ELLIE MAE INC
Form 10-K
March 14, 2014

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

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2013

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

ELLIE MAE, INC.
(Exact name of registrant as specified in its charter)

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)	94588 (Zip Code)

(925) 227-7000
(Registrant’s telephone number, including area code)

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

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, par value $0.0001 per share	New York Stock Exchange

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

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

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 of Section 15(d) of the Act. Yes o 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 o

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of 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. o

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

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant as of June 28, 2013, the last business day of the registrant's most recently completed second fiscal quarter, was approximately $574,006,000 (based on the last reported sale price of $23.08 on June 28, 2013).

27,915,358 shares of the registrant's common stock, par value $0.0001 per share, were outstanding as of March 10, 2014.

Documents Incorporated by Reference

Portions of the registrant's Proxy Statement for the registrant's 2014 Annual Meeting of Stockholders are incorporated by reference into Part III of this Form 10-K to the extent stated herein. The Proxy Statement will be filed within 120 days of the registrant's fiscal year ended December 31, 2013.

Ellie Mae, Inc.
Form 10-K
For the Year Ended December 31, 2013
TABLE OF CONTENTS

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K and the documents incorporated herein by reference contains 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, which are subject to the “safe harbor” created by those sections. These statements relate to future events or our future financial performance. Forward-looking statements may include words such as “may,” “will,” “should,” “expect,” “plan,” “intend,” “anticipate,” “believe,” “estimate,” “predict,” “potential,” “continu wording indicating future results or expectations. Forward-looking statements are subject to risks and uncertainties, and actual events or results may differ materially. Factors that could cause our actual results to differ materially include, but are not limited to, those discussed under “Risk Factors” in this report. We also face risks and uncertainties relating to our business including: fluctuations in mortgage lending volume; the volume of mortgages originated by our Encompass users; the impact of changes in mortgage interest rates; changes in mortgage originator, lender, investor or service provider behavior and any related impact on the residential mortgage industry; our ability to accurately forecast revenues and appropriately plan our expenses; the number of Encompass users, including contracted SaaS Encompass users; the effectiveness of our marketing and sales efforts to attract new and retain existing SaaS Encompass users and Ellie Mae Network participants; transaction volume on the Ellie Mae Network; the level of demand for our Encompass Docs Solution and other services we offer; the level of adoption of our Total Quality Loan, or TQL, program; the timing of the introduction and acceptance of new Ellie Mae Network offerings and new on-demand services; interruptions in Ellie Mae Network service, our hosted Encompass software and any related impact on our reputation; our ability to protect the confidential information of our Encompass users, Ellie Mae Network participants and their respective customers; customer renewal and upgrade rates; the increased time, cost and complexity that may be required to successfully target larger customers; our ability to scale our operations and increase productivity to support our existing and growing customer base; our ability to successfully manage our growth and any future acquisitions of businesses, solutions or technologies; the risk that the anticipated benefits and growth prospects expected from the ARG Interactive, LLC (dba MortgageCEO), or MortgageCEO, acquisition may not be fully realized or may take longer to realize than expected; the timing of future acquisitions of businesses, solutions or technologies and new product launches; the impact of uncertain domestic and worldwide economic conditions, including the resulting effect on residential mortgage volumes; changes in government regulation affecting Ellie Mae Network participants or our business, and potential structural changes in the U.S. residential mortgage industry; the attraction and retention of qualified employees and key personnel; our ability to compete effectively in a highly competitive market and adapt to technological changes; our ability to enhance the features and functionality of our Encompass software and the Ellie Mae Network; our ability to protect our intellectual property, including our proprietary Encompass software; costs associated with defending intellectual property infringement and other claims; our ability to maintain effective internal controls and the risk of natural and man-made catastrophic interruptions to our business. We undertake no obligation to revise or update any forward-looking statements to reflect any event or circumstance that arises after the date of this report, or to conform such statements to actual results or changes in our expectations.

In this report, references to “Ellie Mae,” “the Company,” “we,” “our” or “us” refer to Ellie Mae, Inc. together with its subsidiaries, unless the context requires otherwise.

PART I

ITEM 1. BUSINESS

Our Company

We provide on-demand software solutions and services for the residential mortgage industry in the United States. Our mortgage management solutions help streamline and automate the process of originating and funding new mortgage loans, thereby increasing efficiency, improving loan quality, facilitating regulatory compliance and reducing documentation errors while providing one system of record for loans.

Our Encompass software is an end-to-end, comprehensive enterprise solution that handles most of the functions involved in running the business of originating mortgages: customer relationship management; loan processing; underwriting; preparation of application, disclosure and closing documents; funding and closing the loan for the borrower; compliance with regulatory and investor requirements and overall enterprise management that provides one system of record. Delivery of our Encompass software in an 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 as well as providing access to the most current release of an application, 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 settlement service providers they work with in order to process and fund loans. As of December 31, 2013, the Ellie Mae Network electronically connects the approximately 92,000 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.

For mortgage originators, Encompass is a comprehensive operating 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, 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 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; 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; 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; and Encompass Flood Service, which allows Encompass users to order and transfer flood zone certifications.

