to bolster our infrastructure and enhance our system capacity, reliability and security. We also expect increases to general and administrative expenses as we hire additional personnel and grant stock-based awards to attract and retain the employees needed to continue to grow our business and as we pursue additional strategic acquisitions.

##### Other Income, Net

Other income, net consists of: interest income earned on investments, cash accounts and notes receivable, offset by investment discount amortization and imputed interest expense related to our acquisition holdback payments and

interest expense paid on equipment and software leases.

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### Income Taxes

On a quarterly basis, we evaluate our expected income tax expense or benefit based on our year-to-date operations, and we record an adjustment in the current quarter. The net tax provision is the result of the mix of profits earned by us and our subsidiaries in tax jurisdictions with a broad range of income tax rates. We are required to estimate deferred tax assets and liabilities based on the differences between the financial reporting and tax bases of assets and liabilities measured using the enacted tax rates that will be in effect when the differences are expected to reverse. In general, deferred tax assets represent future tax benefits to be received when certain expenses previously recognized in our consolidated statements of operations become deductible expenses under applicable income tax laws or loss or credit carry forwards are utilized. Accordingly, realization of our deferred tax assets is dependent on future taxable income against which these deductions, losses and credits can be utilized. We use management judgment to assess the likelihood that our deferred tax assets will be recovered from future taxable income and to the extent we believe that recovery is not more likely than not, we must establish a valuation allowance to reduce the deferred tax assets to the amount that is more likely than not to be realized.

### Critical Accounting Policies and Estimates

Our discussion and analysis of our financial condition and results of operations are based on our consolidated financial statements which are prepared in accordance with GAAP. The preparation of these consolidated financial statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, expenses and related disclosures. We evaluate our estimates and assumptions on an ongoing basis. Our estimates are based on historical experience and various other assumptions that we believe to be reasonable under the circumstances. Our actual results could differ from these estimates.

We believe that the assumptions and estimates associated with revenue recognition, income taxes, stock-based compensation, goodwill and intangible assets, fair value of investments, deferred commissions and software and website development costs have the greatest potential impact on our consolidated financial statements. Therefore, we consider these to be our critical accounting policies and estimates. For further information on all of our significant accounting policies, please see Note 2 of the Notes to Consolidated Financial Statements.

### Revenue Recognition

We generate revenues from sales of software and services. We categorize our revenues as either on-demand or on-premise revenues.

#### On-Demand Revenues

**Subscription Services and Usage-Based Fee Arrangements.** Subscription services and usage-based fee arrangements generally include a combination of our products delivered as SaaS and support services. These arrangements are generally non-cancelable and do not contain refund-type provisions. These revenues typically include the following: **SaaS Encompass Revenues.** We offer web-based, on-demand access to our Encompass software for a monthly recurring fee. We provide the right to access our loan origination software and handle the responsibility of managing the servers, providing security, backing up the data and applying updates. Customers under SaaS arrangements may not take possession of the software at any time during the term of the agreement. Subscription revenues are recognized ratably over the contract terms as subscription services are provided, beginning on the commencement date of each contract, which is the date the Company's service is made available to customers. Contracts generally range from one to five years. Alternatively, customers can elect to pay on a success basis. Success basis contracts generally have a term of one to five years and are subject to monthly base fees, which enable customers to close loans up to a contractually agreed-to minimum number of transactions, and additional closed loan fees, which are assessed for loans closed in excess of the minimum. Revenue is earned from both base fees and additional closed loan fees as the result of the customer's usage of Encompass. Monthly base fees are recognized over the respective monthly service period as the subscription services are provided. Additional closed loans fees are recognized when the loans are reported as closed. This offering also includes Encompass CenterWise, Encompass Compliance Service and Encompass Docs Solution as integrated components, which are combined elements of the arrangement that are delivered in conjunction with the SaaS Encompass offering and therefore are not accounted for separately.

**Encompass CenterWise Revenues.** Encompass CenterWise is a bundled offering of EDM and websites used for customer relationship management. Generally, revenue is recognized for Encompass CenterWise after the service is rendered, except when Encompass CenterWise is automatically included as an integrated component of the SaaS

Encompass offering, in which case the associated revenue is recognized as described above.

**Services Revenues.** We provide a variety of mortgage-related and other business services, including automated documentation; fraud detection, valuation, validation and risk analysis; income verification; marketing and customer management; flood zone certifications; and compliance reports. Services revenues are recognized upon completion of the services.



**Transactional Revenues.** We have entered into agreements with various lenders, service providers and certain government-sponsored entities participating in the mortgage origination process that provide them access to, and ability to interoperate with, mortgage originators on the Ellie Mae Network. Under these agreements, we earn transaction fees when transactions are processed through the Ellie Mae Network. Transaction revenues are recognized when there is evidence that the qualifying transactions have occurred on the Ellie Mae Network and collection of the resulting receivable is reasonably assured.

**Subscriptions to Online Research and Data Resources:** We provide mortgage originators and underwriters with access to online databases of various federal and state laws and regulations and forms as well as mortgage investor product guidelines. Subscription fees are recognized ratably over the subscription term as subscription services are provided, which is typically one year.

**Professional Services Revenues:** Professional services revenues are generally recognized when milestones are achieved for fixed price contracts or as the services are rendered for time and material contracts. The majority of our professional services contracts are on fixed price basis. Training revenues are recognized as the services are rendered.

#### **On-Premise Revenues**

Revenue from the sale of software licenses is recognized in the month in which the required revenue recognition criteria are met, generally in the month in which the software is delivered. Revenue from the sale of maintenance services and professional services is recognized over the period in which the services are provided.

#### **Multiple Element Arrangements**

We have entered into both subscription services and software arrangements with multiple elements. For arrangements with multiple deliverables, we evaluate whether the individual deliverables qualify as separate units of accounting. In order to treat deliverables in a multiple-deliverable arrangement as separate units of accounting, the deliverables must have standalone value upon delivery.

Subscription services agreements with multiple elements generally include multiple subscriptions and professional services. When such agreements involve multiple elements that qualify as separate units of accounting, we allocate arrangement consideration to all deliverables at the inception of an arrangement based on the relative selling price method in accordance with the selling price hierarchy, which includes: (i) vendor specific objective evidence, or VSOE, if it is available; (ii) third-party evidence, or TPE, if VSOE is not available; and (iii) the best estimate of selling price, or BEBP, if neither VSOE nor TPE is available.

**VSOE.** We determine VSOE based on our historical pricing and discounting practices for the specific product or service when sold separately. In determining VSOE, we require that a substantial majority of the selling prices for these services fall within a reasonably narrow pricing range. We have not historically priced our subscription services within a narrow range. As a result, we have not been able to establish selling prices for subscription services based on VSOE.

**TPE.** When VSOE cannot be established for deliverables in multiple element arrangements, we apply judgment with respect to whether we can establish a selling price based on TPE. TPE is determined based on competitor prices for similar deliverables when sold separately. Generally, our go-to-market strategy differs from that of our peers and our offerings contain a significant level of differentiation such that the comparable pricing of services with similar functionality cannot be obtained. Furthermore, we are unable to reliably determine what similar competitor services' selling prices are on a standalone basis. As a result, we have not been able to establish selling prices based on TPE.

**BESP.** When we are unable to establish a selling price using VSOE or TPE, we use BEBP in our allocation of arrangement consideration. The objective of BEBP is to determine the price at which we would transact a sale if the service was sold on a standalone basis. When establishing BEBP, we review company specific factors used to determine list price and make adjustments as appropriate to reflect current market conditions and pricing behavior. Our process for establishing list price includes assessing the cost to provide a particular product or service, surveying customers to determine market expectations, analyzing customer demographics and taking into account similar products and services historically sold by us. We continue to review the factors used to establish list price and adjust BEBP as necessary.

Because we have determined that neither VSOE nor TPE is available, we use BEBP to allocate the selling price to multiple elements in subscription services arrangements. The amount of revenue allocated to delivered items is limited by contingent revenue, if any.

Subscription services have standalone value as such services are often sold separately. Additionally, we have concluded that professional services included in multiple element arrangements have standalone value. In establishing standalone value, we considered the following factors for each professional services agreement: availability of the services from other vendors, the

nature of the professional services, and the timing of when the professional services contract was signed in comparison to the subscription service start date.

For software arrangements with multiple elements (e.g., maintenance and support contracts bundled with licenses), revenue is allocated to the delivered elements of the arrangement when VSOE is determinable, using the residual value method based on objective evidence of the fair value of the undelivered elements, which is specific to us. When VSOE is not determinable, the entire arrangement is recognized ratably over the term of the contract. Revenue is recognized under this model upon receipt of cash payment from the customer if collectability is not reasonably assured and when other revenue recognition criteria have been met. The VSOE of fair value for maintenance and support obligations related to licenses is based upon the prices paid for the separate renewal of these services by customers. Maintenance revenues are recognized ratably over the period of the maintenance contract.

#### Income Taxes

We account for income taxes under the asset and liability method, which requires the recognition of taxes payable or refundable for the current year, and deferred tax liabilities and assets for the future tax consequences of events that have been recognized in our financial statements or tax returns. The measurement of current and deferred tax liabilities and assets is based on provisions of the enacted tax law; the effects of future changes in tax laws or rates are not anticipated. Valuation allowances are established when necessary to reduce deferred tax assets to the amount that we believe is more likely than not to be realized.

We operate in various tax jurisdictions and are subject to audit by various tax authorities. We provide for tax positions whenever it is deemed likely that a tax asset has been impaired or a tax liability has been incurred for events such as tax claims or changes in tax laws. A tax position is only recognized in the financial statements if it is “more likely than not” to be sustained based solely on its technical merits as of the reporting date.

We consider many factors when evaluating and estimating our tax positions and tax benefits, which may require periodic adjustments and which may not accurately anticipate actual outcomes. Our judgments, assumptions and estimates relative to the current provision for income tax take into account current tax laws, our interpretation of current tax laws and possible outcomes of current and future audits conducted by domestic tax authorities. Changes in tax laws or our interpretation of tax laws and the resolution of current and future tax audits could significantly impact the amounts provided for income taxes in our consolidated balance sheets and consolidated statements of comprehensive income. We must also assess the likelihood that deferred tax assets will be realized from future taxable income and, based on this assessment, establish a valuation allowance, if required.

Our determination of our valuation allowance is based upon a number of assumptions, judgments and estimates, including forecasted earnings, future taxable income and the relative proportions of revenue and income before taxes in the various jurisdictions in which we operate. To the extent we establish a valuation allowance or change the valuation allowance in a period, we reflect the change with a corresponding increase or decrease to our tax provision in our consolidated statements of comprehensive income.

#### Stock-based Compensation

We recognize compensation expense related to stock option grants that are ultimately expected to vest based on estimated fair values on the date of grant using the Black-Scholes option-pricing model. Such expense is recognized on a straight-line basis over the requisite service period of the award, which generally equals the vesting period. We recognize compensation expense related to restricted awards, restricted stock unit awards, or RSUs, performance share awards, or Performance Awards, based on the fair market value of the underlying shares of common stock as of the date of grant. Expense related to the restricted awards and the RSUs are recognized on a straight-line basis over the requisite service period of the award, which generally equals the vesting period. Expense related to the Performance Awards is recognized under the graded vesting method over the requisite service period of the award, which recognizes a larger portion of the expense during the beginning of the vesting period than in the end of the vesting period. We estimate the probable number of shares of common stock that will be granted until the achievement of the performance goals is known.

