ELLIE MAE INC
Form 10-K
March 28, 2012

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, 2011

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 No. 001-35140

ELLIE MAE, INC.

(Exact Name of Registrant as Specified in Its Charter)

Delaware	**94-3288780**
(State of Incorporation)	**(I.R.S. Employer Identification Number)**

4155 Hopyard Road, Suite 200

Pleasanton, California 94588

(Address of Principal Executive Offices and 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	NYSE Amex

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 ¨ No x

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 ¨ No x

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate 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 ¨

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

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

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

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant as of June 30, 2011, the last business day of the registrant s most recently completed second fiscal quarter, was approximately $101,826,000 (based on the last reported sale price of $5.74 on June 30, 2011).

21,512,241 shares of the registrant s common stock, par value $0.0001 per share, were outstanding as of February 29, 2012.

Documents Incorporated by Reference

Portions of the registrant s Proxy Statement for the registrant s 2012 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, 2011.

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Ellie Mae, Inc

Form 10-K

For the Year Ended December 31, 2011

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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, continue or other 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: our ability to accurately forecast revenues and appropriately plan our expenses; the impact of changes in mortgage interest rates; the volume of mortgages originated by our Encompass users; fluctuations in mortgage lending volume; the number of Encompass users, and in particular Lender Encompass Users; transaction volume on the Ellie Mae Network; the risk that the anticipated benefits, growth prospects and synergies expected from the Del Mar Datatrac acquisition may not be fully realized or may take longer to realize than expected; the impact of uncertain domestic and worldwide economic conditions, including the resulting effect on residential mortgage volumes; the effectiveness of our marketing and sales efforts to attract new and retain existing Encompass SaaS on-demand users and Ellie Mae Network participants; our ability to enhance the features and functionality of our Encompass software and the Ellie Mae Network; the level of demand for our Encompass Closer document preparation and other services we offer; the timing of the introduction and acceptance of new Ellie Mae Network offerings and additional services including our Encompass SaaS offering; changes in mortgage originator, lender, investor or service provider behavior and any related impact on the residential mortgage industry; changes in government regulation affecting Ellie Mae Network participants or our business; our ability to successfully manage any future acquisitions of businesses, solutions or technologies; the timing of future acquisitions of businesses, solutions or technologies and new product launches; the attraction and retention of qualified employees and key personnel; our ability to protect our intellectual property, including our proprietary Encompass software; interruptions in Ellie Mae Network service, our hosted Encompass software and any related impact on our reputation; and costs associated with defending intellectual property infringement and other claims. 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, except as required by law.

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

PART I

ITEM 1. BUSINESS

Our Company

We provide business automation software for a large segment of the mortgage industry in the United States. Our on-demand, technology-enabled software solutions help streamline and automate the process of originating and funding new mortgage loans, increasing efficiency, facilitating regulatory compliance and reducing documentation errors.

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, assuring compliance with regulatory and investor requirements and overall enterprise management. We also host the Ellie Mae Network, a proprietary electronic platform that allows Encompass users to conduct electronic business transactions with the investors and settlement service providers they work with to process and fund loans.

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The Ellie Mae Network electronically connects approximately 54,000 mortgage professionals to the mortgage lenders, investors and service providers integral to the origination and funding of residential mortgages. In 2011, over three million residential mortgage applications were initiated over Ellie Mae solutions, including Encompass, the Ellie Mae Network and Datatrac. We believe this represented approximately one-third of the total U.S. residential mortgage market.

For mortgage originators, the Encompass software we provide is a comprehensive operating system that handles key business and management functions involved in running a mortgage origination business and serves as a gateway to the Ellie Mae Network. 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 additional software services, including automated preparation of the documents borrowers must sign to obtain a loan, automated review of loan files to check for compliance with federal, state and local regulations, automated product and pricing of loans to determine appropriate mortgage programs for a particular borrower, electronic document management and websites used for customer relationship management.

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

Mortgage originators pay for Encompass software either through licensing and recurring subscription fees or through success-based pricing fees for the mortgages they actually fund. 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.

On August 15, 2011, we acquired all of the outstanding shares of Del Mar Datatrac, Inc., or DMD, a mortgage lending automation business, to increase our customer base and enhance our product offerings with additional proprietary mortgage lending software solutions.

Corporate Information

We were founded in 1997 as a California corporation, reincorporated as a Delaware corporation in November 2009 and completed our initial public offering of our 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, Finance and Nominating and Corporate Governance committees of our board of directors. Our filings with the SEC are posted on our Website 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.

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Mortgage Industry Overview

Overview of Mortgage Origination Market

Mortgage origination is a big business. For each of the past ten years, at least $1 trillion, representing approximately six million new residential mortgages each year, were funded in the United States by a variety of mortgage originators[1]. Mortgage originators typically advise borrowers, process loan files, collect and verify the property and borrower data upon which lending decisions are based and, most often, fund and close the mortgage loan. According to the Bureau of Labor Statistics, there are approximately 265,000 individuals engaged in originating residential mortgages across the United States.[2] These individuals generally are working for one of three categories of originators: mega lenders, other smaller mortgage lenders and mortgage brokerages.

Mega Lenders. Mega lenders typically 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. There are approximately 20 mega lenders, including Wells Fargo Bank, N.A., Bank of America, N.A., JPMorgan Chase Bank, N.A. and PHH Mortgage Corporation.

Mortgage Lenders. There are approximately 7,500 mortgage lenders other than mega lenders, including non-depository mortgage banks, smaller commercial banks, thrifts and credit unions. These mortgage lenders 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, actually fund the loans. The volume of loans originated through mortgage brokerages has declined to under 10% of the mortgage origination market[3] and revenue from this channel is not a significant part of our business.

Based on information provided by Inside Mortgage Finance[3], 57% of mortgages originated nationwide in 2011 were funded directly through the retail channels of the mega lenders and the remaining 43% were funded through other mortgage lenders and brokerages. For 2010 and 2009, this split was 55% / 45% and 48% / 52%, 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 privacy and security breaches.