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 purchase Encompass software as a service, paying either recurring 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 business received from Encompass users.

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, 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.

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 54 state agencies and the sole system of licensure for mortgage originators for 58 state and territorial agencies, there were approximately 534,000 state licensed or federally registered individuals and 27,000 licensed companies or federal institutions engaged in originating residential mortgages across the United States at December 31, 2013.[1] 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.

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1 NMLS, A Nationwide View of State-Licensed Mortgage Entities (2013 Quarter 4) and NMLS Federal Registry Quarterly Report (2013 Quarter 4), Released March 4, 2014.

- 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 $1.8 trillion, $2.0 trillion, $1.4 trillion, $1.7 trillion and $2.0 trillion in loans originated for 1- to 4-family homes during the years ended December 31, 2013, 2012, 2011, 2010 and 2009, respectively.[1]

Based on information provided by Inside Mortgage Finance, 39.0% of mortgages originated nationwide during 2013 were funded directly through the retail channels of mega lenders and the remaining 61.0% were funded through other wholesale channels, mortgage lenders and brokerages[2]. For 2012 and 2011, this split was 43.5% / 56.5%[3] and 45.0% / 55.0%[4], 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.

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.

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

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

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

4 Inside Mortgage Finance, February 17, 2012, p. 4, Top Retail Producers in 2011, Copyright 2012.

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 since 2007, largely in response to the hundreds of billions of dollars of loan defaults and massive losses suffered by lenders and investors. The losses incurred have led to three major trends that significantly impact the residential mortgage industry.

Increased Regulation Affecting Lenders and Investors

Many regulatory reforms have been introduced or proposed 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 final form in 2013 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,” or QM.
- 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 a future 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.

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:

- implementation of the Secure and Fair Enforcement for Mortgage Licensing Act of 2008, as amended, or SAFE, designed to require licensing and tracking of mortgage originators;
- 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 have 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

The regulatory reforms enacted since 2008, combined with increased demands for loan quality, have significantly increased the cost of originating residential mortgages, with direct production costs per loan increasing 38% from 2009 to 2012[1]. 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.

Ellie Mae's Encompass Solution

Ellie Mae's comprehensive on-demand, mortgage management solution provides one system of record that helps streamline and automate the mortgage origination process, increasing efficiency and loan quality, facilitating regulatory compliance and reducing documentation errors for our users.

For mortgage originators:

- Encompass provides mortgage originators with a core business operating system, streamlining and enhancing business-critical functions, including the ability to market to prospective or former borrowers in a controlled and compliant manner, lead generation, lead management and lead distribution, loan processing, task management, communication with borrowers and other mortgage origination participants, reporting, regulatory compliance and general business management. Encompass also provides the ability to collaborate effectively between departments and monitor the business comprehensively, all within a secure environment.
- Additional Encompass services we offer include borrower-facing websites which enable originators to market to, communicate with and support their customers, as well as automated solutions that format disclosure and closing documents, electronically manage loan documents, verify reported income, verify regulatory compliance, order and transfer flood zone certifications and match specific borrowers to the most appropriate mortgage products offered by the lender.
- The Ellie Mae Network enables Encompass users to submit loan data and entire files electronically and securely to lenders and order and receive electronic settlement services necessary to originate a loan.
- In 2011, we launched the pilot program for TQL, and we currently have a limited number of investors and shared lender clients. TQL is designed to further enhance the quality, compliance and saleability of loans that are originated by Encompass users, by providing a centralized ordering and reviewing interface, greater visibility into the quality of each loan through additional reporting and dashboard tools and a best practice workflow designed to ensure a higher level of review, collaboration and loan quality. Through the centralized TQL interface, we offer a suite of fraud detection, valuation, validation and risk analysis services that are presented back to our users in a comprehensive and easy-to-consume manner, with additional data population allowing for greater use of automated rules to ensure compliance and quality. In addition, our secure, tamper-proof technology enables correspondent lenders to share the original findings and data from those services with investors and other stakeholders in the industry supply chain, in a manner that allows the investor to avoid having to reorder those services, knowing that they are the original documents that were delivered directly from the original vendor and held securely in an electronic TQL vault.

For lenders, investors and service providers:

- The Ellie Mae Network provides lenders, investors and service providers greater and more cost-effective electronic access to a significant percentage of mortgage origination professionals, increasing their revenue opportunities and lowering their marketing and loan aggregation costs.
- Lenders, investors and service providers can seamlessly receive data directly from mortgage originators, reducing redundant data entries and errors and lowering loan-fulfillment and customer support costs.
- Lenders use the rules and services in our TQL program to process their loans, which provides several advantages, including more efficient loan processing, higher quality loans and faster purchase by investors and, therefore, faster turnover of lenders' warehouse lines.
- Our TQL program also provides the investors that purchase loans from the lenders greater assurance of both loan quality and compliance with their own lending requirements.

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Mortgage Bankers Association, Annual Mortgage Bankers Performance Report 2012 Data, Net Loan Production Income and Expense, $ per loan, Copyright June 2013.