The date of grant is the date at which we and the employee reach a mutual understanding of the key terms and conditions of the award, appropriate approvals are received by approval by the board of directors and we become contingently obligated to issue equity instruments to the employee who renders the requisite service.

We are required to estimate potential forfeitures of stock grants and adjust recorded compensation cost accordingly. The estimate of forfeitures is based on historical experience and is adjusted over the requisite service period to the extent that actual forfeitures differ, or are expected to differ, from the prior estimates. Changes in estimated forfeitures will be recognized in the period of change and will impact the amount of stock-based compensation expense to be recognized in future periods, which could be material if actual results differ significantly from our estimates.

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All stock option awards to non-employees are accounted for at the fair value of the consideration received or the fair value of the equity instrument issued, as calculated using the Black-Scholes option-pricing model. The measurement of stock-based compensation for non-employees is subject to periodic adjustments as the options vest, and the expense is recognized over the period services are rendered.

The following table summarizes the assumptions used in the Black-Scholes option-pricing model relating to stock options in the years ended December 31, 2014, 2013 and 2012:

	Year ended December 31,					
	2014		2013		2012	
Stock option plans:						
Risk-free interest rate	1.55-2.02	%	0.95-1.87	%	0.74-1.10	%
Expected life of options (in years)	5.27-6.08		5.27-6.08		5.27-6.08	
Expected dividend yield	—	%	—	%	—	%
Volatility	49-53	%	50-52	%	52-59	%
Employee Stock Purchase Plan: (1)						
Risk-free interest rate	0.05-0.08	%	0.05-0.13	%	0.13-0.14	%
Expected life of options (in years)	0.5		0.5		0.5	
Expected dividend yield	—	%	—	%	—	%
Volatility	38-39	%	36-37	%	37-47	%

#### Goodwill and Intangible Assets

Goodwill and intangible assets are stated at cost less accumulated amortization, as appropriate. Intangible assets include developed technology, trade names and customer lists and contracts. Intangible assets with finite lives are amortized on a straight-line basis over the estimated periods of benefit, generally two to nine years. Goodwill and intangible assets with indefinite lives are not amortized, but tested for impairment at least annually, or whenever changes in circumstances indicate that the carrying amount of the goodwill or indefinite-lived intangible assets may not be recoverable. Intangible assets with finite lives are tested for impairment whenever changes in circumstances indicate that the carrying amount of the finite-lived intangible assets may not be recoverable. Goodwill impairment tests are performed at the reporting unit level, which is the company as a whole, using a two-step, fair-value approach. Intangible asset impairment tests consist of a comparison of the fair value of an intangible asset with its carrying amount.

If management's estimates of future operating results change, if there are changes in identified reporting units or if there are changes to other significant assumptions, the estimated carrying values of any such reporting units and the estimated fair value of goodwill could change significantly, and could result in an impairment charge. Such changes could also result in goodwill impairment charges in future periods, which could have a significant impact on our operating results and financial condition therein.

We assess the impairment of identifiable intangible assets whenever events or changes in circumstances indicate that an asset's carrying amount may not be recoverable. An impairment loss would be recognized when the sum of the undiscounted estimated future cash flows expected to result from the use of the asset and its eventual disposition is less than its carrying amount. Such impairment loss would be measured as the difference between the carrying amount of the asset and its fair value. Cash flow assumptions are based on historical and forecasted revenue, operating costs and other relevant factors.

During the fourth quarter of 2014, we identified certain indicators of impairment for both the customer relationships and developed technology acquired in the MortgageCEO acquisition. Specifically, we determined we would need to make additional investments in the Encompass CRM product, including in the areas of security, stability and functionality in order to attract new customers (which were not expected and therefore not contemplated in the valuation of customer relationships and developed technology in the purchase price allocation at the acquisition date). The need to make these investments has resulted in a significant delay in our ability to release an integrated Encompass CRM product to our customers. As a result, we determined it was necessary to assess the recoverability of the customer relationships and developed technology associated with generating Encompass CRM cash flows. We used an income approach to determine if the sum of the undiscounted cash flows expected to result from the use and eventual disposition of each asset exceeded the carrying amount of that asset. As a result of this assessment, it was

determined that the sum of undiscounted cash flows was less than the carrying amount for each of the two assets. In order to determine the amount of impairment to each asset, we performed an analysis to determine the fair value of each asset, which was determined using the present value of expected future cash flows which were based on estimates, assumptions and judgments. These include the forecast of future cash flows related to each asset, the discount rate used in discounting those cash flows, and the expected

remaining useful life of each asset. This analysis resulted in a non-cash impairment charge of \$0.3 million to customer relationships and a non-cash impairment charge of \$1.7 million to developed technology, which were included in sales and marketing expenses and research and development expenses, respectively, in the consolidated statements of comprehensive income for the year ended December 31, 2014. We reassessed the useful life of the customer relationships and developed technology and determined that they remained appropriate.

If management's estimates of future operating results change, or if there are changes to other assumptions, the estimate of the fair value of our acquired product rights and other identifiable intangible assets could change significantly. Such change could result in impairment charges in future periods, which could have a significant impact on our operating results and financial condition.

#### Fair Value of Investments

All of our investments that have maturities of greater than 90 days are classified as available-for-sale and are carried at fair value. We invest excess cash primarily in investment-grade interest-bearing securities, such as money market accounts, certificates of deposit, commercial paper, corporate bonds, municipal and government agency obligations and guaranteed obligations of the U.S. government. Fair value is determined based on quoted market rates when observable or utilizing data points that are observable, such as quoted prices, interest rates and yield curves. The cost of available-for-sale marketable securities sold is based on the specific identification method. Unrealized gains and losses are reported in stockholders' equity as accumulated other comprehensive (income) loss. Realized gains and losses are included in other income (expense), net. Interest and dividends are included in other income (expense), net when they are earned.

At December 31, 2014, our assets measured and recorded at fair value on a recurring basis included \$3.2 million of money market funds and \$108.0 million of marketable debt instruments. Of these marketable debt instruments, \$16.9 million was classified as Level 1 and \$91.1 million as Level 2. All of our money market funds are classified as Level 1. When determining fair value, we consider the principal or most advantageous market in which we would transact, and we consider assumptions that market participants would use when pricing the asset or liability. For further information, see "Fair Value of Financial Instruments" in Notes 2 and 4 of the Notes to Consolidated Financial Statements.

Credit risk is factored into the valuation of financial instruments that we measure and record at fair value. When fair value is determined using pricing models, such as a discounted cash flow model, the issuer's credit risk is factored into the calculation of the fair value, as appropriate.

Our money market funds and marketable debt instruments that are measured and recorded at fair value on a recurring basis and classified as Level 1 were classified as such due to the use of observable market prices for identical securities that are traded in active markets. Management judgment was required to determine the levels for the frequency of transactions that should be met for a market to be considered active. Our assessment of an active market for our marketable debt instruments generally takes into consideration the number of days each individual instrument trades over a specified period.

When we use observable market prices for identical securities that are traded in less active markets, we classify our marketable financial instruments as Level 2. When observable market prices for identical securities are not available, we price our marketable financial instruments using non-binding market consensus prices that are corroborated with observable market data; quoted market prices for similar instruments; or pricing models with all significant inputs derived from or corroborated with observable market data. Non-binding market consensus prices are based on the proprietary valuation models of pricing providers. These valuation models incorporate a number of inputs, including non-binding and binding broker quotes; observable market prices for identical or similar securities; and the internal assumptions of pricing providers or brokers that use observable market inputs and, to a lesser degree, unobservable market inputs. We corroborate non-binding market consensus prices with observable market data as such data exists. We had no investments classified as Level 3 at December 31, 2014.

#### Deferred Commissions

Deferred commission expenses are the incremental costs that are directly associated with non-cancelable subscription contracts with customers and consist of sales commissions paid to our direct sales force. Commissions are calculated based on a percentage of the revenues for the non-cancelable term of subscription contracts, which are typically 1 to 5 years.

Prior to 2013, commissions were paid and recognized as sales expense when customer payments for contracted services were received on a monthly basis because commissions were earned based on receipt of customer payments. In 2013, we amended our commission plans to provide for payment after the customer's contract is signed. As a result of the change in commission plans, beginning in 2013, commission expense is deferred and amortized to sales expense over the non-cancelable terms of the related subscription contracts. The deferred commission expense amounts are recoverable through the future revenue streams under the non-cancelable customer contracts. The plans also include claw back provisions, which require



repayment of a proportionate amount of commissions, should customers cancel their contracts prior to the end of the initial contractual term.

#### Software and Website Development Costs

The Company capitalizes internal and external costs incurred to develop internal-use software and website applications. Capitalized internal costs include salaries, benefits and stock-based compensation charges for employees that are directly involved in developing the software or website application, and depreciation of assets used in the development process. Capitalized external costs include third-party consultants involved in the development process, as well as other direct costs incurred as part of the development process.

Capitalization of costs begins when the preliminary project stage has been completed, management authorizes and commits to funding a project and it is probable that the project will be completed and the software or website application will be used to perform the function intended. Internal and external costs incurred as part of the preliminary project stage are expensed as incurred.

Capitalization ceases at the point at which the project is substantially complete and ready for its intended use. Internal and external training costs and maintenance costs during the post-implementation operation stage are expensed as incurred.

Internal-developed core software is amortized on a straight-line basis over its estimated useful life, generally three to five years. Amortization of product related internal-use software and website applications is typically recorded to cost of revenues, and amortization of other internal-use software and website applications is typically recorded to the operating expense line to which it most closely relates. Our management evaluates the useful lives of these assets on an annual basis and tests for impairment whenever events or changes in circumstances occur that could impact the recoverability of these assets. The capitalized costs are included in the property and equipment, net line in the accompanying consolidated balance sheets. For the years ended December 31, 2014, 2013 and 2012, we capitalized software and website application development costs of \$15.9 million, \$5.1 million and \$0.5 million, respectively.

#### Results of Operations

The following tables set forth our results of operations for the periods presented and as a percentage of our revenues for those periods. The period-to-period comparison of financial results is not necessarily indicative of future results.