1 Mortgage Bankers Association, *U.S. Residential Mortgage Origination Estimates from 2002 to 2011*. Copyright 2012; Federal Housing Finance Agency, Combined Datasets Average Loan Size: 2010Q2.

2 Bureau of Labor Statistics, *Mortgage Employment Statistics,* February 2012.

3 Inside Mortgage Finance, February 17, 2012, p. 3, *Mortgage Brokers Carry Significant Portions Of Increased Origination Volume in Late 2011.* Copyright 2012.

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

In addition to the challenges involved in processing loans, mortgage originators must satisfy a multitude of federal, state and local regulations and address basic business needs, including marketing, sales, product fulfillment, customer support, reporting, regulatory compliance 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, inadequate security and control over the process and expensive technical integration and maintenance costs.

Recent Mortgage Industry Trends and Developments

The mortgage industry has undergone 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 underlying causes of the loan defaults and losses included the widespread availability, for several years prior to 2007, of high-risk mortgage loans made to unqualified borrowers, significantly reduced underwriting and documentation requirements and overall lack of controls over the mortgage origination process. The losses incurred have led to four major trends that have significantly impacted the residential mortgage industry.

Increased Regulation

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, including:

- material changes to Regulation X of the Real Estate Settlement Procedures Act of 1974, as amended, or RESPA, by the Department of Housing and Urban Development, or HUD, effective January 1, 2010, which requires enhanced disclosure to protect borrowers in the mortgage process;

changes to the Truth in Lending Act of 1968, as amended, or TILA, and the Mortgage Disclosure Improvement Act of 2008, as amended, or MDIA, which are intended to increase consumer protection and expand disclosure requirements;

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

the passage of the Dodd-Frank Act and the establishment of the Consumer Financial Protection Bureau, which are in part designed to prevent predatory lending practices and other borrower abuses.

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 Lenders and Investors

Lenders have eliminated almost all 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, lenders and investors are demanding increased levels of documentation of the data upon which a lending decision will be based, an 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 complicates the process by increasing the amount of documentation and number of services required to originate and fund residential mortgages.

Greater Focus on Operational Efficiencies

The reduced volume of mortgages over the past several years and elimination of high-risk, high-profit loans are encouraging mortgage originators to increase their efficiency and reduce fixed expenses. This has led mortgage originators 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.

Significant Market Shift from Mortgage Brokerages to Mortgage Lenders

Investors, including mega lenders, increasingly prefer acquiring loans from mortgage lenders that actually fund the underlying loan and retain financial risk for non-performing loans. As a result, over the past several years, mortgage origination volume has shifted significantly from mortgage brokerages to mortgage banks, commercial banks, thrifts and credit unions. These mortgage lenders generally require software with greater functionality to meet their business needs and typically order more settlement and other services in the process of funding loans. The following table illustrates the shift in the production channel source of mortgage origination volume from 2007 to 2011:

Mortgage Originations by Production Channel

(% of mortgage origination volume)

	2007	2008	2009	2010	2011
Mega lenders	43.1%	48.4%	47.9%	54.7%	57.2%
Mortgage brokers	28.2	19.7	15.0	12.0	9.9
Mortgage lenders	28.6	31.9	37.1	33.3	33.0

Source: Inside Mortgage Finance, February 17, 2012, p. 3, *Mortgage Brokers Carry Significant Portions Of Increased Origination Volume in Late 2011.* Copyright 2012.

The Ellie Mae Solution

Ellie Mae s platform of on-demand, technology-enabled solutions helps streamline and automate the mortgage origination process, increasing efficiency, facilitating regulatory compliance and reducing documentation errors for our users.

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For mortgage originators:

- Encompass software provides mortgage originators with a core business operating system, streamlining and enhancing 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. Encompass software also provides the ability to collaborate effectively between departments and monitor the business comprehensively, all within a secure environment.

- The other Encompass software services we offer Encompass users 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 regulatory compliance 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.

For lenders, investors and service providers:

- The Ellie Mae Network provides 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.

- The Ellie Mae Network facilitates targeted marketing by lenders, investors and service providers and allows them to set specific criteria to identify the loans for which they wish to provide funding or their settlement services, thereby significantly reducing traditional sales and marketing costs and potentially increasing market penetration for existing participants as well as new entrants.

- Lenders can also use the Ellie Mae Network to ensure they only receive loan applications that meet their specific loan quality and compliance standards.

We market our Encompass software primarily to mortgage lenders and large mortgage brokerages rather than to mega lenders, which generally have their own proprietary loan origination software. However, the wholesale divisions of many mega lenders participate in the Ellie Mae Network and interact electronically with Encompass users and fund or purchase loans processed by those originators.

Our Strategy

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

Increase the number of Encompass Users. We intend to continue to focus our marketing efforts and product development to increase the number of mortgage banks, commercial banks, thrifts and credit unions using Encompass solutions. 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.

Focus sales efforts on Encompass SaaS. We are focusing our marketing and sales efforts on our Encompass software-as-a-service on-demand offering, or Encompass SaaS, particularly our success-based pricing model, in contrast to our on-premise license model. In our Encompass SaaS offering, the customer does not pay the significant up-front licensing fee associated with our on-premise license software. We believe this offering is particularly attractive in the present residential mortgage origination market as it aligns fees for our software and services with the customers receipt 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 Banker Edition, CenterWise, Encompass Closer, Encompass Compliance Service and Encompass Pricing and Product Service, to our mortgage lender customers in a single sales effort.

Sell additional products and services to Encompass users. To the extent users do not subscribe to our bundled, success-based pricing offering, we intend to encourage use of more of the Encompass software services we currently offer, such as document preparation, electronic document management, compliance services, product and pricing services and website hosting. 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. Currently our Encompass users employ the Ellie Mae Network to handle on average four transactions per loan file, including 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 limited use is in part because the electronic solutions provided by settlement service entities do not offer superior electronic solutions 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.