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We market Encompass primarily to mortgage originators and wholesale divisions of many mega lenders that participate in the Ellie Mae Network and interact electronically with Encompass users to fund or purchase loans processed by those originators. Although retail channels of mega lenders generally have their own proprietary loan origination software, we have begun to market to them as well.

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 efforts and product development to increase the number of mortgage banks, 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.

Focus sales efforts on Encompass as Software-as-a-Service (SaaS). We are focusing our marketing and sales efforts on our Encompass on-demand offering, or SaaS Encompass, particularly our Success-Based Pricing model, in contrast to our on-premise license model. With 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 this offering 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 2013 and 2012, Encompass users employed the Ellie Mae Network to process on average approximately six and five transactions per loan file, respectively. 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 Encompass. For example, 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; in January 2011, we acquired and integrated certain assets of Mortgage Pricing System, LLC, or MPS, to introduce our Encompass Product and Pricing Service; and in August 2011, we acquired all of the outstanding shares of Del Mar Datatrac, Inc., or DMD, a mortgage lending automation business, to increase our lender user base and our product offerings by providing additional proprietary back-end mortgage lending software and to broaden the functionality of our Encompass solutions. We intend to continue pursuing additional strategic acquisitions.

Products and Services

Encompass

Encompass is our proprietary comprehensive software solution that combines loan origination, business management and customer relationship management software for mortgage originators into one end-to-end 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. The core architecture of Encompass utilizes a single database that is accessible to all participants throughout the mortgage origination process.

Encompass provides the following features and benefits:

Feature	Benefits
Customer Acquisition and Relationship Management	• Sales and marketing tools to help acquire and grow new business and pre-qualify prospective borrowers. • 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. • Automatic lead follow-up and customer retention through campaign management capabilities that allow design and execution of multi-step marketing campaigns. • Pre-qualification tools to start loan applications, access integrated pricing engines and easily find appropriate loan products and prices for a borrower. • Automatic status updates posted to a branded website to keep customers and their real estate and other designated agents informed throughout the loan process. • Tools used to track the effectiveness of marketing and relationship building activities.
Processing	• Configurable pipeline, forms and workflow enable faster loan processing, reduced errors and more efficient business operations. • Support for multiple business channels using configurable workflows • “Alert” management allows focus on urgent and relevant issues. • Collaboration tools keep stakeholders informed and reduce need to manually update other employees, partners and borrowers. • Seamless access to electronic document management simplifies document handling and increases data security.
Risk Management and Business Reporting	• Centralization of all business data and electronic images. • Built-in rules and safeguards to set and enforce business practices. • Management dashboards highlighting key performance indicators. • Predefined reports provide out-of-the-box intelligence and can be modified with a custom report writer.
Connectivity, Personalization and Integration	• Seamless and secure connections to thousands of service providers and investors on the Ellie Mae Network.

- Workflow management to define customer-specific business processes.
- User-defined experience through a personalized homepage.
- Integration with third-party applications through a software development kit to leverage existing technology investments.

Feature	Benefits
Underwriting	• Collaborate with all origination team members to respond effectively to underwriting requests and track underwriting conditions. • Communicate loan conditions, request and receive mortgage documents and track conditions and documents in a single system. • Access electronic copies of borrower documents within the loan file and compare them with actual loan data to reduce risk of data inconsistencies.
Secondary Marketing and Trade Management	• Manage lock requests and accurately track buy-side and sell-side pricing. • Allocate loans that qualify for trades, track progress and capture key trade details. • Alerts provide notification of deadlines to help avoid late-delivery fees.
Closing and Funding	• Enter closing data, perform audits and order closing documents all within a single loan file. • Closing data populates funding worksheets, helping to reduce errors and enable faster funding.
Post-Closing, Shipping and Delivery	• Comprehensive tracking, fulfillment and shipping of loan package. • Tools to manage interim servicing before selling loans to investors.
Advanced Customization and Business Rule Management	• Enterprise-level functionality for higher level security, more granular control of processes and flexible customization of the software. • Comprehensive control over workflow, business rules, processes and user groups.

Mortgage originators can subscribe to SaaS Encompass, an on-demand solution that we host 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 Services.

Encompass Solutions and Services

Solutions offered within our on-demand platform include the Ellie Mae TQL Program, Encompass CenterWise, Encompass TPO WebCenter, Encompass Docs Solution, Encompass Compliance Service, Encompass Product and Pricing Service, Encompass 4506-T Service, Encompass Appraisal Service, and Encompass Flood Service. We have expanded our solution offerings to include Encompass CRM since acquiring MortgageCEO in 2014.

Ellie Mae TQL Program: The Ellie Mae TQL Program 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 more, 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 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 and 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. TPO WebCenter provides a secure, synchronized web-based environment for the TPO to upload loan files and supporting documentation directly into 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 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, state and local regulations. Quick results analysis and review capabilities help identify any compliance problem or data that needs 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 the latest 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 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 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 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 was made available to SaaS Encompass users in January 2014, 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.

The Ellie Mae Network

A key component of SaaS 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.