	Year ended December 31,		
	2014	2013 (2)	2012
	(in thousands)		
Revenues	\$161,537	\$128,481	\$101,845
Cost of revenues (1)	46,283	32,630	23,114
Gross profit	115,254	95,851	78,731
Operating expenses:			
Sales and marketing (1)	26,544	21,331	17,887
Research and development (1)	28,228	24,695	18,053
General and administrative (1)	39,361	30,853	21,601
	94,133	76,879	57,541
Income from operations	21,121	18,972	21,190
Other income (expense), net	488	460	(43 )
Income before income taxes	21,609	19,432	21,147
Income tax provision	6,786	6,114	1,683
Net income	\$14,823	\$13,318	\$19,464

## (1) Stock-based compensation included in the above line items:

	Year ended December 31,		
	2014	2013	2012
	(in thousands)		
Cost of revenues	\$1,579	\$745	\$271
Sales and marketing	1,562	1,041	467
Research and development	3,672	3,469	1,552
General and administrative	7,735	9,004	4,559
	\$14,548	\$14,259	\$6,849

	Year ended December 31,			
	2014	2013 (2)	2012	
	(as a percentage of revenues)			
Revenues	100.0	% 100.0	% 100.0	%
Cost of revenues	28.7	25.4	22.7	
Gross profit	71.3	74.6	77.3	
Operating expenses:				
Sales and marketing	16.4	16.6	17.6	
Research and development	17.5	19.2	17.7	
General and administrative	24.4	24.0	21.2	
	58.3	59.8	56.5	
Income from operations	13.0	14.8	20.8	
Other income (expense), net	0.3	0.4	—	
Income before income taxes	13.3	15.2	20.8	
Income tax provision	4.2	4.8	1.7	
Net income	9.1	% 10.4	% 19.1	%

- The Consolidated Statement of Operations for the year ended December 31, 2013 has been revised, primarily to reflect an immaterial correction of the income tax provision related to the deductibility of compensation to our executive officers for income tax purposes under Section 162(m) of the Internal Revenue Code. The primary impact of the revision to 2013 was a decrease in the tax provision of \$0.6 million. See Note 2 to our consolidated financial statements for further discussion.

## Revenues

The following table sets forth our revenues by type for the periods presented:

	Year ended December 31,		
	2014	2013	2012
	(in thousands)		
Revenue by type:			
On-demand	\$ 154,315	\$ 118,555	89,251
On-premise	7,222	9,926	12,594
Total	\$ 161,537	\$ 128,481	\$ 101,845

	Year ended December 31,			
	2014	2013	2012	
	(as a percentage of revenues)			
Revenue by type:				
On-demand	96	% 92	% 88	%
On-premise	4	% 8	% 12	%
Total	100	% 100	% 100	%

Year Ended December 31, 2014 Compared to Year Ended December 31, 2013. Total revenues increased \$33.1 million, or 25.7%, for the year ended December 31, 2014 as compared to the same period of 2013.

On-demand revenues increased by \$35.8 million, consisting primarily of a \$22.5 million increase in SaaS Encompass revenues, of which \$20.2 million is related to our Success-Based Pricing model. The increase in SaaS Encompass revenues resulted from additional base fees generated from new contracted SaaS Encompass users and from upgrades of existing on-premise customers to our SaaS platform. Contracted revenues, which are not sensitive to mortgage origination volume, increased from \$71.5 million for the year ended December 31, 2013 to \$102.5 million for the year ended December 31, 2014. The number of contracted SaaS users increased by 32.9% from 95,044 as of December 31, 2013 to 126,346 as of December 31, 2014. Additionally, the number of average active SaaS Encompass users increased by 33.8% from 55,421 for the year ended December 31, 2013 to 74,168 for the year ended December 31, 2014.

This revenue growth attributable to the increase in SaaS Encompass users was partially offset by a 3.1% decrease in SaaS Encompass revenue per average active SaaS user from \$1,367 for the year ended December 31, 2013 to \$1,325 for the year ended December 31, 2014. This decrease was caused primarily by fluctuations in transactional volumes and the timing of user additions for the year ended December 31, 2014 compared to the same period of 2013.

Additional contributors to the growth in on-demand revenues were a \$6.1 million increase in revenues from professional services driven primarily by implementation and training services provided to new customers and to customers that upgraded from on-premise to SaaS users, a \$3.5 million increase in revenues from network transactions due to increased network usage in the areas of Flood, Appraisal, Credit and Fraud, \$2.0 million of revenues from AllRegs products and services and a \$1.5 million increase in revenues from other software and services due to an increase in TQL adoption by Encompass users.

On-premise revenues decreased by \$2.7 million for the year ended December 31, 2014 compared to the same period of 2013, primarily due to a \$2.5 million decrease in software license and maintenance fees as our on-premise customers converted to SaaS Encompass Success-Based Pricing users.

Year Ended December 31, 2013 Compared to Year Ended December 31, 2012. Total revenues increased \$26.6 million, or 26.2%, for the year ended December 31, 2013 as compared to the same period of 2012.

On-demand revenues increased by \$29.3 million, consisting primarily of a \$27.8 million increase in SaaS Encompass revenues, of which \$24.2 million related to our Success-Based Pricing model. SaaS Encompass revenues increased as a result of the addition of new SaaS Encompass users and as a result of upgrades of existing customers to our SaaS platform. The number of average active SaaS Encompass users increased by 66.9% from 33,203 for the year ended December 31, 2012 to 55,421 for the year ended December 31, 2013 due to the addition of new customers and the transition of on-premise licensed users to our SaaS Encompass Success-Based Pricing offering. The revenue growth attributable to the increase in average active SaaS Encompass users was partially offset by a 5.3% decrease in SaaS Encompass revenue per average active SaaS user from \$1,444 for the year ended December 31, 2012 to \$1,367 for year ended December 31, 2013, caused primarily by a decline in closed loan volume, lenders' focus on preparing for ATR/QM rules and longer implementation cycles for some of the larger customers that were added earlier in 2013. Additional contributors to the growth in on-demand revenues were a \$1.0 million increase in revenues from our Encompass CenterWise offering primarily due to an increase in users, a \$2.5 million increase in revenues from our TQL program and a \$0.3 million increase in revenues from network transactions due to increased network usage for the year ended December 31, 2013 compared to the same period of 2012. Partially offsetting the increase in on-demand revenues was a \$2.9 million decrease in revenues from our standalone Encompass Docs Solution for the year ended December 31, 2013 compared to the same period of 2012, primarily as a result of the conversion of customers from standalone solutions to SaaS Encompass and partially from two standalone solutions subscription customers having gone out of business during the third quarter of 2013.

On-premise revenues decreased by \$2.7 million for the year ended December 31, 2013 compared to the same period of 2012, primarily due to a \$2.7 million decrease in software license and maintenance fees as our on-premise customers converted to SaaS Encompass Success-Based Pricing users.

Gross Profit

	Year ended December 31,			
	2014	2013	2012	
	(in thousands except percentages)			
Gross profit	\$115,254	\$95,851	\$78,731	
Gross margin	71.3	% 74.6	% 77.3	%

Year Ended December 31, 2014 Compared to Year Ended December 31, 2013. Gross profit increased by \$19.4 million and gross margin percentage decreased by 3.3 percentage points during the year ended December 31, 2014 as compared to the same period of 2013 as revenues increased by \$33.1 million and cost of revenues increased by \$13.7 million. The decrease in the gross margin percentage for 2014 is primarily a result of an increase in fixed costs associated with headcount added to our implementation, professional services and customer support organizations, investments we have made in expanding our data centers and amortization of intangible assets acquired in business combinations. The increase in cost of revenues was primarily due to a \$8.1 million increase in salary, employee benefit and stock-based compensation expenses associated with headcount added to our professional services and customer support organizations in anticipation of continued increasing demand for our software solutions and additions to headcount from the AllRegs acquisition, a \$2.8 million increase in third-party royalty expenses arising from the increased revenues, a \$1.3 million increase in amortization expenses related to the intangible assets acquired from MortgageCEO and AllRegs and a \$1.0 million increase in expenses related to our data centers and technology. The increase in cost of revenues was offset by a \$0.8 million decrease in temporary staff and consulting costs.

Year Ended December 31, 2013 Compared to Year Ended December 31, 2012. Gross profit increased by \$17.1 million and gross margin percentage decreased by 2.7 percentage points during the year ended December 31, 2013 as compared to the same period of 2012 as revenues increased by \$26.6 million and cost of revenues increased by \$9.6 million. The decrease in the gross margin percentage for 2013 is primarily a result of an increase in fixed costs associated with headcount added to our implementation, professional services and customer support organizations and investments we have made in expanding our data centers. Cost of revenues increased primarily due to a \$1.2 million increase in third-party royalty expenses to support the increased revenues, a \$5.8 million increase in salaries and employee benefits from increased professional services and customer support headcount, a \$0.5 million increase in

stock-based compensation expense relating to our increased headcount, a \$0.5 million increase in temporary staff and consulting costs associated with improvements to our data center operations and a \$1.0 million increase in depreciation expense due to capital additions.

## Sales and Marketing

	Year ended December 31,			
	2014	2013	2012	
	(in thousands except percentages)			
Sales and marketing	\$26,544	\$21,331	\$17,887	
Sales and marketing as a % of revenues	16.4	% 16.6	% 17.6	%

Year Ended December 31, 2014 Compared to Year Ended December 31, 2013. Sales and marketing expenses increased by \$5.2 million, or 24.4%, in the year ended December 31, 2014 as compared to the same period of 2013. Sales and marketing expenses as a percentage of revenues decreased by 0.2% of revenues. The increase to expense was primarily due to a \$3.9 million increase in salary, employee benefit and stock-based compensation expenses related to increased headcount as we continued to grow our sales and marketing departments in an effort to increase our market share and address anticipated demand for our software solutions and additions to headcount from the AllRegs acquisition, as well as a \$0.3 million impairment loss on customer relationships acquired from MortgageCEO.

Year Ended December 31, 2013 Compared to Year Ended December 31, 2012. Sales and marketing expenses increased by \$3.4 million, or 19.3%, in the year ended December 31, 2013 as compared to the same period of 2012. Sales and marketing expenses as a percentage of revenues decreased by 1.0% of revenues. The increase in expense was primarily due to a \$1.9 million increase in salaries and employee benefits as well as a \$0.6 million increase in stock-based compensation expense, both reflecting an increase in headcount as we continued to grow our sales and marketing departments in an effort to increase our market share. Additionally, travel and entertainment expenses in support of our sales function increased by \$0.5 million.

## Research and Development

	Year ended December 31,			
	2014	2013	2012	
	(in thousands except percentages)			
Research and development	\$28,228	\$24,695	\$18,053	
Research and development as a % of revenues	17.5	% 19.2	% 17.7	%

Year Ended December 31, 2014 Compared to Year Ended December 31, 2013. Research and development expenses increased by \$3.5 million, or 14.3%, in the year ended December 31, 2014 compared to the same period of 2013. Research and development expenses as a percentage of revenues decreased by 1.7% of revenues. The increase in expense was due to a \$11.8 million increase in total research and development costs, primarily driven by salary, employee benefits and stock compensation costs from additions to headcount as we continued to invest in our products and services and additions to headcount from the AllRegs acquisition, and a \$1.7 million impairment loss recorded on developed technology acquired from MortgageCEO, offset by a \$8.2 million decrease relating to costs that were capitalized to property and equipment rather than expensed because they were associated with the development of internal-use software and website development. Such costs will be amortized over their respective useful lives when such assets are placed into service.

Year Ended December 31, 2013 Compared to Year Ended December 31, 2012. Research and development expenses increased by \$6.6 million, or 36.8%, in the year ended December 31, 2013 compared to the same period of 2012. Research and development expenses as a percentage of revenues increased by 1.5% of revenues. The increase in expense was primarily due to a \$3.8 million increase in salaries and employee benefits reflecting an increase in headcount, a \$1.9 million increase in stock-based compensation expense primarily resulting from Performance Awards granted to certain executives during the third quarter of 2012 and the first quarter of 2013 and stock option and RSU grants made to new and existing employees and a \$0.5 million increase in the use of consultants.

