SolarWinds, Inc.
Form 10-K
February 27, 2012
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

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

For the fiscal year ended: December 31, 2011

Commission file number: 001-34358

SOLARWINDS, INC.

(Exact name of registrant as specified in its charter)

Delaware	**73-1559348**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification Number)**

3711 S. MoPac Expressway

Austin, Texas	**78746**
(address of principal executive offices)	**(zip code)**

Registrant s telephone number, including area code: (512) 682-9300

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

Title of Each Class	**Name of Each Exchange on Which Registered**
Common Stock, $0.001 par value	New York Stock Exchange

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.   Yes x   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 x

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 x   No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).   Yes x   No ¨

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.   x

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

Large accelerated filer x   Accelerated filer ¨   Non-accelerated filer ¨   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 x

Based on the closing price of the registrant s common stock on the last business day of the registrant s most recently completed second fiscal quarter, which was June 30, 2011, the aggregate market value of its shares held by non-affiliates on that date was approximately $1,411,700,000.

On February 17, 2012, 72,425,562 shares of common stock were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Part III of this Annual Report on Form 10-K incorporates certain information by reference from the definitive proxy statement for the registrant s 2012 Annual Meeting of Stockholders to be filed within 120 days of the registrant s fiscal year ended December 31, 2011 (the Proxy Statement). Except with respect to information specifically incorporated by reference in this Form 10-K, the Proxy Statement is not deemed to be filed as part of this Form 10-K.

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Safe Harbor Cautionary Statement

Discussions under the captions Business, Risk Factors, and Management s Discussion and Analysis of Financial Condition and Results of Operations contain or may contain forward-looking statements that are based on our management s beliefs and assumptions and on information currently available to our management. These statements are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act). Such statements may be signified by terms such as anticipates, believes, could, seeks, estimates, expects, intends, may, plans, potential, predicts, would or similar expressions and the negatives of those terms. Forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements to be materially and adversely different from any future results, performance or achievements expressed or implied by the forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those discussed under the heading Risk Factors in this report and in other documents we file with the Securities and Exchange Commission (SEC). Given these risks and uncertainties, you should not place undue reliance on these forward-looking statements. Also, forward-looking statements represent our management s beliefs and assumptions only as of the date of this report. Except as required by law, we assume no obligation to update these forward-looking statements publicly, or to update the reasons actual results could differ materially and adversely from those anticipated in these forward-looking statements, even if new information becomes available in the future.

PART I

ITEM 1.   BUSINESS
Overview

SolarWinds, Inc. and its subsidiaries (SolarWinds, the Company, we, us or our) design, develop, market, sell and support enterprise information technology, or IT, infrastructure management software to IT professionals in organizations of all sizes. Our product offerings range from individual software tools to more comprehensive software products that solve problems encountered every day by IT professionals. Our products are designed to help enable efficient and effective management of their infrastructure, including networks, applications, storage and physical and virtual servers as well as products for log and event management.

As a core part of our strategy, we utilize a differentiated business model for providing enterprise-class software to IT professionals within organizations of all sizes worldwide. Key differentiating elements of our business model include powerful and scalable, yet easy-to-use and affordable IT management software that is produced utilizing a highly efficient product development and engineering process, a scalable marketing model and a high-volume, transaction-oriented inside sales model that have allowed us to drive and support rapid growth in our business at high operating margins while offering our products at prices that are typically significantly lower than competing framework vendors.

We manage our business with a culture and systems that are focused on metrics, helping us to achieve consistency in our execution. We design our products to be easy-to-install and easy-to-evaluate, allowing potential buyers of our software to see the value that the products provide after downloading a free version of the software from our website for evaluation. We design our marketing programs to drive visitors to our websites in order to generate large volumes of highly qualified leads. Our inside sales force uses a disciplined, transaction-oriented process to convert these leads into paying customers at a higher level of productivity at a lower cost than is typically achieved with a traditional direct sales force.

We incorporated in the State of Oklahoma in 1999 and reincorporated in the State of Delaware in 2008 under the name SolarWinds, Inc. Our principal executive offices are located at 3711 South MoPac Expressway, Building Two, Austin, Texas 78735, and our telephone number is (512) 682-9300.

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2011 Highlights and Acquisitions

During 2011, we engaged in a number of activities and completed several initiatives intended to drive and support rapid growth in our business. The following are highlights related to these efforts:

In January 2011, we entered into the system and application performance management market through the launch of SolarWinds Application Performance Monitor.

In January 2011, we also entered the virtualization management market through the acquisition of Hyper9, Inc., or Hyper9, a privately-held virtualization management software provider based in Austin, Texas.

In July 2011, we entered the log and event management market through the acquisition of TriGeo Network Security, Inc., a privately-held log and event management software provider based in Post Falls, Idaho.

In August 2011, we extended our systems and application performance management product portfolio with the release of SolarWinds Synthetic End User Monitor.