Type	Description
Credit Report	A report verifying a loan applicant’s credit standing to predict statistically how likely the applicant is to repay 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 the requirements for eventual acquisition by them.
Data Transmission to and from Lenders and Investors	Mortgage originators transmit data for loan underwriting, pricing and registration prior to delivery of loan package to the lender.
Appraisal Report	An estimate of 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 make loans with lower down payments from borrowers.
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.

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, focus on continuing to expand the customer base and encourage adoption of the Ellie Mae Network.

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 product training representatives offer live and online technical support and product training. Our training catalogue includes a variety of training programs including 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 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 has significantly increased overall systems capacity while adopting industry standard certified design which is independently audited for security and scalability.

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 data transmitted and processed within the Ellie Mae Network and to our customers is encrypted using industry standard Secure Sockets Layer (SSL) protocol 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 constantly 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. Threats and vulnerabilities to any network infrastructure are exposed continuously and there are often time lags before mitigations are deployed by our vendors.

Research and Development

We devote substantial resources to enhance the features and functionality of our offerings as well as developing new products and services. Our research and development expenses totaled $24.7 million, $18.1 million and $13.0 million in 2013, 2012 and 2011, 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 seven United States, or U.S., patents, with two patent applications pending and three continuing patent applications in the United States. 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 No. 8,126,920, which applies to the enterprise security management system of the Encompass Loan Origination System, expires in 2029. 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, expire in 2024. US. 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, 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.; Davis + Henderson Corporation; Harland Financial Solutions, a subsidiary of Davis + Henderson Corporation; ISGN Solutions Inc.; Mortgage Builder Software, Inc.; OpenClose Mortgage Software; and PCLender.com, Inc., a subsidiary of Fidelity National Financial, Inc.. 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 business 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 single database 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 protection.

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.; Mortgagebot, a Davis + Henderson company 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 Verisk Analytics, Inc.; 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; NYLX, Inc. and Optimal Blue, LLC.

Electronic Document Management. We compete against EDM providers, including: Encomia, LLC; 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 RealEC Technologies, Inc., 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 SAFE. 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 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, as well as 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, 2013, we had 407 full-time employees, including 79 in sales and marketing, 275 in research and development and technology and 53 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 May 2015. We also have field-based staff operating in several areas around the country, primarily based in Irvine, California; Calabasas, California; San Diego, California; Worcester, Massachusetts; Omaha, Nebraska; and Montville, New Jersey.

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.

13

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

To maintain or increase our revenues, we must increase the number of users of our software and 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. We cannot guarantee our Success-Based Pricing strategy will continue to be successful. If it is not successful, or if we are unable to identify an alternate strategy and successfully increase the number of SaaS Encompass customers, our business may be materially adversely affected.

Our success will also 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.

System interruptions that impair access to the Ellie Mae Network or SaaS Encompass could damage our reputation and brand and 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. 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. 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, cause us to issue credits, 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 harm our business and operating results.

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. 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 have little 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, it would require a significant amount of time to transition the hosting of our data centers to a new third-party service provider. 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, if at all.

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 certain of 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 and authentication technology licensed from third parties to effect secure transmission of confidential information, 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. These 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 to 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 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 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 may be harmed.

Mortgage lending volume was lower in 2013 than in 2012, and it is expected to be lower in 2014 than in 2013 due to various factors which could adversely affect our business.

Mortgage lending volume was lower in 2013 than in 2012, and it is expected to be lower in 2014 than in 2013. 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. In addition, mortgage interest rates were at historic lows and recently have been rising. 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 has some sensitivity to volume. The forecasted lower levels in residential mortgage loan volume in 2014 as compared to 2013 levels will require us to increase our

user base and/or our revenues per loan processed by our customers in order to maintain our financial performance. Any additional decrease in residential mortgage volumes would heighten our need to increase these revenue drivers. 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 anticipated 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;
- the timing of the introduction and acceptance of Ellie Mae Network offerings and new on-demand services;
- 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. We anticipate that 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.

Continued growth may place significant demands on our management and our infrastructure and require significant expenditures and resources.

Our growth 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 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 will actually increase. 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.

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 are also in the process of upgrading and/or replacing various software systems including our new enterprise resource planning, or ERP, system, which we began using during the fourth quarter of 2013. The implementation of an ERP system entails certain risks, including difficulties with changes in business processes that could disrupt our company's operations, such as our ability to process orders, provide services and customer support, fulfill contractual obligations and aggregate financial and operational data, and the ERP providers to deliver the functionality we require and in a timely manner. Unanticipated problems impacting the implementation of these systems could significantly increase the expenditures and resources allocated to this project, divert the attention of management and harm our business. If the implementations of these 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 January 2014, we acquired substantially all the assets of 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;
- depreciation and amortization of amounts related to acquired intangible assets, fixed assets and deferred compensation; and
- adverse tax consequences of any such acquisitions.

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

17

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 effective in January 2014. These additions and updates have caused us to incur significant expense, and future updates will likely similarly cause us to incur significant expense.