Sell enhanced Ellie Mae Network offerings to investors, mega lenders and service providers. We intend to continue to add functionality and electronic and real-time marketing services to the Ellie Mae Network so investors, mega lenders and service providers can more effectively market to and do business with mortgage originators. For example, in early 2010 we introduced services that offer targeted marketing for lenders and service providers, allowing them to set specific criteria for the loans or settlement services they wish to offer mortgage originators, thereby significantly reducing their sales and marketing costs. 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. During 2011, we launched the pilot program for our Total Quality Loan initiative, or TQL, with one of the top three mega lender investors in the United States. TQL allows our lender customers to originate higher quality loans more efficiently, and provides the investors to whom they sell those loans greater assurance of both loan quality and compliance with their own lending requirements. We are working to add more of our lender customers and investors to the program.

Acquisitions. Our industry is highly fragmented, and we believe there are strategic opportunities available to acquire competing software companies or software providers that offer related mortgage origination functionality that will complement and increase the attractiveness of our Encompass software offerings. For example, 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 DMD, a mortgage lending automation business, to increase our lender user base and provide additional proprietary back-end mortgage lending software. We intend to continue pursuing additional strategic acquisitions.

Products and Services

Encompass Software

Encompass is our proprietary software product that combines loan origination, business management and customer relationship management software for mortgage originators, and also provides seamless access to the lenders and service providers on the Ellie Mae Network. The Encompass software platform helps users structure

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and streamline their mortgage origination process and facilitates collaboration among internal departments of a mortgage origination company. It creates 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 uses 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 a custom branded website 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.
Processing	Configurable pipeline, forms and workflow enable faster loan processing, reduced errors and more efficient business operations.
	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, or EDM, 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 dashboard 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.

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Encompass Banker Edition is marketed to mortgage lenders and incorporates both front-end customer relationship management and loan processing capabilities along with back-end loan fulfillment functionalities. The following additional features and benefits, tailored to the specific needs of mortgage lenders, are available on Encompass Banker Edition:

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 Encompass SaaS, an on-demand solution that we host which the customer accesses through the Internet. Mortgage originators subscribing to Encompass SaaS pay monthly per-user subscription fees or fees on a success basis, either separately or as a bundled package, subject to monthly base fees. The success-based pricing model also includes our Encompass Closer and Encompass Compliance Services. Alternatively, mortgage originators can license Encompass software for an initial fee as a perpetual license with annual maintenance fees, an on-premise solution which is self-hosted and maintained by the customer.

Encompass Services

Our Encompass services in our on-demand platform include Encompass Closer, CenterWise, Encompass Compliance Service and Encompass Product and Pricing Service.

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Encompass Closer

Encompass Closer is a 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 Closer do not have to move loan data from their loan origination system to a separate closing system of a third-party vendor. As a result, Encompass Closer accelerates the closing process, eliminates re-typing of data and reduces errors in the loan package. We also provide document preparation services to a number of legacy accounts of Online Documents, Inc., or ODI, a company we acquired in 2008, that do not use Encompass software.

CenterWise

CenterWise is a bundled offering of Electronic Document Management, or EDM, and Encompass WebCenter.

Electronic Document Management. EDM gives Encompass users the ability to create virtual loan folders containing all documents involved in the loan process. These include documents generated by the Encompass software, documents received electronically and paper documents that are digitized using facsimile, document recognition and scanner technology. With EDM, Encompass users can receive, store, manage and deliver any documents electronically and securely to borrowers, real estate agents, builders, lenders and settlement service providers. Once a loan is funded, Ellie Mae servers retain the virtual loan folder for long-term storage and compliance.

Encompass WebCenter. Our Encompass WebCenter uses a website to 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 mortgage originator s Encompass loan processing pipeline. Encompass WebCenter allows borrowers and mortgage originators to electronically sign and transmit required disclosures and other loan documentation. It also provides borrowers and their real estate agents real-time 24/7 loan status updates.

Encompass Compliance Service

Our Encompass Compliance Service analyzes mortgage loan data for compliance with consumer protection laws and institutionally mandated compliance policies. Encompass Compliance Service can check loan data multiple times during processing, underwriting, closing or funding a loan. Encompass Compliance Service is integrated with Encompass software but can be used with other loan origination software as well. It is used by Fannie Mae and several mega lenders.

Encompass Product and Pricing Service

Our Encompass Product and Pricing Service allows Encompass users to compare loans offered by different lenders and investors to determine the product and pricing options available to a particular borrower. This service is integrated with Encompass software so users can search for and sort results within their core business operating system. Data flows back and forth from the pricing engine to the loan file inside Encompass to help ensure information is accurate and complete.

The Ellie Mae Network

A key component of our on-demand software services is the Ellie Mae Network, which enables mortgage originators to choose from, and connect to, a broad array of investors and mega lenders and service providers essential to the processing and funding of loans. Key functions of the Ellie Mae Network are:

- Mortgage originators can electronically and securely submit loan files to investors and mega lenders in order to underwrite, price and lock rates for individual loans.

- 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 interoperate 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.

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Sales, Marketing and Customer Support

As of December 31, 2011, our sales force consisted of 35 employees who are deployed in our Major Accounts Group and the Inside Sales Group. The Major Accounts Group maintains relationships with our largest 1,000 customers and identifies new potential Encompass Banker Edition and large banking customers. The Inside Sales Group focuses primarily on relationships with smaller lenders and mortgage brokerages.

To build brand awareness and generate sales leads, we conduct direct marketing campaigns, web-based workshops, public relations campaigns and media advertising. We also attend and sponsor many mortgage and banking industry conferences.

As of December 31, 2011, we had a staff of 33 customer support representatives who offer live and online technical support. We have also established a variety of training programs for our customers, including in-field seminars for large 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.

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.

The data centers host all of the Ellie Mae Network Services and SaaS versions of our Encompass software. 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 redirected to the other site as a part of our disaster recovery strategy.

Our infrastructure is designed to scale substantially to accommodate foreseeable growth in the number of participants and transaction volume for our on-demand products and services.