In December 2011, we acquired certain assets of DameWare Development, LLC, or DameWare, further broadening the number of systems and application performance problems we can solve with the addition of powerful, yet affordable and easy-to-use tools for systems administrators to remotely manage the computers on their networks.

Throughout 2011, we broadened and deepened our presence in a number of geographic markets including Asia-Pacific, Latin America, Europe, Middle East and Africa through the establishment of distributor and reseller partnerships.

Our Growth Strategy

Our differentiated business model of providing low-cost, easy-to-install and easy-to-use software marketed and sold directly to IT professionals through a highly productive and efficient inside sales force is the core of our strategy. We evaluate all of our strategic opportunities to ensure that they are compatible with our model for providing cost-efficient, downloadable enterprise-class software that can be marketed and sold through a high volume, transaction-oriented model.

We plan to continue to focus on growth opportunities within our existing customer base and IT infrastructure management markets through increased brand awareness and product depth and breadth, through expansion into adjacent areas of IT infrastructure management and by expanding our business globally. Our objective is to extend our market presence by providing IT professionals with enterprise-class software that solves their specific needs. The following are key elements of our growth strategy:

Continue to Add New Customers Globally. We believe that the IT infrastructure management markets throughout North America and the rest of the world remain significantly under-penetrated and represent a significant opportunity to continue our growth. We intend to penetrate these markets further by leveraging our customer base and end-user community and by using our strategic marketing programs to identify and obtain new customers.

Cross-Sell and Up-Sell Existing Products into Our Growing Customer Base. Our customers are generally IT professionals in small- and mid-size businesses, enterprises, and local, state and federal government entities that have purchased one or more of our products. We have an active, loyal end-user community that is built from our customers and end-users who have downloaded our free tools. We seek to expand, and generate loyalty from, our customer base and our end-user community by providing a variety of

free tools for IT professionals, by hosting our online community website, thwack, and through other marketing programs. We believe our customers are highly satisfied users of our products and that there is a significant opportunity for follow-on sales of both incremental capacity and additional products and modules to these customers.

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Expand Our Business in International Markets. We believe a substantial opportunity exists for sales of our software in the Europe, Middle East and Africa region (EMEA) and the Asian-Pacific region, and we intend to increase our sales, marketing and support operations in these regions. We are in the initial phases of localizing certain of our products with country-specific product documentation, websites and marketing material. We believe our market penetration is low in all geographic and end user markets in which we sell products. We anticipate continuing our international expansion to further market, sell and develop our products. In addition, we plan to continue to scale and develop our existing group of international distributors and resellers. In the new markets we enter, we plan to continue our strategy of delivering powerful, easy-to-use and affordable software while leveraging the web as the primary method to reach potential customers.

Selectively Expand Our Product Portfolio. We plan to continue to develop new software products and modules that enhance and expand our current IT management offerings. We also intend to continue to expand our product offerings into adjacent areas of IT management software in which we can provide differentiated, easy-to-use enterprise-class software products that are marketed and sold directly to IT professionals.

Pursue Strategic Acquisitions of Complementary Products in New and Existing Markets. We expect to continue to pursue acquisitions that will enable us either to bring new product offerings to market more quickly than we can develop them or to enter new markets or segments of markets we currently serve.

Our Products

We offer a broad portfolio of products for IT infrastructure management. Our products fit into one of the following three categories:

Free Tools

Our free tools are desktop, laptop, server-based or internet-based applications designed for use by individual IT professionals, and typically focused on a single network or infrastructure management task or technology. We use free tools primarily to drive awareness of our brand and our paid products within the broader IT management community and to expand and build loyalty among our customers and our end-user community.

Transactional Products

Our transactional products are desktop-based, laptop-based or server-based applications designed for individual IT professionals who need specific solutions for routine, but complicated tasks. Our transactional products include individual tools and toolsets, which combine many powerful tools together into a single package, as well as entry-level IT infrastructure monitoring functionality. We price our transactional products so that an individual IT professional can purchase them with one level of or, in some cases, no management approval. We believe that broad awareness and usage of our tools create positive relationships and loyalty with IT professionals, who in turn influence the purchase of our other products.

Our current transactional products include Standard Toolset, Engineer s Toolset, Kiwi Syslog Server, Kiwi CatTools, and Kiwi Logviewer, or Kiwi products, ipMonitor, LANsurveyor, DameWare SysAdmin Utilities, and DameWare Mini Remote Control, or DameWare products, and various subscription-based tools available at DNSstuff.com.

Core Products

Our core products consist of enterprise-class IT management products that are used by IT professionals and teams in companies of all sizes to configure, monitor and report on network equipment, physical and virtual servers, applications and storage devices to determine the overall health and performance of the IT infrastructure and to automate the processes of change, compliance and inventory. These products provide advanced IT management functionality and are capable of scaling from simple to complex environments.

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Our current core products provide enterprise-class functionality across network management, systems and application management, storage resource management, virtualization management and log and event management:

Network Management. Our enterprise-class network management products share integrated components, databases, web servers and user administration. Our network management products are designed to operate together seamlessly, while still allowing network professionals to purchase and deploy only the products they need.