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. 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.; Harland Financial Solutions, a subsidiary of Davis + Henderson Corporation; and PCLender.com, Inc., a subsidiary of Fidelity National Financial, Inc., 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 RealEC Technologies, Inc., a subsidiary of Fidelity National Financial, Inc. We also compete with compliance and document preparation service providers that are much larger and 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. 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: Accenture's acquisition of Mortgage Cadence LLC in August 2013; Davis + Henderson Corporation’s acquisitions of Harland Financial Solutions in August 2013, Mortgagebot LLC in April 2011 and Avista Solutions, Inc. in May 2012; Lender Processing Services, Inc.’s acquisition of PCLender.com, Inc. in March 2011; 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” and “Encompass” 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. 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.

Current or future litigation could substantially harm our business.

We have been and continue to be involved in legal proceedings, claims and other litigation. For more on legal proceedings, see Note 8 of the Notes to Condensed Consolidated Financial Statements.

We are also subject to various other legal proceedings and claims arising out of the ordinary course of business. While we do not expect the outcome of any such pending litigation to have a material adverse effect on our financial position, litigation is unpredictable and excessive verdicts, both in the form of monetary damages and injunctions, could occur. In the future, litigation could result in substantial costs and diversion of resources and we could incur judgments or enter into settlements of claims that 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.

Because we act as a third-party technology service provider to financial institutions and provide mission-critical products and services for 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. A sufficiently unfavorable review from the FFIEC could result in our financial institution customers not being allowed to use our technology products and services, which 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 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 Securities and Exchange Commission, 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.

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;

22

- 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 2018.

Location	Primary Use	Approximate Square Footage
Pleasanton, CA	Headquarters	54,000
San Diego, CA	Branch office	14,400
Omaha, NE	Branch office	10,500
Irvine, CA	Branch office	3,400
Calabasas, CA	Branch office	1,500
Montville, NJ	Branch office	1,000
Worcester, MA	Branch office	1,000

We believe that these facilities 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" since June 5, 2012, after having been traded on NYSE MKT, formerly the NYSE Amex, since April 15, 2011. The following table sets forth the high and low sales prices of our common stock as reported on the NYSE and NYSE MKT for the periods indicated.

	Low	High
Year ended December 31, 2012		
First Quarter	$5.39	$11.16
Second Quarter	$10.59	$18.15
Third Quarter	$17.53	$30.40
Fourth Quarter	$21.27	$29.46
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

Holders of Our Common Shares

As of March 10, 2014, there were approximately 69 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.

Securities Authorized for Issuance Under Equity Compensation Plans

See Item 12 of Part III of this report regarding information about securities authorized for issuance under our equity compensation plans.

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, the NYSE Arca Technology 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, 2013. The graph reflects the closing sales price of $6.77 per share on April 15, 2011 as the initial value of our common stock. We selected the S&P 500 North American Technology-Software Index as a replacement for the NYSE Arca Technology Index, which was discontinued as a published index during 2013. As such, we do not present the total cumulative return for the NYSE Arca Technology Index beyond December 31, 2012.

	4/15/2011	12/31/2011	12/31/2012	12/31/2013
Ellie Mae, Inc.	100.00	83.46	409.90	396.90
NYSE Composite	100.00	90.64	105.13	132.74
NYSE Arca Technology	100.00	71.86	77.14	—
S&P 500 North American Technology-Software	100.00	87.52	102.77	134.74

* 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 Securities Exchange Act of 1934, as amended (the Exchange Act), or incorporated by reference into any filing of Ellie Mae, Inc. under the Securities Act of 1933, as amended, or the Exchange Act, 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, 2013, 2012 and 2011 and the consolidated balance sheets data as of December 31, 2013 and 2012 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, 2010 and 2009 and the consolidated balance sheets data as of December 31, 2011, 2010 and 2009 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,				
	2013	2012	2011	2010	2009
	(in thousands, except share and per share data)				
Consolidated Statements of Operations Data:					
Revenues	$128,481	$101,845	$55,494	$43,234	$37,707
Cost of revenues (1)	32,748	23,114	15,784	12,505	12,163
Gross profit	95,733	78,731	39,710	30,729	25,544
Operating expenses:					
Sales and marketing (1)	21,331	17,887	12,126	9,555	7,532
Research and development (1)	24,695	18,053	12,975	10,468	7,945
General and administrative (1)	30,853	21,601	12,900	9,823	8,213
Total operating expenses	76,879	57,541	38,001	29,846	23,690
Income from operations	18,854	21,190	1,709	883	1,854
Other income (expense), net	460	(43)	76	119	72
Income before income taxes	19,314	21,147	1,785	1,002	1,926
Income tax provision (benefit)	6,738	1,683	(1,835)	225	264
Net income	$12,576	$19,464	$3,620	$777	$1,662
Net income per share of common stock:					
Basic	$0.47	$0.83	$0.23	$0.22	$0.51
Diluted	$0.44	$0.76	$0.18	$0.05	$0.11
Weighted average shares outstanding:					
Basic	26,581,962	23,523,222	15,618,053	3,495,731	3,266,133
Diluted	28,502,403	25,537,192	20,649,451	17,146,735	15,536,269