## General and Administrative

	Year ended December 31,			
	2014	2013	2012	
	(in thousands except percentages)			
General and administrative	\$39,361	\$30,853	\$21,601	
General and administrative as a % of revenues	24.4	% 24.0	% 21.2	%



Year Ended December 31, 2014 Compared to Year Ended December 31, 2013. General and administrative expenses increased by \$8.5 million, or 27.6%, in the year ended December 31, 2014 as compared to the same period of 2013. General and administrative expenses as a percentage of revenues increased by 0.4%. These changes were primarily due to a \$5.3 million increase in salaries and employee benefits related to increased headcount, a \$1.7 million increase in professional fees and legal expenses in connection with the settlement of a legal claim and our network outage earlier this year, a \$1.4 million increase in the use of consultants and temporary contractors, and a \$0.5 million increase in business tax. The increase in general and administrative expenses were offset by a \$1.3 million decrease in stock-based compensation expense primarily relating to Performance Awards for which expense is recognized on an accelerated basis over the vesting period, as well as changes to the estimated shares of stock-based awards that are expected to vest.

Year Ended December 31, 2013 Compared to Year Ended December 31, 2012. General and administrative expenses increased by \$9.3 million, or 42.8%, in the year ended December 31, 2013 as compared to the same period of 2012. General and administrative expenses as a percentage of revenues increased by 2.8% of revenues. The increase in expense was primarily due to a \$4.4 million increase in stock-based compensation expense primarily resulting from Performance Awards granted to certain executives during the third quarter of 2012 and the first quarter of 2013 and stock option and RSU grants made to new and existing employees, a \$1.4 million increase in the use of consultants and temporary contractors for infrastructure and compliance projects, a \$1.1 million increase in technology expenses relating to licenses and support for software used to manage our business, a \$0.9 million increase in fees to professional service firms for accounting, tax, and investor relations services and a \$0.4 million increase in depreciation expenses resulting from overall growth of our business and headcount.

#### Other Income, Net

Other income, net includes imputed interest expense related to capital lease obligations and acquisition holdback liabilities, interest income from notes receivable and investments, and realized gains and losses on sales of investments. The amounts were not significant in the years ended December 31, 2014, 2013 and 2012.

#### Income Taxes

Income tax provision of \$6.8 million in 2014 was primarily due to statutory taxes on pretax income of \$21.6 million. Income tax provision of \$6.1 million in 2013 was primarily due to statutory taxes on pretax income of \$19.4 million. Income tax provision of \$1.7 million in 2012 was primarily due to statutory taxes on pretax income of \$21.1 million offset by a \$6.6 million reduction in our deferred tax asset valuation allowance.

Our effective tax rate did not significantly differ from the statutory federal rate during the years ended December 31, 2014 and 2013, although there were offsetting differences between the effective tax rate and statutory federal rate due to non-deductible items and state taxes, offset by benefits related to federal research and development credits. During the year ended December 31, 2012, our effective tax rate differed from the statutory federal rate principally due to changes in the valuation allowance.

The valuation allowance decreased by \$6.5 million in 2012, increased by \$0.3 million in 2013 and increased by \$0.8 million in 2014. We continue to maintain a valuation allowance against the deferred tax assets related to certain state research and development tax credits, the realization of which is uncertain as we expect to generate additional such credits at a faster rate than we are able to utilize them. We will continue to assess the need for a valuation allowance on deferred tax assets by evaluating both positive and negative evidence that may exist. Any adjustment to the deferred tax asset valuation allowance will be recorded in the income statement for the periods that the adjustment is determined to be required.

#### Liquidity and Capital Resources

As of December 31, 2014, we had cash, cash equivalents and short-term investments of \$76.1 million and long-term investments of \$58.7 million. Cash and cash equivalents consist of cash and money market accounts. Both short and long-term investments consist of corporate bonds and obligations, certificates of deposit, municipal obligations, U.S. government notes and U.S. government agency securities.

We believe that our existing cash, cash equivalents and short-term investments will be sufficient to fund capital expenditures, operating expenses and other cash requirements for at least the next 12 months. We may enter into acquisitions in the future, which could require us to seek additional equity or debt financing. Additional funds may not be available on terms favorable to us or at all.





The following table sets forth our statement of cash flows data for the periods presented:

	Year ended December 31,		
	2014	2013	2012
	(in thousands)		
Net cash provided by operating activities	\$40,598	\$28,959	\$27,753
Net cash used in investing activities	\$(61,237 )	\$(52,314 )	\$(69,121 )
Net cash provided by financing activities	\$13,933	\$12,703	\$61,750
Net increase (decrease) in cash and cash equivalents	\$(6,706 )	\$(10,652 )	\$20,382

#### Operating Activities

Year Ended December 31, 2014 Compared to Year Ended December 31, 2013. Cash provided by operating activities increased by \$11.6 million from \$29.0 million in 2013 to \$40.6 million in 2014. In the consolidated statements of cash flows, cash provided by operating activities is presented as net income adjusted for non-cash expense items and changes in operating assets and liabilities. Net income increased by \$1.5 million for the year ended December 31, 2014 as compared to the same period of 2013. The net contribution of non-cash items to cash provided by operating activities increased by \$10.6 million for the year ended December 31, 2014 as compared to the same period of 2013. The net contribution of changes in operating assets and liabilities to cash provided by operating activities decreased by \$0.5 million for the year ended December 31, 2014 as compared to the same period of 2013.

The \$10.6 million increase in the net contribution of non-cash items to cash provided by operating activities was primarily due to a \$4.8 million increase to cash from the realization of deferred taxes, a \$2.0 million non-cash impairment loss on intangible assets acquired from MortgageCEO, a \$1.3 million increase from the amortization of intangible assets as a result of the MortgageCEO and AllRegs acquisitions and a \$1.1 million increase from excess tax benefits from the exercise of stock options that were reclassified from operating activities to financing activities.

Changes in operating assets and liabilities resulted in a net decrease of \$0.5 million to cash provided by operating activities in the year ended December 31, 2014 as compared to the same period in 2013. Our net accounts receivable balance fluctuates from period to period, depending on the amount and timing of sales and billing activity, our customers' payment method, and cash collections. The change in prepaid expenses and other current assets was primarily due to the timing of payments for computer software licenses. The change in deposits and other assets was due to deferred commission expenses and timing of the payment for software licenses. The change in accounts payable and accrued and other liabilities was due to the timing of additional liabilities and payments in general, and does not reflect any significant change in the nature of accrued liabilities. The increase in deferred revenue is primarily the result of continued sales of publishing subscriptions following the acquisition of AllRegs as well as an increase in sales of professional services, offset by a decrease in undelivered software maintenance as more customers adopt our SaaS platform which does not include the sale of stand-alone maintenance.

Year Ended December 31, 2013 Compared to Year Ended December 31, 2012. Cash provided by operating activities increased by \$1.2 million from \$27.8 million in 2012 to \$29.0 million in 2013. Net income decreased by \$6.1 million for the year ended December 31, 2013 as compared to the same period of 2012. The net contribution of non-cash items to cash provided by operating activities increased by \$1.5 million for the year ended December 31, 2013 as compared to the same period of 2012. The net contribution of changes in operating assets and liabilities to cash provided by operating activities increased by \$5.9 million for the year ended December 31, 2013 as compared to the same period of 2012.

Contributing to the increase in the net contribution of non-cash expense items was a \$7.4 million increase in stock-based compensation expense, primarily due to Performance Awards granted to certain executives during the third quarter of 2012 and the first quarter of 2013 and new stock option and RSUs grants made to new and existing employees, offset in part by reductions from fully vested, fully amortized stock options, which no longer impacted expense in 2013. Also contributing was a \$1.6 million increase in depreciation expense, primarily due to purchases of property and equipment for our data centers and for our new ERP system, which was placed into service during the fourth quarter of 2013. Additionally, amortization of investment premium increased by \$1.6 million due to purchases of short-term and long-term investments starting in the fourth quarter of 2012. Offsetting these contributors to cash provided by operating activities were excess tax benefits, which reduce cash provided by operating activities and increased by \$5.0 million primarily as a result of windfall tax benefits on the exercise of stock options, of which there

were none in 2012. Also reducing cash provided by operating activities was the benefit from deferred income taxes, which increased by \$3.8 million, primarily due to increases to deferred taxes related to stock-based compensation, and the lack of a reduction in the deferred tax asset valuation allowance during 2013, as there was in 2012.

Changes in operating assets and liabilities resulted in a net increase of \$5.9 million to cash provided by operating activities in the year ended December 31, 2013 as compared to the same period in 2012. Our net accounts receivable balance fluctuates from period to period, depending on the timing of sales and billing activity, cash collections and changes to our allowance for doubtful accounts. The change in prepaid expenses and other current assets was primarily due to the timing of the payment for computer software licenses, as well as an increase in taxes receivable resulting from windfall tax benefits on the exercise of stock options. The change in deposits and other assets was due to deferred commission expenses which started in 2013 and timing of the payment for software licenses. The change in accounts payable and accrued and other liabilities was due to the timing of additional liabilities and payments in general, and does not reflect any significant change in the nature of accrued liabilities.

#### Investing Activities

Our primary investing activities have consisted of purchases and maturities of investments, purchases of property and equipment (including costs incurred to develop internal-use software) and payments for acquisitions (including holdback payments). Purchases of property and equipment may vary from period to period due to the timing of the expansion of our operations and the timing of our internal-use software projects subject to capitalization. We plan to continue to increase investments in hardware and software to support our growth and corporate infrastructure, and we intend to continue pursuing strategic acquisitions.

Cash used in investing activities of \$61.2 million for the year ended December 31, 2014 was primarily the result of \$19.8 million for purchases of property and equipment and costs incurred to develop internal-use software and website applications, \$6.8 million in net purchases of investments, cash payments of \$28.1 million and \$4.5 million for the AllRegs and MortgageCEO acquisitions, respectively, and the final \$2.0 million payment of the holdback from the acquisition of Del Mar Datatrac, Inc.

Cash used in investing activities of \$52.3 million for the year ended December 31, 2013 was the result of \$44.2 million in net purchases of investments, \$6.1 million for purchases of property and equipment and costs incurred to develop internal-use software and website applications and \$3.0 million in scheduled payments of the holdback from the 2011 acquisition of Del Mar Datatrac, Inc.

Cash used in investing activities of \$69.1 million for the year ended December 31, 2012 was primarily the result of \$58.1 million in net purchases of investments, \$8.1 million for purchases of property and equipment mainly for our data centers and a \$2.9 million holdback payment relating to the acquisition of DMD.

#### Financing Activities

Financing activities have consisted primarily of cash provided from the exercise of stock options, excess tax benefits from employee exercises of stock options, payments related to capital lease obligations and tax payments related to shares withheld by us upon the vesting of restricted stock units (RSUs). In May 2014, our board of directors approved a stock repurchase program under which we are authorized to repurchase up to \$75.0 million of our common stock over a 36-month period, all of which remains available as of December 31, 2014. Under the program, purchases may be made from time to time on the open market, and will be funded from available working capital. There were no repurchases under the program during the year ended December 31, 2014.