Network Performance Monitor. Our flagship product, Network Performance Monitor, is a server-based fault and performance management platform designed to minimize network downtime. Network Performance Monitor monitors and analyzes real-time, in-depth network performance metrics for routers, switches, servers and other Simple Network Management Protocol, or SNMP, enabled devices to provide both current and historical views into the availability and performance of a network and all devices attached to it. Network Performance Monitor is modular and has the ability to scale with the growth of a network. It can also be expanded through the use of add-on modules and polling engines. End-users can configure Network Performance Monitor to alert network professionals of network events, including thresholds, correlated events, sustained conditions and complex combinations of device states. Network Performance Monitor drives follow-on sales of our other products and, together with its related modules, currently generates a majority of our revenue.

Network Performance Monitor Modules. Our Network Performance Monitor modules are a series of add-ons that extend the network management capabilities of our Network Performance Monitor to network traffic analysis and WAN performance monitoring. These modules are purchased separately and are fully integrated with our Network Performance Monitor s web console and database. Based on the nature of the issue they address, these modules are either available for use on a stand-alone basis or must be used in conjunction with our Network Performance Monitor. Our current Network Performance Monitor modules are:

NetFlow Traffic Analyzer. NetFlow Traffic Analyzer utilizes Cisco Systems NetFlow protocol and other similar protocols to extract data from network devices to provide an in-depth view of which end-users, protocols and applications are consuming network bandwidth.

IP SLA Manager. IP SLA Manager monitors WAN performance from the perspective of multiple remote sites by tracking key edge-to-edge router performance statistics using Cisco IP SLA technology.

IP Address Manager. IP Address Manager tracks, manages and reports on the use of IP addresses through a web interface. IP Address Manager is available as a module of Network Performance Monitor and on a stand-alone basis.

Network Configuration Manager. Network Configuration Manager is a server-based product that automates the processes of network device discovery, network inventory management and network change management. Compliance with internal controls and regulatory standards is growing in importance to companies of all sizes, and network configuration and device configuration changes impact network availability, access and security controls that are critical to ensuring up-time and compliance. Network Configuration Manager automates many device configuration management tasks, including bulk network configuration changes, real-time detection and alerts of network configuration problems and rolling back configuration changes on demand. These capabilities help avoid network downtime and are essential to meeting compliance objectives.

User Device Tracker. User Device Tracker is a server-based switch port management tool for tracking and identifying the devices connected to the network, managing network port capacity and responding to network threats posed by rogue devices.

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Scalability Engines. Scalability engines increase the scale of a number of the products based on their infrastructure increasing their monitoring capabilities to a larger number of devices by distributing the polling load across additional servers.

Enterprise Operations Console. Enterprise Operations Console is a server-based product that provides summarized web-based views of multiple instances of Network Performance Monitor modules and Application Performance Monitor, enabling flexible deployment architectures for large or distributed environments.

<u>Systems and Application Management.</u> Our enterprise-class systems and application performance management products allow system administrators to monitor and manage the performance of systems and applications and end-user application experience as well as perform patch management. In addition, our transactional DameWare products allow system administrators to remotely manage the computers on their networks. Our systems and application management products are designed to operate together seamlessly, as well as with our network management products. Our systems and application management products also integrate with our products for storage resource management.

SolarWinds Application Performance Monitor. Application Performance Monitor is a server-based availability and performance management system for applications and server infrastructure, both virtual and physical. Application Performance Monitor provides a view of critical IT services and allows system administrators to drill down and view application-specific server processes, performance counters, synthetic end-user transactions and custom data collected via scripts. With Application Performance Monitor, end-users can configure customized alerts and reports for tracking and managing application and server performance. These capabilities allow system administrators to monitor, manage and optimize the performance of an increasingly complex and growing number of mission-critical business applications. Application Performance Monitor supports over 200 major applications, with extensibility to support additional applications on both the Windows and Linux operating systems.

SolarWinds Patch Manager. Patch Manager is a server-based product that allows Systems Administrators to automate and improve the process of deploying, managing, and reporting on patches and configuration settings of Microsoft Windows servers and workstations. Patch Manager allows Systems Administrators to automate patching applications across thousands of servers and workstations and receive automatic notifications of new third party patches from vendors of commonly-used commercial software applications. In addition, Patch Manager allows users to leverage the investments they have made in Microsoft Windows Server Update Services (WSUS) and System Center Configuration Manager (SCCM) by extending the capabilities of those products to provide Systems Administrators with an efficient, centralized method of tracking, maintaining, and resolving configuration and health issues on servers and workstations.

SolarWinds Synthetic End User Monitor. Synthetic End User Monitor captures the user steps of any web application through an easy-to-use recorder and continuously monitors the end-user experience of those web applications.

<u>Storage Resource Management.</u> Our enterprise-class storage resource management capabilities are represented by SolarWinds Storage Manager.