Network Security

All data transmitted and processed within the Ellie Mae network and to our customers is encrypted using standard SSL session 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. All security services are monitored and updated in a timely manner to address emerging vulnerabilities. We cannot guarantee that our security measures will prevent security breaches and may need to expend significant resources to protect against and remedy any potential security breaches and their consequences.

Research and Development

As of December 31, 2011, we had 89 software engineers and support staff in our research and development group. We devote substantial resources to enhance the features and functionality of our product and service offerings. Our research and development expenses totaled $13.0 million, $10.5 million and $7.9 million in 2011, 2010 and 2009, respectively.

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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 six 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 No. 7,444,302, which applies to the Internet-based transaction platform that connects our customers to lenders, vendors and GSEs used in our embedded interface of the Ellie Mae Network within the Encompass360 Loan Origination System, expires in 2025. U.S. Patent No. 8,126,920, which applies to the enterprise security management system of the Encompass360 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 and 2030, respectively. 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 2021 and 2025, respectively. 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 Calyx Technology, Inc., Byte Software Inc., ISGN Solutions Inc., PCLender.com, Avista Solutions, Inc., Mortgage Builder Software, Inc., OpenClose Mortgage Software and Harland Financial Solutions. 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;

- customizable business rules to automate processes, drive 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 MGIC Investment Corporation, Mortgagebot LLC, Mortgage Internet Technologies, Inc. and a la mode, inc.

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

Compliance Service Providers. We compete against compliance software service providers, including LogicEase Solutions Inc., Wolters Kluwer Financial Services, Inc. and Interthinx, Inc.

Product and Pricing Service Providers. We compete against product and pricing service providers, including Loan Sifter, Inc., Mortech,Inc., NYLX, Inc., Optimal Blue, LLC and Insight Lending Solutions, Inc.

Electronic Document Management. We compete against electronic document management providers, including Xerox Mortgage Services, Inc., VirPack Corporation, SigniaDocs, Inc. and Encomia, LLC.

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 the overall workflow of Encompass. 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 software. The principal competition to the use of the Ellie Mae Network remains traditional methods of exchanging data and documents among mortgage industry participants by e-mail, 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 MGIC Investment Corporation and RealEC Technologies, 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 as 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.

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We believe we generally compete favorably with our competitors, however, many 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 RESPA, TILA, MDIA 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 Consumer Financial Protection Bureau 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, 2011, we had 270 full-time employees, including 136 in sales and marketing, 109 in research and development and technology and 25 in general and administrative functions. None of our employees are covered by collective bargaining agreements.

Facilities

Our corporate headquarters are located in Pleasanton, California, in a 43,000 square-foot facility, under a sublease expiring on April 29, 2015. We also have field-based staff operating in several areas around the country, primarily based in Irvine, California; Calabasas, California; San Diego, California; and Montville, New Jersey.

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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.

The extreme turmoil in the mortgage industry that began in 2007 has adversely affected and may continue to adversely affect our business.

As a result of the extreme turmoil in the mortgage industry and general economy that began in 2007, many mortgage originators, especially mortgage brokers, and other mortgage industry participants have gone out of business. In addition, those industry participants that continue in business face increased operating and regulatory challenges. Conditions that negatively impact our Encompass users or Ellie Mae Network participants have had a significant adverse effect on our business. For example, the number of Encompass users declined 32% from approximately 79,000 at December 31, 2006 to approximately 54,000 at December 31, 2011. During this period, the number of Active Broker Encompass Users, which are mortgage brokerage professionals who have used Encompass software at least once within the preceding 90 days, declined by approximately 84%. In addition, the population of mortgage origination professionals who are the potential users of our Encompass software dropped 46% from approximately 495,000 at December 31, 2006[4] to approximately 265,000 at December 31, 2011.[5] If conditions in the mortgage industry were to deteriorate further, our business would be materially adversely affected.

Mortgage lending volume is expected to be lower in 2012 and 2013 than it was in 2011 due to various economic factors, including the anticipated increase in mortgage interest rates, which could adversely affect our business.

Mortgage lending volume is expected to be lower in 2012 and 2013 than it was in 2011 due to various economic factors. Factors that adversely impact mortgage lending volumes include reduced consumer and investor demand for mortgages, more stringent underwriting guidelines, increased illiquidity in the secondary mortgage market, high levels of unemployment, high levels of consumer debt, lower consumer confidence, changes in tax and other regulatory policies, including the recent expiration of the home buyer s tax credit and other macroeconomic factors.

In addition, mortgage interest rates are currently near historic lows and many economists predict that mortgage interest rates will rise modestly in 2012. Mortgage interest rates are influenced by a number of factors, particularly 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 would reduce the volume of new mortgages originated, in particular the volume of mortgage refinancings. For example, the increase in mortgage interest rates in the second half of 2009 contributed to a significant decline in our revenues from transactions through the Ellie Mae Network and the services we provide.

The expected lower levels in residential mortgage loan volume in 2012 as compared to 2011 levels will require us to increase our revenues per loan effected through the Ellie Mae Network in order to maintain our financial performance. Any additional decrease in residential mortgage volumes would exacerbate our need to increase revenues per loan effected through the Ellie Mae Network. We cannot guarantee we will be successful in our efforts to increase our revenues per loan effected through the Ellie Mae Network, which could materially adversely affect our business.

4 Bureau of Labor Statistics, *Mortgage Employment Statistics,* February 2007.
5 Bureau of Labor Statistics, *Mortgage Employment Statistics,* February 2012.

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Our future performance will be highly dependent on our ability to continue to attract Encompass SaaS customers and, to a lesser extent, to grow revenues from new Ellie Mae Network offerings and new on-demand services.

Mortgage loan volume is expected to be lower in 2012 and 2013 than it was in 2011. To increase our revenues, we must increase the percentage of our software users who choose Encompass SaaS, from which we generate greater revenues than from our license offering. We believe that recent increases in the number of Encompass SaaS customers were driven by our success-based pricing strategy. Initiatives we have implemented in the past have, from time to time, been successful initially but not over the long term. 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 Encompass SaaS customers, we may be materially adversely affected.