Cash provided by financing activities of \$13.9 million for the year ended December 31, 2014 consisted primarily of \$10.2 million in proceeds from the exercise of stock options and \$5.9 million in excess tax benefits from employee exercises of stock options, offset in part by tax payments of \$0.9 million related to shares withheld for vested restricted stock units and payments on capital leases of \$1.2 million.

Cash provided by financing activities of \$12.7 million for the year ended December 31, 2013 consisted primarily of \$6.5 million in proceeds from the exercise of stock options, and \$7.0 million in excess tax benefits from employee exercises of stock options.

Cash provided by financing activities of \$61.8 million for the year ended December 31, 2012 consisted primarily of \$55.5 million in proceeds from our follow-on public offering, net of offering costs, \$4.3 million in proceeds from the exercise of stock options and \$2.0 million in excess tax benefit from exercise of stock options.

#### Off Balance Sheet Arrangements

As of December 31, 2014, we had no off-balance sheet arrangements and operating leases were the only financing arrangements not reported on our consolidated financial statements.



## Contractual Obligations

At December 31, 2014, our contractual payment obligations are as follows:

	Payment due by period (as of December 31, 2014*)				
	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
	(in thousands)				
Acquisition holdback, net of discounts	\$522	\$522	\$—	\$—	\$—
Capital lease obligations	885	437	448	—	—
Operating lease obligations	38,096	3,409	7,638	7,645	19,404
Purchase obligations	11,482	6,780	4,702	—	—
Total	\$50,985	\$11,148	\$12,788	\$7,645	\$19,404

In January 2015, we entered into a lease agreement to finance the purchase of computer equipment for our data centers with payments of \$0.3 million per month over the 24 month term of the agreement. The Company has reflected the payments associated with this lease as a purchase obligation at December 31, 2014 in the table above.

Acquisition holdback, net of discounts is related to the acquisition of MortgageCEO. See Notes 5 and 8 of the Notes to Consolidated Financial Statements.

Purchase obligations are associated with agreements that are enforceable and legally binding and that specify all significant terms, including: fixed or minimum services to be used; fixed, minimum or variable price provisions; and the approximate timing of the transaction. Obligations under contracts that we can cancel without a significant penalty are not included in the table above. See Note 8 of the Notes to Consolidated Financial Statements.

## Recent Accounting Pronouncements

See Note 2 of the Notes to Consolidated Financial Statements for a full description of recent accounting pronouncements, including the expected dates of adoption and estimated effects on results of operations and financial condition, which is incorporated herein by reference.

## ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to market risks in the ordinary course of our business. These risks primarily include interest rate risks and inflation.

## Interest Rate Fluctuation Risk

We do not have any long-term borrowings.

Our investments include cash, cash equivalents and both short-term and long-term investments including investment-grade interest-bearing securities, such as money market accounts, certificates of deposit, commercial paper, corporate bonds, municipal and government agency obligations and guaranteed obligations of the U.S. government. The primary objective of our investment activities is to preserve principal while maximizing income without significantly increasing risk. We do not enter into investments for trading or speculative purposes. Our investments are exposed to market risk due to a fluctuation in interest rates, which may affect our interest income and the fair market value of our investments.

A hypothetical increase in interest rates of 1.0% would have resulted in a decrease in the fair value of our investment portfolio of \$1.3 million as of December 31, 2014. The fluctuations in fair value of our investment portfolio reflect only the direct impact of the change in interest rates. Other economic variables, such as equity market fluctuations and changes in relative credit risk, could result in a significantly higher decline in the fair value of our net investment position. For further information on how credit risk is factored into the valuation of our investment portfolio see Note 4 of the Notes to Consolidated Financial Statements.

**Inflation Risk**

We do not believe that inflation has had a material effect on our business, financial condition or results of operations. If our costs were to become subject to significant inflationary pressures, we may not be able to fully offset such higher costs through price increases. Our inability or failure to do so could harm our business, financial condition and results of operations.

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ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

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All other schedules are omitted because they are not applicable or the required information is shown in the consolidated financial statements or notes thereto.



Report of Independent Registered Public Accounting Firm  
Board of Directors and Shareholders  
Ellie Mae, Inc.

We have audited the accompanying consolidated balance sheets of Ellie Mae, Inc. (a Delaware corporation) and subsidiaries (the "Company") as of December 31, 2014 and 2013, and the related consolidated statements of comprehensive income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2014. Our audits of the basic consolidated financial statements included the financial statement schedule listed in the index appearing under Item 15(a)(2). These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Ellie Mae, Inc. and subsidiaries as of December 31, 2014 and 2013, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2014, in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the related financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of December 31, 2014, based on criteria established in the 2013 Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 2, 2015 expressed an unqualified opinion thereon.

/s/ GRANT THORNTON LLP  
San Francisco, CA  
March 2, 2015

Report of Independent Registered Public Accounting Firm  
Board of Directors and Shareholders  
Ellie Mae, Inc.

We have audited the internal control over financial reporting of Ellie Mae, Inc. (a Delaware corporation) and subsidiaries (the "Company") as of December 31, 2014, based on criteria established in the 2013 Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed 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. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2014, based on criteria established in the 2013 Internal Control - Integrated Framework issued by COSO.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements of the Company as of and for the year ended December 31, 2014, and our report dated March 2, 2015 expressed an unqualified opinion on those financial statements and schedule.

/s/ GRANT THORNTON LLP  
San Francisco, CA  
March 2, 2015

Ellie Mae, Inc.

## CONSOLIDATED BALANCE SHEETS

(in thousands, except share and per share amounts)

	December 31,	
	2014	2013
Assets		
Current assets:		
Cash and cash equivalents	\$26,756	\$33,462
Short-term investments	49,352	46,325
Accounts receivable, net of allowances for doubtful accounts of \$66 and \$81 as of December 31, 2014 and December 31, 2013, respectively	20,403	12,024
Prepaid expenses and other current assets	16,021	6,176
Total current assets	112,532	97,987
Property and equipment, net	28,694	12,869
Long-term investments	58,679	56,285
Intangible assets, net	21,452	5,089
Goodwill	65,338	51,051
Deposits and other assets	3,425	6,322
Total assets	\$290,120	\$229,603
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	\$6,726	\$3,783
Accrued and other current liabilities	16,822	9,326
Acquisition holdback, net of discount	522	1,965
Deferred revenue	9,729	4,752
Total current liabilities	33,799	19,826
Leases payable, net of current portion	443	175
Other long-term liabilities	2,994	1,675
Total liabilities	37,236	21,676
Commitments and contingencies (Note 8)		
Stockholders' equity:		
Common stock, \$0.0001 par value per share; 140,000,000 authorized shares, 28,907,147 and 27,624,025 shares issued and outstanding as of December 31, 2014 and December 31, 2013, respectively	3	3
Additional paid-in capital	242,527	212,332
Accumulated other comprehensive loss	(95	) (34
Retained earnings (accumulated deficit)	10,449	(4,374
Total stockholders' equity	252,884	207,927
Total liabilities and stockholders' equity	\$290,120	\$229,603
See accompanying notes to these consolidated financial statements.		

Ellie Mae, Inc.

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands, except share and per share amounts)

	Year ended December 31,		
	2014	2013	2012
Revenues	\$161,537	\$128,481	\$101,845
Cost of revenues	46,283	32,630	23,114
Gross profit	115,254	95,851	78,731
Operating expenses:			
Sales and marketing	26,544	21,331	17,887
Research and development	28,228	24,695	18,053
General and administrative	39,361	30,853	21,601
Total operating expenses	94,133	76,879	57,541
Income from operations	21,121	18,972	21,190
Other income (expense), net	488	460	(43)
Income before income taxes	21,609	19,432	21,147
Income tax provision	6,786	6,114	1,683
Net income	\$14,823	\$13,318	\$19,464
Net income per share of common stock:			
Basic	\$0.53	0.50	0.83
Diluted	\$0.50	0.47	0.76
Weighted average common shares used in computing net income per share of common stock:			
Basic	27,858,828	26,581,962	23,523,222
Diluted	29,593,873	28,502,403	25,537,192
Net income	\$14,823	\$13,318	\$19,464
Other comprehensive income (loss), net of taxes:			
Unrealized gain (loss) on investments	(61)	31	(65)
Comprehensive income	\$14,762	\$13,349	\$19,399

See accompanying notes to these consolidated financial statements.

Ellie Mae, Inc.

## CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(in thousands, except share amounts)

	Common Stock		Additional	Other	Accumulated	Total
	Shares	Amount	Paid-in	Comprehensive	Accumulated	Stockholders'
			Capital	Loss	Deficit	Equity
Balances, December 31, 2011	21,019,590	2	116,012	—	(37,156 )	78,858
Issuance of common stock under stock incentive plans	1,447,456	—	3,516	—	—	3,516
Issuance of common stock under employee stock purchase plan	126,242	—	742	—	—	742
Issuance of common stock in connection with public offering, net	3,465,245	1	55,530	—	—	55,531
Stock-based compensation	—	—	6,849	—	—	6,849
Excess tax benefit from exercise of stock options	—	—	1,967	—	—	1,967
Unrealized losses on investments	—	—	—	(65 )	—	(65 )
Net income	—	—	—	—	19,464	19,464
Balances, December 31, 2012	26,058,533	3	184,616	(65 )	(17,692 )	166,862
Issuance of common stock under stock incentive plans	1,462,566	—	4,623	—	—	4,623
Shares withheld for employee taxes related to vested restricted stock units	(6,344 )	—	(174 )	—	—	(174 )
Issuance of common stock under employee stock purchase plan	109,270	—	1,922	—	—	1,922
Stock-based compensation	—	—	14,390	—	—	14,390
Excess tax benefit from exercise of stock options	—	—	6,955	—	—	6,955
Unrealized gains on investments	—	—	—	31	—	31
Net income	—	—	—	—	13,318	13,318
Balances, December 31, 2013	27,624,025	3	212,332	(34 )	(4,374 )	207,927
Issuance of common stock under stock incentive plans	1,210,435	—	7,537	—	—	7,537
Shares withheld for employee taxes related to vested restricted stock units	(29,424 )	—	(902 )	—	—	(902 )
Issuance of common stock under employee stock purchase plan	102,111	—	2,624	—	—	2,624
Stock-based compensation	—	—	15,084	—	—	15,084
Excess tax benefit from exercise of stock options	—	—	5,852	—	—	5,852
Unrealized losses on investments	—	—	—	(61 )	—	(61 )
Net income	—	—	—	—	14,823	14,823
Balances, December 31, 2014	28,907,147	\$3	\$242,527	\$ (95 )	\$ 10,449	\$ 252,884

See accompanying notes to these consolidated financial statements.