SolarWinds Storage Manager, powered by Profiler. Storage Manager is a server-based product that combines reporting, monitoring and notification on the performance of storage resources, including DAS (direct-attached storage), NAS (network-attached storage) and SAN (storage area networks), from a wide range of storage hardware vendors. In addition, Storage Manager provides mapping of storage resources to physical and virtual infrastructure to help optimize storage allocation.

SolarWinds Backup Profiler. Backup Profiler provides storage administrators with a consolidated view of the status of backup operations across all major backup applications.

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Virtualization Management. Our enterprise-class virtualization management capabilities are represented by SolarWinds Virtualization Manager.

SolarWinds Virtualization Manager. Virtualization Manager is a server-based product that provides virtualization administrators with a single solution to manage all the aspects of a virtual server infrastructure, including inventory, sprawl control, performance monitoring, capacity planning, and configuration tracking. Using a multi-dimensional, search-based approach Virtualization Manager combines multiple disparate data points into useable insights, which are presented in management dashboards and reports. Virtualization Manager integrates with other key enterprise applications such as configuration management databases, service desks and enterprise portals.

Log and Event Management. Our enterprise-class log and event management capabilities are represented by SolarWinds Log and Event Manager.

SolarWinds Log and Event Manager. Log and Event Manager is a server-based product that automates the collection and interpretation of logs from a wide variety of sources including network devices, physical and virtual servers, applications and storage infrastructure, providing IT professionals with real-time availability and performance monitoring of the IT infrastructure. Through log analysis and event correlation provided with approximately 700 built-in correlation rules along with customizable rules, Log and Event Manager supports compliance verification with internal policies and regulatory requirements and SOX and also provides IT professionals with real-time and forensic tools for responding to security threats and events.

Maintenance and Support

Our perpetual license customers receive one or more years of software maintenance and support as part of their initial purchase of our products and have the option to renew their maintenance agreements. These maintenance agreements provide customers the right to receive software updates, maintenance releases and patches, when and if they become available, and access to our internal support representatives.

Our typical customers are network professionals, systems administrators, storage administrators or virtual administrators who are sophisticated users of software and related technologies. We devote significant resources to designing software products that are easy-to-install, configure and use, and to developing extensive, easy-to-understand instruction manuals and online tutorials for our products. We also utilize community websites, such as thwack, as forums for our end-users to share information, tips, tools and other valuable resources. Through these online communities, users of our software are able to find answers for many technical problems, discover new uses for our software, and provide suggestions or feedback to our product development teams. As a result of these efforts, our customers are able to resolve most technical issues without having to contact our support representatives, which significantly reduces our total support expenses.

Research and Development

Our research and development organization is responsible for the design, development and testing of our software. Our current research and development efforts are focused on new releases of existing products, as well as new products and modules.

We work closely with our customers in developing our products and have designed a product development process that is responsive to customer feedback throughout the process. Our customers and end-user community provide extensive input regarding a wide variety of use cases that we incorporate into our product definitions and requirements. A subset of customers participates in our product testing, helping us to identify issues prior to product release. Our research and development organization regularly assists customer support personnel with customer inquiries, which provides another mechanism for customer feedback during the development process.

We utilize small development teams. Each of these teams is dedicated to specific products and work according to a structured and repeatable, iterative process. These teams apply a standard architecture to their

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individual products, and are managed centrally to ensure standardization, efficiency and interoperability. We use a hybrid onshore and offshore development model, wherein product requirements definition and technical design are performed in the United States, and our U.S. technical staff work closely with development teams in our international facilities and with two contract development vendors in Eastern Europe that write code and do testing and quality assurance. Since establishing our research and development center in the Czech Republic and as a result of our acquisitions, we have significantly increased our research and development employee headcount. As part of our acquisitions, we increased research and development personnel in New Zealand, India and the United States. We expect to continue to invest in our research and development activities by hiring engineers in the United States and in our international locations. In 2011, we started and completed the expansion of our development center in India which has resulted in and will result in an increase in facilities and personnel costs. We believe that we have developed a differentiated process that allows us to release new software rapidly and cost effectively, a process that we continue to improve upon each year. Using our development model, we made 73 product releases in 2009, 53 product releases in 2010 and 64 product releases in 2011.

Our research and development expenses were $11.2 million, $15.7 million and $21.3 million in 2009, 2010, and 2011, respectively.

Marketing and Sales

We have designed our marketing and sales model to be efficient for very high volumes of low-price transactions. Our marketing efforts focus on driving traffic to our websites and on generating high quality sales leads, primarily consisting of end-users who download a free evaluation of our software. Our sales efforts focus on converting these leads into paying customers through a high volume, short duration, inside sales process that we measure and manage frequently.

Marketing

We use a variety of online marketing programs for lead generation, as well as more traditional direct marketing and indirect channel partner marketing programs to drive traffic to our websites. These efforts leverage the ubiquity of Internet search engines through search engine marketing and optimization programs. In addition, we send a series of targeted emails to end-users who have downloaded free evaluations of one or more of our software products or received our corporate communications or public relations material. Once we drive traffic to our websites, we have a well-defined process that allows us automatically to track visitors activities, communicate with potential customers, encourage downloads of our software and provide highly qualified leads to our sales organization.