We must also increase use of our Ellie Mae Network offerings and our other services, such as compliance and document preparation. We only introduced certain Ellie Mae Network offerings in the fourth quarter of 2009 and our Encompass Compliance Service in the first quarter of 2010. We cannot guarantee these Ellie Mae Network and other service offerings will achieve market acceptance and be successful. In the event these efforts are not successful, our business and growth prospects would be adversely affected.

If we fail to increase the number of Lender Encompass Users and other Ellie Mae Network participants or retain existing users and participants, our business may be harmed.

Ellie Mae revenue from Broker Encompass Users has declined significantly as a result of the significant reduction in the number of mortgage brokers. Our growth depends in large part on increasing the number of Lender Encompass Users and other Ellie Mae Network participants. To attract mega lenders and service providers to the Ellie Mae Network, we must convince them that the utility of, and access to mortgage originators on, the Ellie Mae Network is worth making payments to us for transactions ordered through the network by Encompass users. To grow our base of Encompass software users, in particular, we must increase the number of our Lender Encompass Users. We must also enhance the features and functionality of our Encompass software, convince mortgage lenders of the benefits of our software solution and the Ellie Mae Network and encourage them to switch from competing loan origination software products or to forego using traditional mortgage origination methods, including paper, facsimile, courier, mail and e-mail. Due to the fragmented nature of the mortgage industry, many mortgage industry participants may not be familiar with our Encompass solutions and the benefits of the Ellie Mae Network. We cannot guarantee we will be successful in attracting new Lender Encompass Users and other Ellie Mae Network participants and if we are unsuccessful in these efforts our business may be harmed.

Additionally, existing Lender Encompass Users and other Ellie Mae Network participants may decide not to continue to use our solutions for financial or other reasons. We have agreements in place with various third-party lenders, service providers and investors to facilitate integration between their businesses and the Ellie Mae Network. Most of these contracts are not long term or are subject to termination rights. An unexpected termination, or a failure to renew, of a significant number of our agreements or relationships with third-party lenders, service providers or investors could have an adverse effect on our business.

The success of our business depends both on the continuation of the trend toward electronic processing of mortgages and our ability to increase the use of the Ellie Mae Network to order settlement services.

In order to grow our business, we must expand the use of settlement services on, and increase the number of transactions ordered through, the Ellie Mae Network. Our Encompass users currently employ the Ellie Mae Network to handle on average only four out of the approximately ten transactions per loan file, typically including ordering credit reports and accessing the automatic underwriting systems of Fannie Mae and Freddie Mac. This limited use is in part due to the fact that many providers of other settlement services, such as title reports and appraisals, do not provide electronic solutions that are superior to traditional processes. Increasing the number of transactions ordered through the Ellie Mae Network depends in large part on our ability to educate providers of settlement services of the benefits of electronic origination and network participation and our ability to encourage providers of settlement services to deliver their services electronically through the Ellie Mae Network in a manner that is attractive to mortgage professionals. If our future sales and marketing efforts are not successful in educating and encouraging additional mortgage originators and providers of settlement services to change their current business practices and adopt electronic mortgage origination and electronic delivery practices, our business may be adversely affected.

A continuation of the shift in residential mortgage volume to the retail channels of mega lenders would adversely affect our business opportunities.

Due in part to the turmoil in the mortgage industry, the percentage of the national volume of residential mortgages in the United States that were funded directly through the retail channels of mega lenders increased from 38% in 2006 to 57% in 2011.[6] We market our Encompass software to mortgage lenders and mortgage brokers but not to mega lenders as they generally have their own proprietary loan origination software. If the shift towards mega lenders continues, our business and growth prospects would be materially adversely affected.

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 our control. As a result, comparing our operating results on a period-to-period basis may not be meaningful. In addition to other risk factors discussed in this section, factors that may contribute to the variability of our quarterly and annual results include:

- fluctuations in mortgage lending volume;
- the number of Encompass users;
- the volume of mortgages originated by our Encompass users, especially users on our success-based pricing model;
- transaction volume on the Ellie Mae Network;
- the level of demand for our Encompass Closer document preparation and other services we offer;
- the timing of the introduction and acceptance of new Ellie Mae Network offerings and additional services;
- our ability to successfully integrate and capture synergies from the DMD acquisition;
- costs associated with defending intellectual property infringement and other claims; and
- changes in government regulation affecting Ellie Mae Network participants or our business.

Because of these and other factors, our past and 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.

[6] Inside Mortgage Finance, February 17, 2012, p.3, *Mortgage Brokers Carry Significant Portions Of Increased Origination Volume in Late 2011.* Copyright 2012.

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System interruptions that impair access to the Ellie Mae Network or our hosted Encompass software could damage our reputation and brand and substantially harm our business.

The satisfactory performance, reliability and availability of the Ellie Mae Network, our hosted Encompass software, website and network infrastructure are critical to our reputation and our ability to attract and retain Ellie Mae Network participants and Encompass software users. Any systems interruption that results in the unavailability of our network or our Encompass software or impairs access to Ellie Mae Network participants connected to our network could result in negative publicity, damage our reputation and brand, and hinder our ability to enroll new customers and cause us to lose current customers, all of which could cause our business and operating results to suffer.

We have experienced and may in the future continue to experience temporary system interruptions, either to the Ellie Mae Network or to our Encompass software hosting locations, for a variety of reasons, including network failures, power failures, software errors, including problems with our Encompass software and other third party firmware updates, as well as when an overwhelming number of Ellie Mae Network participants and Encompass software 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 our hosted Encompass software. 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.

Because 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. As we rely heavily on our servers, computer and communications systems and the Internet to conduct our business, any system disruptions could negatively impact our ability to run our business and either directly or indirectly disrupt our customers businesses, which could have an adverse effect on our business.

Growth may place significant demands on our management and our infrastructure.