	Year ended December 31, 2013	2012	2011	2010	2009
	(in thousands)				
Consolidated Balance Sheet Data:					
Cash and cash equivalents	$33,462	$44,114	$23,732	$14,349	$11,491
Short-term investments	$46,325	$16,243	$1,933	$2,556	$4,719
Long-term investments	$56,285	$43,728	$—	$—	$—
Property and equipment, net	$12,751	$9,494	$5,539	$2,710	$2,921
Working capital	$77,560	$58,784	$19,965	$15,788	$11,548
Total assets	$228,572	$185,615	$99,771	$62,956	$57,718
Redeemable convertible preferred stock	$—	$—	$—	$82,672	$82,672
Total stockholders' equity (deficit)	$206,896	$166,862	$78,858	$(31,825)	$(35,516)

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

	Year ended December 31, 2013	2012	2011	2010	2009
	(in thousands)				
Cost of revenues	$745	$271	$103	$192	$144
Sales and marketing	1,041	467	201	303	145
Research and development	3,469	1,552	406	443	271
General and administrative	9,004	4,559	970	1,130	563
Total	$14,259	$6,849	$1,680	$2,068	$1,123

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 provide on-demand software solutions and services for the residential mortgage industry in the United States. Our mortgage management solutions help streamline and automate the process of originating and funding new mortgage loans, thereby increasing efficiency, improving loan quality, facilitating regulatory compliance and reducing documentation errors while providing one system of record for loans.

Mortgage originators use our Encompass software, a comprehensive operating 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, 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 software services, including: Encompass Docs Solution, which automatically prepares the disclosure and closing documents necessary to fund a mortgage; Encompass CenterWise, a bundled offering of 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 and Encompass Flood Service, which allows Encompass users to order and transfer flood zone certifications. 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 92,000 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.

We were formed as a California corporation in 1997 and reincorporated in Delaware in November 2009. From inception through 2000, we developed consumer-facing websites and initial versions of our network. We launched our first transaction platform in late 2000, the present version of which is the Ellie Mae Network.

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. On-demand revenues also include software services that are sold transactionally as well as Ellie Mae Network transaction fees paid by lender-investors, service providers and certain government-sponsored entities participating on the Ellie Mae Network. On-premise revenues are generated from customer-hosted software licenses and implementations, training and maintenance services. For further discussion of the sources of our revenue and our revenue recognition policy, please see our Critical Accounting Policies and Estimates below.

Our on-demand revenues generally track the seasonality of the residential mortgage industry, typically, but not always, 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 has some sensitivity to volume. Contracted revenues, which are not sensitive to volume, represented 57% of total revenues for the year ended December 31, 2013.

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 2013, we accelerated our investments in our sales and client services capabilities, in research and development and in technology infrastructure to support our user additions and overall business growth. These investments included expanding our talent across the organization by hiring additional personnel, especially for our customer acquisition, client services and implementation teams and our research and development teams; developing next-generation products and enhancements; purchasing computer equipment; upgrading our telephony systems and building out new office facilities.

In addition to our internal initiatives, our business strategy has evolved to address recent industry trends, including:

- expected lower lending volume;
- increased quality standards imposed by regulators, lenders and investors;
- increased regulation affecting lenders and investors;
- greater focus by our customers on operational efficiencies; and
- customers adopting multi-channel strategies

We are responding to these trends as follows:

Expected lower lending volume. Mortgage lending volume is expected to be lower in 2014 than in 2013, as forecasted by Fannie Mae, Freddie Mac and the Mortgage Bankers Association. Since late 2009, we have focused our marketing and sales efforts on our on-demand SaaS Encompass offering, and particularly our SaaS Encompass Success-Based Pricing model, in contrast to our on-premise license model. In our on-demand SaaS Encompass offering, the customer does not pay the significant up-front licensing fee associated with our license model, which we believe is particularly attractive in the present climate of the residential mortgage origination market. Our SaaS Encompass Success-Based Pricing model builds on this value proposition by aligning customers' payments for our software solutions with their own receipts of revenues. Our focus on our SaaS Encompass offering is important in light of lower lending volumes because we typically generate greater revenues per user through our on-demand SaaS Encompass offering than through our on-premise license offering.

We are also focusing on increasing use of our Ellie Mae Network offerings and our other services, which were introduced from late 2009 through late 2011. These offerings include our TQL program, Encompass Compliance Service, Encompass Product and Pricing Service, Encompass Docs Solution and Encompass 4506-T Service.

During 2013 and 2012, Encompass users employed the Ellie Mae Network to process on average approximately six and five transactions per loan file, respectively. By continuing to enhance our service offerings and encouraging providers of settlement services to deliver their services electronically through the Ellie Mae Network, we will continue to build value for Ellie Mae Network participants while increasing the number of transactions for which the Ellie Mae Network is used.

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 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 42% from December 31, 2012 to December 31, 2013 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 automatically checks loan files for compliance with the myriad of federal, state and local regulations and alerts users to possible violations of these regulations. In addition, we have a staff of attorneys and work with compliance experts who help assure that documents prepared using our software and the processes recommended by the Encompass workflow comply with applicable rules and regulations. We believe we are well-positioned to help our customers meet additional requirements from the Dodd-Frank Wall Street Reform and Consumer Protection Act, or Dodd-Frank Act, that became effective in January 2014. Our ATR/QM, functionality is designed to allow our customers to document their compliance with the CFPB's ATR/QM Final Rule that applies to the majority of residential mortgage loan originations in the United States. 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 an approximately 40% increase in direct production costs per loan between 2009 and 2011[1], and we expect this trend to continue 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 and/or loans that fail to comply with applicable regulations.