Our historical marketing approach, which continues to be important to us, was based on word of mouth and customer references. It allowed us to build a substantial customer base and community of network engineers and IT professionals who use our products and act as advocates for them. We continue to build our customer base and this community through marketing of relevant web-based content and online communications. Examples of our initiatives include thwack, a community website designed for IT professionals that provides our end-users and the broader IT management community with information, tools and valuable resources; several company sponsored blogs in which we provide perspectives and information relevant to the IT management marketplace, network engineering, systems management, virtualization, security and other technical topics; and quarterly newsletters designed to inform, and keep us connected to, our end-user base and other prospective customers. Other marketing activities include attending IT management related trade shows, social marketing programs, communicating with industry analysts and hosting webinars on IT management issues to create awareness of our brand and software products.

Sales

We license our software directly to our customers. Our direct sales are made exclusively through a low-cost inside sales force that is devoted to turning highly qualified leads into purchasers of our software. The majority

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of our leads come from potential customers who have downloaded our software and are using it during a trial period or from our existing customer base. As a result, our inside sales team typically is calling potential buyers who are already informed on the use and value of our products and do not require a lengthy sales cycle.

We also sell our software through distributors and resellers to supplement our inside sales force and help us to initiate and fulfill sales orders from state, local and federal governments and those commercial customers that prefer to make purchases through a particular reseller. We provide licenses directly to the end user in sales of our software through our distributors and resellers.

Our sales approach focuses on driving a high volume of standard transactions. We implement our approach through a disciplined sales process that provides clear guidelines for our sales force, and we actively measure and manage our sales results. We offer our products at low prices using standard contract terms. We enable our customers to buy our products in a manner convenient to them, whether by purchase order, online with a credit card or through our channel partners.

We have experienced some seasonality in our new license sales and, consequently, our cash collections. We typically achieve the highest levels of new license sales for the year in the third and fourth quarters. We believe that, in general, historical seasonality results primarily from the budgeting cycles of our customers being typically higher in the third and fourth quarters. New license sales for our U.S. federal business tend to peak in the third quarter of each calendar year as September 30 is the fiscal year end for the U.S. federal government. As a result, cash collections have historically been the highest in the fourth quarter of each calendar year. New license sales for our commercial business tend to peak in the fourth quarter of each calendar year as many companies typically have a December 31 fiscal year end.

We believe we have built a sales process and culture that is unique in the software industry, and that our sales force is able to achieve and maintain a higher level of productivity at a lower cost than most other enterprise software companies. Because our sales personnel do not need a professional software sales background, we are able to keep our personnel costs low and can expand our sales force quickly.

Customers

In 2011, 2010 and 2009, we had one distributor that represented 11.9%, 12.4% and 14.4%, respectively, of our revenue from sales to various end-users. In 2010 and 2009, we had one additional distributor that represented 10.0% and 13.8%, respectively, of our revenue from sales to various end-users. We do not believe, however, that our business is substantially dependent on either distributor or that the loss of either relationship, or both relationships, would have a material adverse effect on our business, as we are generally directly involved with the end user in all of our sales regardless of whether we make the sale direct or through the reseller channel. See Note 1 of the notes to our consolidated financial statements for further information regarding concentrations of risks.

Intellectual Property

We rely on a combination of copyright, trademark, trade dress and trade secret laws, as well as confidentiality procedures and contractual restrictions, to establish and protect our proprietary rights. These laws, procedures and restrictions provide only limited protection. We currently have six patents. We have also filed patent applications, but we cannot guarantee that patents will be issued with respect to our current patent applications in a manner that gives us the protection that we seek or at all. Our patent and any future patents issued to us may be challenged invalidated or circumvented and may not provide sufficiently broad protection or may not prove to be enforceable in actions against alleged infringers.

We endeavor to enter into agreements with our employees and contractors and with parties with which we do business in order to limit access to and disclosure of our proprietary information. We cannot be certain that

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the steps we have taken will prevent unauthorized use or reverse engineering of our technology. Moreover, others may independently develop technologies that are competitive with ours or that infringe our intellectual property. The enforcement of our intellectual property rights also depends on any legal actions against these infringers being successful, but these actions may not be successful, even when our rights have been infringed.

Furthermore, effective patent, trademark, trade dress, copyright and trade secret protection may not be available in every country in which our products are available over the Internet. In addition, the legal standards relating to the validity, enforceability and scope of protection of intellectual property rights are uncertain and still evolving.

Competition

We face competition from both traditional, larger software vendors offering enterprise-wide software frameworks and services and smaller companies offering point solutions for application, log and event, network, storage resource or virtualization management. We also compete with network equipment vendors and systems management product providers whose products and services also address network and IT management requirements. Our principal competitors vary depending on the product we offer and include Hewlett Packard, IBM, CA Technologies, Cisco Systems, Inc., VMware, Inc., EMC Corporation, NetApp, Inc., BMC Software, Inc., Quest Software, Inc. and several smaller vendors.