Our growth has placed and may continue to place significant demands on our management and our operational and financial infrastructure. As our operations grow in size, scope and complexity, we will need to improve and upgrade our systems and infrastructure to offer an increasing number of customers enhanced solutions, features and functionality. The expansion of our systems and infrastructure will require us to commit substantial financial, operational and technical resources in advance of an increase in the volume of business, with no assurance that the volume of business will 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. If we fail to achieve the necessary level of efficiency in our organization as it grows, our business would be harmed.

Integrating our recent acquisitions and 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 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 2011, we acquired MPS to introduce our Encompass Product and Pricing Service, which allows Encompass users to compare loan pricing from multiple lending

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sources. In August 2011, we acquired DMD to add additional potential Encompass users and increased loan volume to monetize our Encompass service offerings and the Ellie Mae Network. 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. 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. In addition, we may issue equity securities to complete an acquisition, which would dilute our stockholders ownership and could adversely affect the price of our common stock.

The 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. For example, 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. Additionally, we substantially updated our Encompass software in 2009 to reflect the changes to the Real Estate Settlement Procedures Act of 1974, as amended, or RESPA, that went into effect on January 1, 2010. The Dodd-Frank Wall Street Reform and Consumer Protection Act, or Dodd-Frank Act, have also and will continue to cause us to make similar updates to our Encompass software to address, among other things, regulations that protect consumers against unfair, deceptive and abusive practices by lenders. These updates have caused us to incur significant expense, and future updates will likely similarly cause us to incur significant expense.

A failure of our products and services or a failure to appropriately update our products and services to reflect and comply with changes to existing laws or regulations or with new laws or regulations may contribute to violations by our customers of such laws and regulations. We also provide a limited warranty for our Encompass Compliance Service, pursuant to which we agree to reimburse customers for losses incurred due to fines, penalties or judgments as a result of a violation of a specific law, rule or regulation tied to an error in the provision of our Encompass Compliance Service up to $2,500 per occurrence. However, with respect to some legacy customers that we inherited from our acquisition of Mavent Holdings Inc., or Mavent, our exposure could be greater. Our typical services agreement with new customers limits our exposure to a maximum of three months of fees paid by customer preceding the claim and, with respect to CenterWise and Encompass Closer, the lesser of three months of fees paid by customer preceding the claim or $25,000 per occurrence. For most customers, our exposure for warranties is limited to an amount equal to the total service fees paid by a customer for base services during a specified period preceding the relevant claim, typically six to 12 months. For a few of these legacy customers, our liability is a specified dollar amount, which in the aggregate does not exceed approximately $1.0 million. Although we have not historically incurred any claims and maintain professional liability insurance coverage of $5.0 million per occurrence and in the aggregate, to the extent we were to become liable for an amount in excess of such coverage, our business and our reputation would be materially adversely affected.

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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 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 insurance currently available on 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. The effects of these proposals or any significant structural change to the U.S. residential mortgage industry, if implemented, would cause significant disruption to the 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; 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. Our 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. Finally, 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.

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. Advances in computer capabilities, new discoveries in the field of cryptography or other developments may result in a compromise or breach of the technology used by us to protect customer transaction data. These servers may also be vulnerable to computer viruses, break-ins and similar disruptions from unauthorized tampering with our computer systems, which could lead to loss of critical data or the unauthorized disclosure of confidential customer data. 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 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 have become, or will soon become, vested in a substantial amount of stock options. 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 Calyx Technology, Inc., Byte Software Inc., PCLender.com and Harland Financial Solutions, 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 vendors such as MGIC Investment Corporation and RealEC Technologies. 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 closed loan basis, which could adversely impact the effectiveness of our success-based pricing strategy for increasing the number of Encompass SaaS on-demand 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 electronic document management. 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.

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The Ellie Mae Network is only available to mortgage originators using Encompass software. 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 e-mail, facsimile, phone, courier and mail. In addition, mortgage originators 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 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.

Many 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. 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, our Encompass software 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 our Encompass software and the Ellie Mae Network. The effective performance, reliability and availability of our Encompass software 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.

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 software features and functionality or obtain and use information that we consider proprietary. Policing our proprietary rights is difficult and may not always be effective.

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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 360 loan management software system and related operations infringes a single patent. See Legal Proceedings in Note 8 of the Notes to 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 reengineer 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 example, we are currently a defendant in litigation initiated by DocMagic Inc., which alleges, among other claims, that we had engaged in monopolization and/or attempted monopolization, intentional interference with contractual relationship, interference with prospective economic advantage, unfair competition and breach of contract. In addition, we are currently involved in defending against a patent infringement lawsuit against us and one other party filed by Industry Access Incorporated. See Legal Proceedings in Note 8 of the Notes to Consolidated Financial Statements. Furthermore, 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.

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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.

We incur increased costs as a result of being a public company, which may strain our resources and adversely affect our operating results and financial condition.

As a public company, we incur significant accounting, legal and other expenses that we did not incur as a private company. We incur costs associated with our public company reporting requirements, since we are subject to the requirements of the Exchange Act, the Sarbanes-Oxley Act of 2002, the NYSE Amex LLC and other rules and regulations. We expect these rules and regulations will continue to increase our legal and financial compliance costs and to make some activities more time-consuming and costly. Furthermore, these laws and regulations could make it more difficult or more costly for us to obtain certain types of insurance, including director and officer liability insurance, and we may be forced to accept reduced policy limits and coverage or incur substantially greater costs to obtain the same or similar coverage. The impact of these requirements could also make it more difficult for us to attract and retain qualified persons to serve on our board of directors, our board committees or as executive officers.

We will be required to assess our internal control over financial reporting on an annual basis and any future adverse findings from such assessment 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.