Ellie Mae, Inc.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	Year ended December 31,		
	2014	2013	2012
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>			
Net income	\$14,823	\$13,318	\$19,464
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation	5,605	4,727	3,144
Provision for uncollectible accounts receivable	1	32	70
Amortization of intangible assets	2,779	1,442	1,635
Impairment loss on intangible assets	1,968	—	—
Amortization of discount related to acquisition holdback	36	106	186
Amortization of investment premium	1,280	1,614	—
Stock-based compensation expense	14,548	14,259	6,849
Write-off of internal-use software costs	693	—	19
Excess tax benefit from exercise of stock options	(5,852)	(6,955)	(1,967)
Deferred income taxes	395	(4,364)	(559)
Changes in operating assets and liabilities:			
Accounts receivable	(8,380)	(2,303)	(3,004)
Prepaid expenses and other current assets	(4,867)	4,219	(1,506)
Deposits and other assets	(1,146)	(1,353)	50
Accounts payable	2,675	907	500
Accrued, other current and other liabilities	13,436	3,437	2,538
Deferred revenue	2,604	(127)	334
Net cash provided by operating activities	40,598	28,959	27,753
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>			
Acquisition of property and equipment	(19,834)	(6,092)	(8,121)
Purchases of investments	(64,748)	(101,121)	(65,811)
Maturities of investments	57,986	56,899	7,708
Acquisitions, net of cash acquired	(34,641)	(3,000)	(2,907)
Other investing activities, net	—	1,000	10
Net cash used in investing activities	(61,237)	(52,314)	(69,121)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>			
Proceeds from public offerings, net of commissions	—	—	55,964
Offering costs paid during the period	—	—	(433)
Payment of capital lease obligations	(1,178)	(624)	(6)
Proceeds from issuance of common stock under employee stock plans	10,161	6,546	4,258
Tax payments related to shares withheld for vested restricted stock units	(902)	(174)	—
Excess tax benefit from exercise of stock options	5,852	6,955	1,967
Net cash provided by financing activities	13,933	12,703	61,750
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	<b>(6,706)</b>	<b>(10,652)</b>	<b>20,382</b>
CASH AND CASH EQUIVALENTS, Beginning of period	33,462	44,114	23,732
CASH AND CASH EQUIVALENTS, End of period	\$26,756	\$33,462	\$44,114
<b>Supplemental disclosure of cash flow information:</b>			
Cash paid for interest	\$40	\$268	\$356
Cash paid for income taxes	\$126	\$4,582	\$212
<b>Supplemental disclosure of non-cash investing and financing activities:</b>			
Fixed asset purchases not yet paid	\$921	\$884	\$186

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Stock-based compensation capitalized to property and equipment	\$534	\$131	\$—
Acquisition of property and equipment under capital leases	\$1,269	\$1,271	\$—
See accompanying notes to these consolidated financial statements.			

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Ellie Mae, Inc.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### NOTE 1—Description of Business

Ellie Mae, Inc. (the “Company” or “Ellie Mae”) is a leading provider of innovative on-demand software solutions and services for the residential mortgage industry in the United States. Its end-to-end Encompass mortgage management solution provides one system of record that allows banks, credit unions and mortgage lenders to originate and fund mortgages and improve compliance, loan quality and efficiency.

### NOTE 2—Basis of Presentation and Significant Accounting Policies

#### Principles of Consolidation

The consolidated financial statements include the accounts of Ellie Mae and its wholly-owned subsidiaries. All intercompany balances and transactions have been eliminated.

Certain adjustments primarily related to the Company’s tax provision for the year ended December 31, 2013 have been made as further described in Note 2, under “Correction of Immaterial Errors.” In addition, certain amounts in prior periods have been reclassified to conform to current period presentation, with no effect on previously reported net income or stockholders’ equity.

#### Applicable Accounting Guidance

Any reference in these notes to applicable accounting guidance is meant to refer to the authoritative generally accepted accounting principles in the United States (“U.S. GAAP”), as found in the Financial Accounting Standards Board’s (“FASB”) Accounting Standards Codification (“ASC”).

#### Use of Estimates

The preparation of consolidated financial statements in conformity with U.S. 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 period. Management evaluates estimates on a regular basis including those relating to revenue recognition, the allowance for doubtful accounts, goodwill, intangible assets, the valuation of deferred income taxes, stock-based compensation and unrecognized tax benefits, among others. Actual results could differ from those estimates and such differences may have a material impact on the Company’s consolidated financial statements and footnotes.

#### Cash and Cash Equivalents

All highly liquid investments with original maturities of 90 days or less are considered to be cash equivalents. Cash equivalents are recorded at cost, which approximates fair value.

#### Fair Value of Financial Instruments

The fair values of the Company’s cash equivalents, accounts receivable and accounts payable approximate their carrying values due to the short maturities of the instruments. The fair value of the Company’s capital lease obligations approximates the carrying value due to the terms continuing to approximate prevailing market terms.

All of the Company’s investments that have maturities of greater than 90 days are classified as available-for-sale and are carried at fair value. The Company invests excess cash primarily in investment-grade interest-bearing securities, such as money market accounts, certificates of deposit, commercial paper, corporate bonds, municipal and government agency obligations and guaranteed obligations of the U.S. government. Fair value is determined based on quoted market rates when observable or utilizing data points that are observable, such as quoted prices, interest rates and yield curves. The cost of available-for-sale marketable securities sold is based on the specific identification method. Unrealized gains and losses are reported in stockholders’ equity as accumulated other comprehensive (income) loss. Realized gains and losses are included in other income (expense), net. Interest and dividends are included in other income (expense), net when they are earned.

#### Accounts Receivable and Allowance for Doubtful Accounts

Trade accounts receivable consist of amounts billed to customers in connection with sales of services. The Company analyzes individual trade accounts receivable by considering historical bad debts, customer creditworthiness, current economic trends, changes in customer payment terms and collection trends when evaluating the adequacy of the allowance for doubtful accounts.





Allowances for doubtful accounts are recognized in the period in which the associated receivable balance is not considered recoverable. Any change in the assumptions used in analyzing accounts receivable may result in changes to the allowance for doubtful accounts and is recognized in the period in which the change occurs. The Company writes off a receivable when all rights, remedies and recourses against the account and its principals are exhausted and records a benefit when previously reserved accounts are collected.

#### Concentration of Credit Risk

The financial instruments that potentially expose the Company to concentrations of credit risk consist primarily of cash and cash equivalents, investments and accounts receivable. The Company's cash and cash equivalents are deposited with major financial institutions in the United States. At times, such deposits may be in excess of federally insured limits. Management believes that the Company's investments in cash equivalents and available-for-sale investments are financially sound. The Company's accounts receivable are derived from revenue earned from customers located in the United States. The Company had no customers that represented 10% or more of revenues for the years ended December 31, 2014, 2013 and 2012. No customer represented more than 10% of accounts receivable as of December 31, 2014 and 2013.

#### Software and Website Development Costs

The Company capitalizes internal and external costs incurred to develop internal-use software and website applications. Capitalized internal costs include salaries, benefits and stock-based compensation charges for employees that are directly involved in developing the software or website application, and depreciation of assets used in the development process. Capitalized external costs include third-party consultants involved in the development process, as well as other direct costs incurred as part of the development process.

Capitalization of costs begins when the preliminary project stage has been completed, management authorizes and commits to funding a project and it is probable that the project will be completed and the software or website application will be used to perform the function intended. Internal and external costs incurred as part of the preliminary project stage are expensed as incurred.

Capitalization ceases at the point at which the project is substantially complete and ready for its intended use. Internal and external training costs and maintenance costs during the post-implementation operation stage are expensed as incurred.

Internal-developed core software is amortized on a straight-line basis over its estimated useful life, generally three to five years. Amortization of product related internal-use software and website applications is typically recorded to cost of revenues, and amortization of other internal-use software and website applications is typically recorded to the operating expense line to which it most closely relates. Management evaluates the useful lives of these assets on an annual basis and tests for impairment whenever events or changes in circumstances occur that could impact the recoverability of these assets. The capitalized costs are included in property and equipment, net in the accompanying consolidated balance sheets. For the years ended December 31, 2014, 2013 and 2012, the Company capitalized software and website application development costs of \$15.9 million, \$5.1 million, and \$0.5 million, respectively. During the year ended December 31, 2014, the Company recorded a \$0.7 million impairment loss on the write-off of internal-use software. There were no such write-offs during the years ended December 31, 2013 and 2012.

#### Property and Equipment

Property and equipment are stated at cost less accumulated depreciation and are depreciated on a straight-line basis over their estimated useful lives, which is generally three to seven years. Leasehold improvements are amortized on a straight-line basis over their estimated useful lives or over the term of the lease, whichever is shorter.

#### Business Combinations

The Company recognizes and measures the identifiable assets acquired in a business combination, the liabilities assumed and any non-controlling interest in the acquiree, measured at their fair values as of the acquisition date. The Company recognizes contingent consideration arrangements at their acquisition-date fair values with subsequent changes in fair value reflected in earnings, recognizes pre-acquisition loss and gain contingencies at their acquisition-date fair values (with certain exceptions), capitalizes in-process research and development assets and expenses acquisition-related transaction costs as incurred. Due to the inherent uncertainty in the Company's best estimates and assumptions, they are subject to refinement. During the measurement period, which may be up to one year from the acquisition date, the Company may record adjustments to the fair value of assets acquired and liabilities

assumed, with the corresponding offset to goodwill. Any subsequent adjustments, including changes in accounting for deferred tax asset valuation allowances and acquired income tax uncertainties after the measurement period, are recognized in earnings rather than as an adjustment to the cost of the acquisition.

## Goodwill

The Company records goodwill in a business combination when the consideration paid exceeds the fair value of the net assets acquired. Goodwill is not amortized, but is tested for impairment at least annually in the fourth quarter of the Company's fiscal year, or whenever changes in circumstances indicate that the fair value of a reporting unit is less than its carrying amount, including goodwill. The annual test is performed at the reporting unit level using a fair-value based approach. The Company's operations are organized as one reporting unit. In testing for a potential impairment of goodwill, the Company first compares the carrying value of assets and liabilities to the estimated fair value. If estimated fair value is less than carrying value, then potential impairment exists. The amount of any impairment is then calculated by determining the implied fair value of goodwill using a hypothetical purchase price allocation. Impairment is equivalent to any excess of goodwill carrying value over its implied fair value. There were no impairment charges related to goodwill during the years ended December 31, 2014, 2013, and 2012.

The process of evaluating the potential impairment of goodwill requires significant judgment at many points during the analysis, including calculating fair value of the reporting unit based on estimated future cash flows and discount rates to be applied.

## Intangible Assets

Intangible assets are stated at cost less accumulated amortization. Intangible assets include developed technology, trade names and customer lists and contracts. Intangible assets with finite lives are amortized on a straight-line basis over the estimated periods of benefit, as follows:

Developed technology	2-5 years
Trade names with finite lives	2-3 years
Customer lists and contracts	4-9 years

Intangible assets with indefinite useful lives, including the AllRegs trade name, are stated at cost. The Company evaluates the remaining useful life of indefinite-lived intangible assets each reporting period to determine whether events and circumstances continue to support an indefinite useful life.

The Company evaluates its finite-lived intangible assets for impairment whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset or asset group to future undiscounted net cash flows expected to be generated by the asset or asset group. If such assets or asset groups are considered to be impaired, the impairment loss to be recognized is measured by the amount by which the carrying amounts of the assets or asset groups exceed the fair value of the assets or asset groups. Assets to be disposed of are reported at the lower of the carrying amount and fair value less costs to sell. Except as described in Note 6, there has been no loss on impairment or disposal of intangible assets.