Competition in our market is based on the level of difficulty in using, maintaining and installing solutions; total cost of ownership, including product price and implementation and support costs; professional services implementation; product performance, functionality, flexibility, scalability and interoperability; brand and reputation; distribution channels; vertical markets or industries; and financial resources of the vendor. We generally compete favorably with respect to these factors; however, many of our actual and potential competitors enjoy substantial competitive advantages over us, such as greater name recognition, more comprehensive and varied products and services and substantially greater financial, technical and other resources. We expect competition to continue to increase both from existing competitors and new market entrants.

Employees

As of December 31, 2011, we had 628 full-time employees, of which 367 were employed in the United States and 261 were employed outside of the United States. We consider our current relationship with our employees to be good. None of our employees is represented by a labor union or is a party to a collective bargaining agreement.

Additional Information

Our website address is www.solarwinds.com. Our website and the contents therein or connected thereto are not intended to be incorporated into this Annual Report on Form 10-K. Through a link on the Investor Relations section of our Website, we make available the following filings as soon as reasonably practicable after they are electronically filed with or furnished to the SEC: our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and any amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act. All such filings are available free of charge. The public may read and copy any materials we file with SEC at the SEC s Public Reference Room at 100 F Street, NE, Washington, DC 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. In addition, the SEC maintains an Internet site (http : / /www.sec.gov) that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC.

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ITEM 1A. RISK FACTORS
Risks Related to Our Business and Industry

Our quarterly revenue and operating results have fluctuated in the past and may fluctuate in the future due to a number of factors. As a result, we may fail to meet or exceed the expectations of securities analysts or investors, which could cause our stock price to decline.

We believe our quarterly revenue and operating results may vary significantly in the future. As a result, you should not rely on the results of any one quarter as an indication of future performance and period-to-period comparisons of our revenue and operating results may not be meaningful.

Our quarterly results of operations may fluctuate as a result of a variety of factors, including, but not limited to, those listed below, many of which are outside of our control:

- our inability to increase sales to existing customers and to attract new customers;

- general economic, industry and market conditions that impact expenditures for enterprise IT management software in the United States and other countries where we sell our software;

- the mix of our direct and indirect sales;

- the timing and success of new product introductions by us or our competitors;

- changes in our pricing policies or those of our competitors;

- higher marketing expenditures in an attempt to generate growing numbers of sales leads;

- potential foreign exchange gains and losses related to expenses and sales denominated in currencies other than the functional currency of an associated entity;

- the timing of revenue and expenses related to the development or acquisition of technologies, products or businesses;

- potential goodwill and intangible asset impairment charges and amortization associated with acquired businesses;

- the amount and timing of operating expenses and capital expenditures related to the expansion of our operations and infrastructure;

- occasional large customer orders, including in particular those placed by the U.S. federal government; and

- unpredictability and timing of buying decisions by the U.S. federal government.

Fluctuations in our quarterly operating results might lead analysts to change their models for valuing our common stock. As a result, our stock price could decline rapidly and we could face costly securities class action suits or other unanticipated issues.

Our actual operating results may differ significantly from our operating results guidance.

From time to time, we may release operating results guidance in our quarterly earnings releases, quarterly earnings conference calls, or otherwise, regarding our future performance that represents our management s estimates as of the date of release. This guidance, which includes forward-looking statements, will be based on projections, including those related to certain of the factors listed above, prepared by our management. Neither our independent registered public accounting firm nor any other independent expert or outside party will compile or examine the projections nor, accordingly, will any such person express any opinion or any other form of assurance with respect thereto.

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These projections will be based upon a number of assumptions and estimates that, while presented with numerical specificity, will be inherently subject to significant business, economic and competitive uncertainties and contingencies, many of which will be beyond our control, and will also be based upon specific assumptions with respect to future business decisions, some of which will change. For example, our management has excluded and currently intends to continue to exclude in their projections the potential revenue associated with certain transactions with U.S. federal government entities that are associated with projects involving larger end user technology implementations that typically involve multiple companies, resellers and/or service providers, or what we refer to as project-based transactions. To the extent we recognize revenue from these project-based transactions during a specific quarter, actual results may differ significantly from our operating results guidance. We intend to state possible outcomes as high and low ranges, which will be intended to provide a sensitivity analysis as variables are changed but will not be intended to represent that actual results could not fall outside of the suggested ranges. The principal reason that we release guidance is to provide a basis for our management to discuss our business outlook with analysts and investors. We do not accept any responsibility for any projections or reports published by analysts.

Guidance is necessarily speculative in nature, and it can be expected that some or all of the assumptions underlying the guidance furnished by us will not materialize or will vary significantly from actual results. Accordingly, our guidance will only be an estimate of what management believes is realizable as of the date of release. Actual results will vary from our guidance, and the variations may be material and adverse. In light of the foregoing, investors are urged to consider these factors, not to rely exclusively upon our guidance in making an investment decision regarding our common stock, and to take such guidance into consideration only in connection with other information included in our filings filed with or furnished to the SEC, including Risk Factors such as this one.