Pursuant to Section 404 of the Sarbanes-Oxley Act of 2002, as amended, and beginning with our Annual Report on Form 10-K for the year ending December 31, 2012, our management will be required to report on, and our independent registered public accounting firm to attest to, the effectiveness of our internal control over financial reporting. The rules governing the standards that must be met for management to assess our internal control over financial reporting are complex and require significant documentation, testing and possible remediation. We are currently in the process of reviewing, documenting and testing our internal control over financial reporting. We may encounter problems or delays in completing the implementation of any changes necessary to make a favorable assessment of our internal control over financial reporting. In connection with the attestation process by our independent registered public accounting firm, we may encounter problems or delays in completing the implementation of any requested improvements and receiving a favorable attestation. In addition, if we fail to maintain the adequacy of our internal control over financial reporting we will not be able to conclude on an ongoing basis that we have effective internal control over financial reporting in accordance with Section 404. A significant deficiency noted in our past internal controls related to our stock-based compensation. We believe we have remediated this deficiency and have taken steps to improve our internal controls and procedures. 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 NYSE Amex, regulatory investigations, civil or criminal sanctions and class action litigation.

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 this report, these factors include:

- our operating performance and the operating performance of similar companies;
- the overall performance of the equity markets;
- the number of shares of 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 to publish 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;

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- no cumulative voting in the election of directors, which limits the ability of minority stockholders to elect director candidates;

- the exclusive right of our board of directors to elect a director to fill a vacancy created by the expansion of the board of directors or the resignation, death or removal of a director, which prevents stockholders from being able to fill vacancies on our board of directors;

- the ability of our board of directors to determine to issue shares of preferred stock and to determine the price and other terms of those shares, including preferences and voting rights, without stockholder approval, which could be used to significantly dilute the ownership of a hostile acquirer;

- a prohibition on stockholder action by written consent, which forces stockholder action to be taken at an annual or special meeting of our stockholders;

- the requirement that a special meeting of stockholders may be called only by the chairman of the board of directors, the chief executive officer, the president or the board of directors, which may delay the ability of our stockholders to force consideration of a proposal or to take action, including the removal of directors; and

- advance notice procedures that stockholders must comply with in order to nominate candidates to our board of directors or to propose matters to be acted upon at a stockholders meeting, which may discourage or deter a potential acquirer from conducting a solicitation of proxies to elect the acquirer s own slate of directors or otherwise attempting to obtain control of us.

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

ITEM 1B. UNRESOLVED STAFF COMMENTS

Not applicable.

ITEM 2. PROPERTIES

The following table sets forth the location and approximate square footage of each of our principal properties. All properties are leased under operating leases that expire at various times through 2015.

Location	Primary Use	Approximate Square Footage
Pleasanton, CA	Headquarters	43,000
San Diego, CA	Branch office	14,400
Irvine, CA	Branch office	3,400
Calabasas, CA	Branch office	1,500
Montville, NJ	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 in Item 8.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

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PART II

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

Market Information for Common Stock

Our common stock has been traded on the New York Stock Exchange s American Stock Exchange, or NYSE Amex, under the symbol ELLI since April 15, 2011. The following table sets forth the high and low sales prices of our common stock as reported on the NYSE Amex for the periods indicated.

Year ended December 31, 2011	High	Low
Quarter ended June 30, 2011 (from April 15, 2011)	$ 7.60	$ 5.24
Quarter ended September 30, 2011	$ 6.38	$ 3.46
Quarter ended December 31, 2011	$ 5.84	$ 4.76

Holders of Our Common Shares

As of February 29, 2012, there were approximately 123 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.

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Performance Graph

The following graph compares the total cumulative shareholder return on our common stock with the total cumulative return of the NYSE Amex Composite Index and the NYSE Arca Technology Index for the period from April 15, 2011 (the date our common stock commenced trading on the NYSE Amex) through December 31, 2011. The graph reflects the closing sales price of $6.77 per share on April 15, 2011as the initial value of our common stock.

COMPARISON OF EIGHT-MONTH CUMULATIVE TOTAL RETURN*

Among Ellie Mae, Inc., the NYSE Composite Index, and the NYSE Arca Technology Index

	4/15/11	6/30/11	9/30/11	12/31/11
Ellie Mae, Inc.	100.00	84.79	82.13	83.46
NYSE Composite	100.00	99.63	81.83	90.64
NYSE Arca Technology	100.00	94.97	83.47	76.40

* *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. 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.*

Recent Sales of Unregistered Securities

During the three months ended December 31, 2011, we made no sales of unregistered securities.

Use of Proceeds

On April 14, 2011, the SEC declared effective our registration statement on Form S-1 (File No. 333-166438), as amended, filed in connection with the IPO. After deducting underwriting discounts, commissions and offering expenses paid or payable by us, the net proceeds to us from the IPO were approximately $21.3 million.

We used approximately $17.2 million of the net proceeds from the IPO to fund a portion of the purchase price in connection with the acquisition of DMD, which closed on August 15, 2011. The remainder of the net proceeds have been invested in short-term, investment-grade interest-bearing securities such as money market accounts, certificates of deposit, commercial paper and guaranteed obligations of the U.S. government.

Purchases of Equity Securities by the Issuer and Affiliated Purchasers

None.

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ITEM 6. SELECTED CONSOLIDATED FINANCIAL DATA

The consolidated statements of operations data for the years ended December 31, 2011, 2010 and 2009 and the consolidated balance sheets data as of December 31, 2011 and 2010 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, 2008 and 2007 and the consolidated balance sheets data as of December 31, 2009, 2008 and 2007 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.