## Impairment of Long-Lived Assets

The Company evaluates its long-lived assets for indications of possible impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Except for the impairment losses recorded on internal-use software and intangible assets described elsewhere in this note, there has been no loss on impairment or disposal of long-lived assets.

## Revenue Recognition

The Company generates revenues primarily from transaction-based fees and fees for software and related services. On-demand revenues are revenues generated from company-hosted software subscriptions that customers access through the Internet and revenues from customers that pay fees based on a per closed loan, or success, basis subject to monthly base fees, which the Company refers to as Success-Based Pricing. Additionally, on-demand revenues are comprised of software services sold transactionally; Ellie Mae Network transaction fees; education and training, loan product and guideline data and analytics services under the AllRegs brand; and professional services which include consulting, implementation and training services. On-premise revenues are revenues generated from maintenance services, sales of customer-hosted software licenses, and professional services. Sales taxes assessed by governmental authorities are excluded from revenue.

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

- There is persuasive evidence of an arrangement;

- The service has been or is being provided to the customer;
- The collection of the fees is reasonably assured; and

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

#### On-Demand Revenues

**Subscription Services and Usage-Based Fee Arrangements.** Subscription services and usage-based fee arrangements generally include a combination of the Company's products delivered as software-as-a-service ("SaaS") and support services. These arrangements are generally non-cancelable and do not contain refund-type provisions. These revenues typically include the following:

**SaaS Encompass Revenues.** The Company offers web-based, on-demand access to Encompass software for a monthly recurring fee. The Company provides the right to access its loan origination software and handles the responsibility of managing the servers, providing security, backing up the data and applying updates. Customers under SaaS arrangements may not take possession of the software at any time during the term of the agreement. Subscription revenues are recognized ratably over the contract terms as subscription services are provided, beginning on the commencement date of each contract, which is the date the Company's service is made available to customers. Contracts generally range from one year to five years.

Alternatively, customers can elect to pay on a success basis. Success basis contracts generally have a term of one to five years and are subject to monthly base fees, which enable customers to close loans up to a contractually agreed-to minimum number of transactions, and additional closed loan fees, which are assessed for loans closed in excess of the minimum. Revenue is earned from both base fees and additional closed loan fees as the result of the customer's usage of Encompass. Monthly base fees are recognized over the respective monthly service period as the subscription services are provided. Additional closed loans fees are recognized when the loans are reported as closed. This offering also includes Encompass CenterWise, Encompass Compliance Service and Encompass Docs Solution as integrated components, which are combined elements of the arrangement that are delivered in conjunction with the SaaS Encompass offering and therefore are not accounted for separately.

**Encompass CenterWise Revenues.** Encompass CenterWise is a bundled offering of electronic document management ("EDM") and websites used for customer relationship management. Generally, revenue is recognized for Encompass CenterWise after the service is rendered, except when Encompass CenterWise is automatically included as an integrated component of the SaaS Encompass offering, in which case the associated revenue is recognized as described above.

**Services Revenues.** The Company provides a variety of mortgage-related and other business services, including automated documentation; fraud detection, valuation, validation and risk analysis; income verification; marketing and customer management; flood zone certifications; and compliance reports. Services revenues are recognized upon completion of the services.

**Transactional Revenues.** The Company has entered into agreements with various lenders, service providers and certain government-sponsored entities participating in the mortgage origination process that provide them access to, and ability to interoperate with, mortgage originators on the Ellie Mae Network. Under these agreements, the Company earns transaction fees when transactions are processed through the Ellie Mae Network. Transaction revenues are recognized when there is evidence that the qualifying transactions have occurred on the Ellie Mae Network and collection of the resulting receivable is reasonably assured.

**Subscriptions to Online Research and Data Resources:** The Company provides mortgage originators and underwriters with access to online databases of various federal and state laws and regulations and forms as well as mortgage investor product guidelines. Subscription fees are recognized ratably over the subscription term as subscription services are provided, which is typically one year.

**Professional Services Revenues:** Professional services revenues are generally recognized when milestones are achieved for fixed price contracts or as the services are rendered for time and material contracts. The majority of our professional services contracts are on fixed price basis. Training revenues are recognized as the services are rendered.

#### On-Premise Revenues

Revenue from the sale of software licenses is recognized in the month in which the required revenue recognition criteria are met, generally in the month in which the software is delivered. Revenue from the sale of maintenance services and professional services is recognized over the period in which the services are provided.



### Multiple Element Arrangements

The Company has entered into both subscription services and software arrangements with multiple elements. For arrangements with multiple deliverables, the Company evaluates whether the individual deliverables qualify as separate units of accounting. In order to treat deliverables in a multiple-deliverable arrangement as separate units of accounting, the deliverables must have standalone value upon delivery.

Subscription services agreements with multiple elements generally include multiple subscriptions and professional services. When such agreements involve multiple elements that qualify as separate units of accounting, the Company allocates arrangement consideration to all deliverables at the inception of an arrangement based on the relative selling price method in accordance with the selling price hierarchy, which includes: (i) vendor specific objective evidence (“VSOE”) if it is available; (ii) third-party evidence (“TPE”) if VSOE is not available; and (iii) the best estimate of selling price (“BESP”) if neither VSOE nor TPE is available.

**VSOE.** The Company determines VSOE based on its historical pricing and discounting practices for the specific product or service when sold separately. In determining VSOE, the Company requires that a substantial majority of the selling prices for these services fall within a reasonably narrow pricing range. The Company has not historically priced its subscription services within a narrow range. As a result, the Company has not been able to establish selling prices for subscription services based on VSOE.

**TPE.** When VSOE cannot be established for deliverables in multiple element arrangements, the Company applies judgment with respect to whether it can establish a selling price based on TPE. TPE is determined based on competitor prices for similar deliverables when sold separately. Generally, the Company’s go-to-market strategy differs from that of its peers and its offerings contain a significant level of differentiation such that the comparable pricing of services with similar functionality cannot be obtained. Furthermore, the Company is unable to reliably determine what similar competitor services’ selling prices are on a standalone basis. As a result, the Company has not been able to establish selling prices based on TPE.

**BESP.** When the Company is unable to establish a selling price using VSOE or TPE, the Company uses BESP in its allocation of arrangement consideration. The objective of BESP is to determine the price at which the Company would transact a sale if the service was sold on a standalone basis. When establishing BESP, the Company reviews company specific factors used to determine list price and makes adjustments as appropriate to reflect current market conditions and pricing behavior. The Company’s process for establishing list price includes assessing the cost to provide a particular product or service, surveying customers to determine market expectations, analyzing customer demographics and taking into account similar products and services historically sold by the Company. The Company continues to review the factors used to establish list price and adjusts BESP as necessary.

Because the Company has determined that neither VSOE nor TPE is available, it uses BESP to allocate the selling price to multiple elements in subscription services arrangements. The amount of revenue allocated to delivered items is limited by contingent revenue, if any.

Subscription services have standalone value as such services are often sold separately. Additionally, the Company has concluded that professional services included in multiple element arrangements have standalone value. In establishing standalone value, the Company considered the following factors for each professional services agreement: availability of the services from other vendors, the nature of the professional services, and the timing of when the professional services contract was signed in comparison to the subscription service start date.

For software arrangements with multiple elements (e.g., maintenance and support contracts bundled with licenses), revenue is allocated to the delivered elements of the arrangement when VSOE is determinable, using the residual value method based on objective evidence of the fair value of the undelivered elements, which is specific to the Company. When VSOE is not determinable, the entire arrangement is recognized ratably over the term of the contract. Revenue is recognized under this model upon receipt of cash payment from the customer if collectability is not reasonably assured and when other revenue recognition criteria have been met. The VSOE of fair value for maintenance and support obligations related to licenses is based upon the prices paid for the separate renewal of these services by customers. Maintenance revenues are recognized ratably over the period of the maintenance contract.

### Deferred Revenue

Deferred revenue represents billings or payments received in advance of revenue recognition and is recognized as the revenue recognition criteria are met. Balances consist primarily of prepaid subscription services and professional,



training and maintenance services not yet provided as of the balance sheet date. Deferred revenue that will be recognized during the succeeding 12 month period is recorded as current deferred revenue, and the remaining portion is recorded as other long-term liabilities. Long-term deferred revenue at December 31, 2014 and 2013 was not material.

#### Deferred Commission Expense

Deferred commission expenses are the incremental costs that are directly associated with non-cancelable subscription contracts with customers and consist of sales commissions paid to our direct sales force. Commissions are calculated based on a percentage of the revenues for the non-cancelable term of subscription contracts, which are typically one to five years.

Prior to 2013, commissions were paid and recognized as sales expense when customer payments for contracted services were received on a monthly basis because commissions were earned based on receipt of customer payments. In 2013, the Company amended its commission plans to provide for payment after the customer's contract is signed. As a result of the change in commission plans, beginning in 2013, commission expense was deferred and amortized to sales expense over the non-cancelable terms of the related subscription contracts. The deferred commission expense amounts are recoverable through the future revenue streams under the non-cancelable customer contracts. The plans also include claw back provisions, which require repayment of a proportionate amount of commissions, should customers cancel their contracts prior to the end of the initial contractual term.

During the years ended December 31, 2014 and 2013, the Company deferred \$2.5 million and \$1.9 million of commission expense, respectively. No amounts were deferred during the year ended December 31, 2012.

At December 31, 2014 and 2013, \$3.3 million and \$1.6 million of deferred commission remained on our consolidated balance sheets, respectively.

#### Warranties and Indemnification

The Company provides a warranty for its software products and services to its customers and accounts for its warranties as a contingent liability. The Company's software is generally warranted to perform substantially as described in the associated product documentation and to satisfy defined levels of uptime reliability. The Company's services are generally warranted to be performed consistent with industry standards. The Company has not provided for a warranty accrual as of December 31, 2014 or 2013. To date, the Company's product warranty expense has not been significant.

The Company generally agrees to indemnify its customers against legal claims that the Company's software products infringe certain third-party intellectual property rights and accounts for its indemnification obligations as a contingent liability. In addition, the Company may also incur liability under its contracts if it breaches its warranties as well as certain security and/or confidentiality obligations. To date, the Company has not been required to make any payment resulting from either infringement claims asserted against its customers or from claims in connection with a breach of the security and/or confidentiality obligations in the Company's contracts. The Company has not recorded a liability for related costs as of December 31, 2014 or 2013.

The Company has obligations under certain circumstances to indemnify each member of the Company's board of directors against judgments, fines, settlements and expenses related to claims against such directors and otherwise to the fullest extent permitted under Delaware law and the Company's bylaws and certificate of incorporation.

#### Cost of Revenues

The Company's cost of revenues consists primarily of salaries, benefits and related costs (including stock-based compensation), allocated facilities costs, customer support, data centers, expenses for document preparation, income verification and compliance services, depreciation on computer equipment used in supporting the Ellie Mae Network, the Company's SaaS Encompass and Encompass CenterWise offerings, amortization of acquired intangible assets and capitalized internal-use software and website applications directly involved in revenue producing activities and professional services associated with implementation of software.