Any failure to implement our operating strategy successfully or the occurrence of any of the events or circumstances set forth under Risk Factors in this report could result in our actual operating results being different from our guidance, and those differences might be adverse and material.

If we are unable to generate significant volumes of sales leads from Internet search engines, marketing campaigns and traffic to our websites, then our revenue may not grow as expected or may decline.

We generate many of our sales leads through visits to our websites by potential end-users interested in purchasing or downloading evaluations of our products. Many of these potential end-users find our websites by searching for enterprise IT management and monitoring products through Internet search engines, such as Google. A critical factor in attracting potential customers to our websites is how prominently our websites are displayed in response to search inquiries. If we are listed less prominently or fail to appear in search result listings for any reason, visits to our websites by customers and potential customers could decline significantly. We may not be able to replace this traffic and, if we attempt to replace this traffic, we may be required to increase our sales and marketing expenses, which may not be offset by additional revenue and could adversely affect our operating results.

We also generate leads through various marketing activities such as targeted email campaigns, attending networking-based trade shows and hosting webinars on enterprise IT management issues. Our marketing efforts may be unsuccessful in generating evaluation downloads, resulting in fewer sales leads. If we fail to generate a sufficient volume of leads from these activities and/or such sales leads do not result in actual sales, our revenue may not grow as expected or could decrease and our operating results could suffer.

If we are unable to sell products to new customers or to sell additional products to our existing customers, our revenue growth will be adversely affected and our operating income could decrease.

To increase our revenue, we must regularly add new customers and/or sell additional products to existing customers. Even if we generate a significant volume of leads from our marketing activities, we must be able to sell products to a sufficient number of these new sales leads in order to achieve our expected revenue growth. We

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expect to incur significant additional expenses in expanding our sales personnel and our international operations in order to convert leads into sales of our products. If we are unable to sell products to new customers and additional products to our existing customers as a result of these expenditures, we may be unable to grow our revenue and/or our operating results may be adversely affected.

Challenging or uncertain economic conditions could adversely affect our operating results.

Economies in many countries are experiencing uncertain and challenging conditions as a result of a multitude of factors, including, but not limited to, declines in gross domestic product, increases in unemployment, sovereign debt levels and volatility in commodity prices and worldwide stock markets. During these challenging and uncertain economic periods, customers may reduce or delay technology purchases, including purchases of our software products. Our typically short sales cycle may lengthen if purchasing decisions are delayed as a result of uncertain information technology budgets, contract negotiations become more protracted or customers institute additional internal approvals for software purchases. Uncertain and challenging economic conditions could result in reductions in sales of our products, longer sales cycles, difficulties in collecting accounts receivable or delayed payments, slower adoption of new technologies and increased price competition. Any of these events would likely harm our business, financial condition, operating results and cash flows.

The ability to recruit, retain and develop key employees is critical to our success and growth, and our inability to attract and retain qualified personnel could harm our business.

Our business requires certain expertise and intellectual capital, particularly within our management team. For us to compete successfully and grow, we must retain, recruit and develop key personnel who can provide the needed expertise for our industry and products. However, the market for qualified personnel is competitive and we may not succeed in recruiting additional key personnel or may fail to replace current key personnel effectively who depart with qualified or effective successors. We believe that replacing our key personnel with qualified successors is particularly challenging as we feel that our business model and approach to marketing and selling our products are unique. Any successors that we hire from outside of the Company would likely be unfamiliar with our business model and may therefore require significant time to understand and appreciate the important aspects of our business or fail to do so altogether. Our effort to retain and develop personnel may also result in significant additional expenses, which could adversely affect our profitability. We have made significant changes, and may make additional changes in the future, to our senior management team and other key personnel. We cannot provide assurances that key personnel, including our executive officers, will continue to be employed or that we will be able to attract and retain qualified personnel in the future. Failure to retain or attract key personnel could have a material adverse effect on the Company.

If we are not able to integrate future acquisitions successfully, our operating results and prospects could be harmed.

In order to expand our business, we made several acquisitions in 2011 and expect to continue making similar acquisitions and possibly larger acquisitions as part of our growth strategy. The success of our future acquisition strategy will depend on our ability to identify, negotiate, complete and integrate acquisitions and, if necessary, to obtain satisfactory debt or equity financing to fund those acquisitions. Mergers and acquisitions are inherently risky, and any mergers and acquisitions we complete may not be successful. Any mergers and acquisitions that we do in the future would involve, numerous risks, including, but not limited to, the following:

difficulties in integrating and managing the operations, systems, technologies and products of the companies we acquire;

diversion of our management s attention from normal daily operations of our business;

our inability to maintain the key business relationships and the reputations of the businesses we acquire;

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uncertainty of entry into markets in which we have limited or no prior experience and in which competitors have stronger market positions;

our dependence on unfamiliar affiliates and partners of the companies we acquire;

insufficient revenue to offset our increased expenses associated with acquisitions;

our responsibility for the liabilities of the businesses we acquire;

our inability to maintain internal standards, controls, procedures and policies; and

potential loss of key employees of the companies we acquire.