With an eye towards providing customers with ever-greater tools to enhance efficiency, 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 will provide a more comprehensive benefit to our users.

In addition to providing efficiency-enhancing solutions, delivery of our Encompass software in an on-demand 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 as well as providing access to the most current release of an application, periodic upgrades and regulatory updates.

Customers adopting multi-channel strategies. Customers are developing multi-channel strategies beyond a single retail, correspondent or wholesale 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. 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.

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 Encompass. For example, in January 2014, we acquired substantially all the assets of MortgageCEO,

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1 Mortgage Bankers Association, Annual Mortgage Bankers Performance Report 2011 Data, Net Loan Production Income and Expense, $ per loan, Copyright June 2012.

a SaaS company specializing in customer relationship management and marketing solutions for the residential mortgage industry; in January 2011, we acquired and integrated certain assets of MPS to introduce our Encompass Product and Pricing Service; and in August 2011, we acquired all of the outstanding shares of DMD, a mortgage lending automation business, to increase our lender user base and our product offerings by providing additional proprietary back-end mortgage lending software and to broaden the functionality of our Encompass solutions. 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, on-premise revenues, 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 revenues and monthly fees paid by legacy SaaS customers.

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 the SaaS Encompass system 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.

Revenue per average active Encompass user. Revenue per average active Encompass user is calculated by dividing total revenues by average active Encompass users during the 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, 2013, 2012 and 2011:

	Year ended December 31,		
	2013	2012	2011
Revenues (in thousands):			
Total revenues	$128,481	$101,845	$55,494
Total contracted revenues	$72,967	$48,768	$30,312
Total SaaS Encompass revenues	$73,698	$47,940	$19,803
Users at end of period:			
Contracted SaaS users	95,044	60,187	35,745
Active Encompass users	92,161	73,687	53,767
Active SaaS Encompass users	63,695	41,458	24,252
Active SaaS Encompass users as a percentage of active Encompass users	69 %	56 %	45 %
Active SaaS Encompass users as a percentage of contracted SaaS users	67 %	69 %	68 %
Average users during period:			
Active Encompass users	87,276	63,993	51,455
Active SaaS Encompass users	55,421	33,203	19,330
Active SaaS Encompass users as a percentage of active Encompass users	64 %	52 %	38 %
Revenue per average user during period:			
Revenue per average active Encompass user	$1,472	$1,592	$1,078
SaaS Encompass revenue per average active SaaS Encompass user	$1,330	$1,444	$1,024

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 revenue 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 now described as on-demand and on-premise revenues. Sales taxes assessed by governmental authorities are excluded from revenue.

On-demand Revenues

On-demand revenues are revenues generated from company-hosted software subscriptions that customers access through the Internet as well as revenues from a small number of customers that have opted to self-host a portion of the software but pay fees based on a per closed loan, or success, basis subject to monthly base fees, which we refer to as Success-Based Pricing. On-demand revenues are also comprised of software services sold transactionally and Ellie Mae Network transaction fees.

On-premise Revenues

On-premise revenues are revenues generated from maintenance services, sales of customer-hosted software licenses (except for customer-hosted Success-Based Pricing revenues, which are included in on-demand revenues described above), and professional services, which include consulting, implementation and training services.

Cost of Revenues and Operating Expenses

Cost of Revenues

Our cost of revenues consists primarily of: salaries and benefits, including stock-based compensation; 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; 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 make additional investments in our technology infrastructure 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 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 lists and contracts. 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 as we expect an increased number of mortgage lenders to assess new platform options and replace their legacy systems. 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; fees to contractors engaged in the development and support of the Ellie Mae Network infrastructure, 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 infrastructure, including hiring additional engineering and product development personnel.

General and Administrative

Our general and administrative expenses consist primarily of: salaries and benefits, including bonuses and stock-based compensation, for employees involved in finance, accounting, human resources, administrative and legal roles; consulting, legal, accounting and other professional services by third-party providers; and allocated facilities costs. We expect general and administrative expenses to continue to increase in absolute dollars primarily due to greater amounts of stock compensation expense relating to awards granted to attract and retain the employees needed to continue to grow our business.

Other Income (Expense), Net

Other income (expense), net consists of interest income earned on investments, cash accounts and notes receivable, offset by investment discount amortization and imputed interest expense related to the DMD acquisition holdback payments (see Note 5 of the Notes to Consolidated Financial Statements) and interest expense paid on equipment and software leases.

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 generally accepted accounting principles in the United States, or 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.

32

Revenue Recognition

We generate revenue primarily from on-demand and on-premise fees for software and related services.