#### Research and Development Costs

The Company's research and development expenses consist primarily of: salaries and benefits, including bonuses and stock-based compensation expense; fees to contractors engaged in the development and support of the Ellie Mae Network, Encompass software and other products; and allocated facilities costs. Research and development costs that are not capitalized as internal-use software are expensed as they are incurred.

#### Advertising Expenses

The Company expenses advertising costs as incurred. Advertising expenses for the years ended December 31, 2014, 2013 and 2012 were \$0.4 million, \$0.4 million, and \$0.3 million, respectively.



### Stock-Based Compensation

The Company recognizes stock-based compensation related to awards granted under its 2009 Stock Option and Incentive Plan (the “2009 Plan”), 2011 Equity Incentive Award Plan (the “2011 Plan”) and Employee Stock Purchase Plan (“ESPP”).

The Company recognizes compensation expense related to stock option grants that are ultimately expected to vest based on estimated fair values on the date of grant using the Black-Scholes option-pricing model. Such expense is recognized on a straight-line basis over the requisite service period of the award, which generally equals the vesting period.

The Company recognizes compensation expense related to restricted awards, restricted stock unit awards (“RSUs”), and performance share awards (“Performance Awards”) based on the fair market value of the underlying shares of common stock as of the date of grant. Expense related to the restricted awards and the RSUs are recognized on a straight-line basis over the requisite service period of the award, which generally equals the vesting period. Expense related to the Performance Awards is recognized under the graded vesting method over the requisite service period of the award, which recognizes a larger portion of the expense during the beginning of the vesting period than in the end of the vesting period. Management estimates the probable number of shares of common stock that will be granted until the achievement of the performance goals is known.

The date of grant is the date at which the Company and the employee reach a mutual understanding of the key terms and conditions of the award, appropriate approvals are received by approval by the board of directors and the Company becomes contingently obligated to issue equity instruments to the employee who renders the requisite service.

The Company is required to estimate potential forfeitures of stock grants and adjust recorded compensation cost accordingly. The estimate of forfeitures is based on historical experience and is adjusted over the requisite service period to the extent that actual forfeitures differ, or are expected to differ, from the prior estimates. Changes in estimated forfeitures will be recognized in the period of change and will impact the amount of stock-based compensation expense to be recognized in future periods.

All stock option awards to non-employees are accounted for at the fair value of the consideration received or the fair value of the equity instrument issued, as calculated using the Black-Scholes option-pricing model. The measurement of stock-based compensation for non-employees is subject to periodic adjustments as the options vest, and the expense is recognized over the period services are rendered.

### Other Income (Expense), Net

Other income, net consisted of the following:

	Year ended December 31,		
	2014	2013	2012
	(in thousands)		
Interest income	556	650	146
Net realized gain (loss) on investments	1	(55)	—
Interest expense	(69)	(135)	(189)
Total other income (expense), net	488	460	(43)
Income Taxes			

The Company accounts for income taxes under the asset and liability method, which requires the recognition of taxes payable or refundable for the current year, and deferred tax liabilities and assets for the future tax consequences of events that have been recognized in the Company’s financial statements or tax returns. The measurement of current and deferred tax liabilities and assets is based on provisions of the enacted tax law; the effects of future changes in tax laws or rates are not anticipated. Valuation allowances are established when necessary to reduce deferred tax assets to the amount that the Company believes is more likely than not to be realized. The Company’s determination of its valuation allowance is based upon a number of assumptions, judgments and estimates, including forecasted earnings, future taxable income and the relative proportions of revenue and income before taxes in the various jurisdictions in which it operates.

The Company operates in various tax jurisdictions and is subject to audit by various tax authorities. Tax positions are based upon their technical merits, relevant tax law and the specific facts and circumstances as of each reporting

period. Changes in facts and circumstances could result in material changes to the amounts recorded for such tax positions. A tax position is only recognized in the financial statements if it is “more likely than not” to be sustained based solely on its technical merits as of the reporting date. The Company considers many factors when evaluating and estimating its tax positions and tax benefits, which may require periodic adjustments that could result in recognition of additional tax benefits or additional charges to the tax provision and may not

accurately reflect actual outcomes. The Company has a policy to classify accrued interest and penalties associated with uncertain tax positions together with the related liability, and the expenses incurred related to such accruals are included in the provision for income taxes.

#### Comprehensive Income

Comprehensive income consists of net income and other comprehensive income (loss). Other comprehensive income (loss) includes certain changes in equity that are excluded from net income, specifically unrealized gains (losses) on available-for-sale investments. Except for net realized loss on investments which was not significant, there were no reclassifications out of accumulated other comprehensive income (loss) that affected net income during the years ended December 31, 2014 and 2013.

#### Geographical Information

The Company is domiciled in the United States and had no international operations or sales to customers outside of the United States for the years ended December 31, 2014, 2013 and 2012.

#### Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09, Revenue from Contracts with Customers ("ASU 2014-09"), which outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. ASU 2014-09 also requires significantly expanded disclosures about revenue recognition. ASU 2014-09 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2016. The Company has not yet developed an expectation of the impact that adoption will have on its consolidated financial statements.

In August 2014, the FASB issued ASU No. 2014-15, Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern ("ASU 2014-15"), which provides guidance on determining when and how reporting entities must disclose going-concern uncertainties in their financial statements. ASU 2014-15 requires management to perform interim and annual assessments of an entity's ability to continue as a going concern within one year of the date of issuance of the entity's financial statements (or within one year after the date on which the financial statements are available to be issued, when applicable). Further, an entity must provide certain disclosures if there is "substantial doubt about the entity's ability to continue as a going concern." ASU 2014-15 is effective for annual periods ending after December 15, 2016, and interim periods thereafter; early adoption is permitted. The Company does not believe that adoption of ASU 2014-15 will have a material impact on its consolidated financial statements.

#### Correction of Immaterial Errors

During 2013 and the first three quarters of 2014, in preparing its quarterly and annual tax provisions, the Company incorrectly excluded a portion of compensation to the Company's executive officers as nondeductible for income tax purposes under Section 162(m) of the Internal Revenue Code. During the fourth quarter of 2014, management determined that such compensation was, in fact, deductible and should have been included in the computation of the Company's historical income tax computations. The Company assessed the materiality of this misstatement on prior periods' financial statements in accordance with SEC's Staff Accounting Bulletin ("SAB") No. 99, Materiality, codified in ASC 250, ("ASC 250"), Presentation of Financial Statements, and concluded that the misstatement was not material to any prior annual or interim periods, but the cumulative adjustment necessary to correct the classification would be material to the three months ended December 31, 2014. In accordance with ASC 250 (SAB No. 108, Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements), the financial statements as of December 31, 2013 and for the year ended December 31, 2013, which are presented herein, have been corrected. The financial statements have also been revised to reflect the correction of certain other previously uncorrected immaterial prior period errors.

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The following tables summarize the previously reported and corrected amounts of the impacted balances presented in the accompanying consolidated financial statements (in thousands except per share data).

As Previously Reported

	Three months ended							Year ended
	Sep 30, 2014	Jun 30, 2014	Mar 31, 2014	Dec 31, 2013	Sep 30, 2013	Jun 30, 2013	Mar 31, 2013	Dec 31, 2013
Revenues	\$42,798	\$39,984	\$32,178	\$30,350	\$33,006	\$34,270	\$30,855	\$128,481
Cost of revenues	11,669	10,576	9,200	8,198	8,332	8,607	7,611	32,748
Gross profit	31,129	29,408	22,978	22,152	24,674	25,663	23,244	95,733
Operating expenses								
Sales and marketing	6,521	6,451	6,095	6,098	5,163	5,167	4,903	21,331
Research and development	6,456	6,077	6,815	6,044	6,573	6,530	5,548	24,695
General and administrative	9,556	9,551	8,993	7,745	7,547	7,975	7,586	30,853
Total operating expenses	22,533	22,079	21,903	19,887	19,283	19,672	18,037	76,879
Income from operations	8,596	7,329	1,075	2,265	5,391	5,991	5,207	18,854
Other income, net	134	109	100	105	83	151	121	460
Income before income taxes	8,730	7,438	1,175	2,370	5,474	6,142	5,328	19,314
Income tax provision	4,675	3,082	393	752	2,114	2,457	1,415	6,738
Net income	\$4,055	\$4,356	\$782	\$1,618	\$3,360	\$3,685	\$3,913	\$12,576
Net income per share								
Basic	\$0.14	\$0.16	\$0.03	\$0.06	\$0.13	\$0.14	\$0.15	\$0.47
Diluted	\$0.14	\$0.15	\$0.03	\$0.06	\$0.12	\$0.13	\$0.14	\$0.44

Adjustments

	Three months ended							Year ended
	Sep 30, 2014	Jun 30, 2014	Mar 31, 2014	Dec 31, 2013	Sep 30, 2013	Jun 30, 2013	Mar 31, 2013	Dec 31, 2013
Revenues	\$—	\$—	\$—	\$—	\$—	\$—	\$—	\$—
Cost of revenues	—	—	118	(44 )	(44 )	(30 )	—	(118 )
Gross profit	—	—	(118 )	44	44	30	—	118
Operating expenses								
Sales and marketing	(276 )	—	—	—	—	—	—	—
Research and development	—	—	—	—	—	—	—	—
General and administrative	—	—	—	—	—	—	—	—
Total operating expenses	(276 )	—	—	—	—	—	—	—
Income from operations	276	—	(118 )	44	44	30	—	118
Other income, net	—	—	—	—	—	—	—	—
Income before income taxes	276	—	(118 )	44	44	30	—	118
Income tax provision	(686 )	(368 )	(118 )	(49 )	(242 )	(188 )	(145 )	(624 )
Net income	\$962	\$368	\$—	\$93	\$286	\$218	\$145	\$742
Net income per share								
Basic	\$0.04	\$0.01	\$—	\$—	\$0.01	\$0.01	\$0.01	\$0.03
Diluted	\$0.03	\$0.01	\$—	\$—	\$0.01	\$0.01	\$0.01	\$0.03





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	As Corrected							Year ended Dec 31, 2013
	Three months ended							
	Sep 30, 2014	Jun 30, 2014	Mar 31, 2014	Dec 31, 2013	Sep 30, 2013	Jun 30, 2013	Mar 31, 2013	
Revenues	\$42,798	\$39,984	\$32,178	\$30,350	\$33,006	\$34,270	\$30,855	\$128,481
Cost of revenues	11,669	10,576	9,318	8,154	8,288	8,577	7,611	32,630
Gross profit	31,129	29,408	22,860	22,196	24,718	25,693	23,244	95,851
Operating expenses								
Sales and marketing	6,245	6,451	6,095	6,098	5,163	5,167	4,903	21,331
Research and development	6,456	6,077	6,815	6,044	6,573	6,530	5,548	24,695
General and administrative	9,556	9,551	8,993	7,745	7,547	7,975	7,586	30,853
Total operating expenses	22,257	22,079	21,903	19,887	19,283	19,672	18,037	76,879
Income from operations	8,872	7,329	957	2,309	5,435	6,021	5,207	18,972
Other income, net	134	109	100	105	83	151	121	460
Income before income taxes	9,006	7,438	1,057	2,414	5,518	6,172	5,328	19,432