Acquisitions or asset purchases made entirely or partially for cash may reduce our cash reserves. We may seek to obtain additional cash to fund an acquisition by selling equity or debt securities. We may be unable to secure the equity or debt funding necessary to finance future acquisitions on terms that are acceptable to us. If we finance acquisitions by issuing equity or convertible debt securities, our existing stockholders will likely experience ownership dilution, and if we finance future acquisitions with debt funding, we will incur interest expense and may have to comply with financing covenants or secure the debt obligation with our assets.

Businesses that we acquire may have greater than expected liabilities for which we become responsible.

Businesses that we acquire may have liabilities or adverse operating issues, or both, that we fail to discover through due diligence or the extent of which we underestimate prior to the acquisition. For example, to the extent that any business that we acquire or any prior owners, employees or agents of any acquired businesses or properties: (i) failed to comply with or otherwise violated applicable laws, rules or regulations; (ii) failed to fulfill or disclose their obligations, contractual or otherwise, to applicable government authorities, their customers, suppliers or others; or (iii) incurred tax or other liabilities, we, as the successor owner, may be financially responsible for these violations and failures and may suffer harm to our reputation and otherwise be adversely affected. An acquired business may have problems with internal control over financial reporting, which could be difficult for us to discover during our due diligence process and could in turn lead us to have significant deficiencies or material weaknesses in our own internal control over financial reporting. These and any other costs, liabilities and disruptions associated with any of our past acquisitions and any future acquisitions could harm our operating results.

Our operating income could fluctuate and may decline as a percentage of revenue as we make further expenditures to expand our operations in order to support additional growth in our business.

We have continued to make significant investments in our operations to support additional growth, such as hiring substantial numbers of new personnel, investing in new facilities, acquiring other companies or their assets and establishing and broadening our international operations in order to expand our business. We intend to make additional investments in systems and personnel and to continue to expand our operations to support anticipated future growth in our business. We also expect to make acquisitions, many or all of which may increase our operating costs more than our revenue. As a result of these investments, our operating income could fluctuate and may decline as a percentage of revenue.

Our business depends on customers renewing their maintenance contracts. Any decline in maintenance renewals could harm our future operating results.

We sell most of our products pursuant to a perpetual license, which ordinarily includes one year of maintenance as part of the initial price. Our customers have no obligation to renew their maintenance agreements after the expiration of this initial period. We may be unable to predict future customer renewal rates accurately. Our customers renewal rates may decline or fluctuate as a result of a number of factors, including their level of satisfaction with our products, the prices of our products, the prices of products and services offered by our

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competitors or reductions in our customers   spending levels. If our customers do not renew their maintenance arrangements or if they renew them on less favorable terms, our revenue may decline and our business will suffer. A substantial portion of our quarterly maintenance revenue is attributable to maintenance agreements entered into during previous quarters. As a result, if there is a decline in renewed maintenance agreements in any one quarter, only a small portion of the decline will be reflected in our maintenance revenue recognized in that quarter and the rest will be reflected in our maintenance revenue recognized in the following four quarters or more.

Failure to expand our sales operations effectively could harm our ability to increase our customer base and achieve broader market acceptance of our products.

Increasing our customer base and achieving broader market acceptance of our products will depend on our ability to expand our sales operations effectively. We are substantially dependent on our direct inside sales force, and to a significantly lesser extent certain resellers and distributors, to obtain new customers. We plan to continue to expand our direct inside sales force both domestically and internationally. Our ability to achieve significant growth in revenue in the future will depend on our success in recruiting, training and retaining sufficient numbers of direct inside sales personnel, and on the productivity of those personnel. Our recent and planned personnel additions may not become as productive as we would like, and we may be unable to hire or retain sufficient numbers of qualified individuals in the future in the markets where we do or plan to do business. Our operating results will be seriously harmed if these expansion efforts do not generate a corresponding significant increase in revenue.

If we are unable to enhance existing products, particularly our core products, or to develop or acquire new products that respond to rapidly changing customer requirements, technological developments or evolving industry standards, our long-term revenue growth will be harmed.

The market for our products is characterized by rapid technological advances, changes in customer requirements, changes in protocols and evolving industry standards. Our long-term growth depends on our ability to enhance and improve our existing products and to introduce or acquire new products that respond to these demands. The success of any enhancement or new product depends on a number of factors, including its timely completion, introduction and market acceptance. New products that we develop or acquire may not be introduced in a timely or cost-effective manner and may not achieve the broad market acceptance necessary to generate significant revenue. Additionally, our existing and prospective customers may develop their own competing technologies, purchase competitive products or services or engage third party providers. If we are unable to develop or acquire enhancements to, and new features for, our existing products or acceptable new products that keep pace with rapid technological developments, our products may become obsolete, less marketable and less competitive, and our business will be harmed.

We operate much of our research and devel