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 software-as-a-service, or SaaS, and support services. These arrangements are non-cancelable and do not contain refund-type provisions. These revenues generally include the following:

SaaS Encompass Revenues. We offer web-based, on-demand access to Encompass 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; however, except where customers self-host a portion of the software in a Success-Based Pricing structure, 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 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 per closed loan, or 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 software is utilized. 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 for Encompass as integrated components, which are combined elements of the arrangement that is delivered in conjunction with the SaaS Encompass offering and therefore is 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 mortgage-related and other business services, including automated documentation preparation and compliance reports. Services revenues are recognized after the services are rendered.

Transaction Revenues. We have entered into agreements with various lenders, service providers and certain government agencies 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.

On-Premise Revenues

With the exception of revenue from customers that self-host a portion of the software in a Success-Based Pricing structure, which is recognized as described above, 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. When subscription services involve multiple elements that qualify as separate units of accounting, we allocate arrangement consideration at the inception of an arrangement to all deliverables 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 BESP, 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 BESP in our allocation of arrangement consideration. The objective of BESP is to determine the price at which we would transact a sale if the service was sold on a standalone basis. When establishing BESP, 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 BESP as necessary.

Because we have determined that neither VSOE nor TPE is available, we use 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.

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 have standalone value as such services are often sold separately. Additionally, we have concluded that professional services 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., undelivered 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 the customer. 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. As of December 31, 2013, estimated future compensation costs related to unvested stock options are $4.8 million in 2014, $3.6 million in 2015, $2.4 million in 2016, and $0.6 million in 2017.

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 an accelerated 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. As of December 31, 2013, estimated future compensation costs related to unvested RSUs and Performance Awards are $5.9 million in 2014, $3.8 million in 2015, $2.3 million in 2016, and $0.7 million in 2017.

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.

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, 2013, 2012 and 2011:

	Year ended December 31,					
	2013		2012		2011	
Stock option plans:						
Risk-free interest rate	0.95-1.87	%	0.74-1.10	%	1.17-2.20	%
Expected life of options (in years)	5.27-6.08		5.27-6.08		5.27-6.08	
Expected dividend yield	—	%	—	%	—	%
Volatility	50-52	%	52-59	%	53-55	%
Employee Stock Purchase Plan: (1)						
Risk-free interest rate	0.05-0.13	%	0.13-0.14	%	0.05	%
Expected life of options (in years)	0.5		0.5		0.5	
Expected dividend yield	—	%	—	%	—	%
Volatility	36-37	%	37-47	%	52	%

(1) Employee Stock Purchase Plan established in 2011.

Goodwill and Other Intangible Assets

Goodwill and other intangible assets are stated at cost less accumulated amortization, as appropriate. Other intangible assets include developed technology, trade names and customer lists and contracts. Intangibles with finite lives are amortized on a straight-line basis over the estimated periods of benefit, generally one to nine years. Goodwill is not amortized, but tested for impairment at least annually, or whenever changes in circumstances indicated that the carrying amount of goodwill or intangible assets may not be recoverable. These tests are performed at the reporting unit level, which is the company as a whole, using a two-step, fair-value approach. We completed annual impairment tests for the years ended December 31, 2013, 2012 and 2011 and determined that our goodwill was not impaired for those years.

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. 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, all of which are subject to minimal credit and market risks. 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, net of tax, are reported in stockholders' equity as accumulated other comprehensive 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.

As of December 31, 2013, our assets measured and recorded at fair value on a recurring basis included $16.4 million of money market funds and $105.5 million of marketable debt instruments. Of these marketable debt instruments, $11.4 million was classified as Level 1 and $94.1 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, 2013.

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 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, 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 new 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 is completed, and 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, after all substantial testing is completed. Internal and external training costs and maintenance costs during the post-implementation operation stage are expensed as incurred.

Internal-use software is amortized on a straight-line basis over its estimated useful life, generally three years. 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, 2013 and 2012, we capitalized software and website application development costs of $5.0 million and $0.5 million, respectively. There were no such costs capitalized in the year ended December 31, 2011. There was $69,000 in amortization of capitalized internal-use software and website development costs recorded during the year ended December 31, 2013 and no such amortization recorded during the years ended December 31, 2012 and 2011.

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,		
	2013	2012	2011
	(in thousands)		
Revenues	$128,481	$101,845	$55,494
Cost of revenues (1)	32,748	23,114	15,784
Gross profit	95,733	78,731	39,710
Operating expenses:			
Sales and marketing (1)	21,331	17,887	12,126
Research and development (1)	24,695	18,053	12,975
General and administrative (1)	30,853	21,601	12,900
	76,879	57,541	38,001
Income from operations	18,854	21,190	1,709
Other income (expense), net	460	(43)	76

Income before income taxes	19,314	21,147	1,785
Income tax provision (benefit)	6,738	1,683	(1,835)
Net income	$12,576	$19,464	$3,620

37

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

	Year ended December 31,		
	2013	2012	2011
	(in thousands)		
Cost of revenues	$745	$271	$103
Sales and marketing	1,041	467	201
Research and development	3,469	1,552	406
General and administrative	9,004	4,559	970
	$14,259	$6,849	$1,680

	Year ended December 31,		
	2013	2012	2011
	(as a percentage of revenues)		