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	Year ended December 31, 2011	2010	2009	2008	2007
	(in thousands, except share and per share data)				
Consolidated Statements of Operations Data:					
Revenues	$ 55,494	$ 43,234	$ 37,707	$ 33,573	$ 38,493
Cost of revenues (1)	15,784	12,505	12,163	13,028	13,096
Gross profit	39,710	30,729	25,544	20,545	25,397
Operating expenses:					
Sales and marketing (1)	12,126	9,555	7,532	7,553	9,890
Research and development (1)	12,975	10,468	7,945	6,898	7,140
General and administrative (1)	12,900	9,823	8,213	7,470	8,273
Total operating expenses	38,001	29,846	23,690	21,921	25,303
Income (loss) from operations	1,709	883	1,854	(1,376)	94
Other income, net	76	119	72	293	544
Income (loss) before income taxes	1,785	1,002	1,926	(1,083)	638
Income tax provision (benefit)	(1,835)	225	264	(24)	104
Net income (loss)	3,620	777	1,662	(1,059)	534
Accretion of preferred stock to redemption value, net					(96)
Net income (loss) available to common stockholders	$ 3,620	$ 777	$ 1,662	$ (1,059)	$ 438
Net income (loss) per share:					
Basic	$ 0.23	$ 0.22	$ 0.51	$ (0.33)	$ 0.14
Diluted	$ 0.18	$ 0.05	$ 0.11	$ (0.33)	$ 0.03
Weighted average shares outstanding:					
Basic	15,618,053	3,495,731	3,266,133	3,206,957	3,192,158
Diluted	20,649,451	17,146,735	15,536,269	3,206,957	15,466,646

	As of December 31, 2011	2010	2009	2008	2007
	(in thousands)				
Consolidated Balance Sheet Data:					
Cash and cash equivalants	$ 23,732	$ 14,349	$ 11,491	$ 10,754	$ 13,011
Short-term investments	1,933	2,556	4,719	997	
Property and equipment, net	5,539	2,710	2,921	4,924	7,461
Working capital	19,965	15,788	11,548	8,834	7,399
Total assets	99,771	62,956	57,718	52,676	56,180
Redeemable convertible preferred stock		82,672	82,672	82,672	82,672
Total stockholders' equity (deficit)	78,858	(31,825)	(35,516)	(38,565)	(37,832)

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

	Year ended December 31, 2011	2010	2009	2008	2007
	(in thousands)				

Cost of revenues	$ 103	$ 192	$ 144	$ 19	$ (39)
Sales and marketing	201	303	145	35	
Research and development	406	443	271	78	(45)
General and administrative	970	1,130	563	147	(66)
Total	$ 1,680	$ 2,068	$ 1,123	$ 279	$ (150)

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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 Regarding Forward-Looking Statements.

Overview

We provide business automation software for a large segment of the mortgage industry in the United States. Our on-demand, technology-enabled software solutions help streamline and automate the process of originating and funding new mortgage loans, increasing efficiency, facilitating regulatory compliance and reducing documentation errors. Mortgage originators participating in the Ellie Mae Network use our Encompass software, a comprehensive operating system that handles key business and management functions, 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 mortgage lenders, investors and service providers over the Ellie Mae Network. We also offer Encompass users a variety of other on-demand services, including Encompass Closer, which automatically prepares the disclosure and closing documents necessary to fund a mortgage; CenterWise, a bundled offering of electronic document management and websites used for customer relationship management; Encompass Compliance Service, which automatically conducts compliance checks throughout the origination process; and tax transcript services which provides income verification capability to our customers. In addition, in January 2011 we acquired and began integrating assets from MPS to introduce our Encompass Product and Pricing Service, which allows Encompass users to compare loans offered by different lenders and investors to determine the best product and price available to a particular borrower.

Lenders, service providers and certain government-sponsored entities using the Ellie Mae Network pay us fees, which we refer to as Network Transaction revenues, when they effect a transaction over the Ellie Mae Network. A Network Transaction occurs when an Encompass user sends an electronic service request to any lender, service provider or other participant through our network and that request has been accepted.

We also generate revenues from the sale of our software and services, which we refer to as Software and Services revenues. The software component of Software and Services revenues is derived from mortgage originators who either subscribe to Encompass SaaS, our on-demand solution which we host and the customer accesses through the Internet, or license Encompass software as an on-premise solution for an initial perpetual license fee with annual maintenance, which is self-hosted and maintained by the customer. Mortgage originators subscribing to Encompass SaaS either pay monthly per-user subscription fees or fees on a success basis based on loans actually funded, subject to monthly base fees, which we refer to as success-based pricing. In addition, we offer CenterWise software either as a standalone product on a subscription fee basis or bundled as part of our Encompass SaaS offering. The services component of Software and Services revenues is derived from fees paid by mortgage originators for Ellie Mae services they order. These services include document preparation, Encompass Compliance Service and Encompass Product and Pricing Services.

Our Network Transaction revenues, success-based pricing revenues and the services component of Software and Services revenues, such as document preparation services, generally track the seasonality of the mortgage industry, with increased activity in the second and third quarters and reduced activity in the first and fourth quarters as home buyers tend to purchase their homes during the spring and summer in order to move to a new home before the start of the school year. These revenues are also affected by factors that impact mortgage volumes, such as interest rate fluctuations and general economic conditions.

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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. We acquired two software companies in 2000 and 2001 as our initial entry into the business of providing loan processing software and document preparation services for mortgage originators. We introduced our internally developed Encompass software solution in 2003. We acquired software and related assets from ODI to enhance our document preparation services in September 2008, commenced our compliance services offering in December 2009 through our acquisition of Mavent and added our Encompass Product and Pricing Service to our Encompass software in January 2011 through our acquisition of assets from MPS. On August 15, 2011, we acquired all of the outstanding shares of DMD, a mortgage lending automation business, to increase our customer base and our product offerings by providing additional proprietary back-end mortgage lending software and to broaden the functionality of our Encompass solutions.

Prior to 2006, we financed our operations and capital expenditures primarily through private sales of preferred stock and lease financing. From 2006 through the first quarter of 2011, we financed our operations with existing cash and cash flows from operating activities, and responded to adverse economic conditions, such as those that commenced in 2007, by reducing headcount, which is a major component of our operating expenses. As explained later in this section, our initial public offering in April 2011 raised $21.3 million, net of offering costs, most of which was used to fund our acquisition of DMD in August 2011.

The mortgage industry has undergone 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. Our business strategy has evolved to address recent industry trends, including:

- the lower mortgage lending volumes expected in 2012 and 2013 as compared to 2011, as forecasted by Fannie Mae, Freddie Mac and the Mortgage Bankers Association;
- decreased profitability for mortgage originators as a result of reduced mortgage originations;
- a continued significant decline in the number of mortgage brokerages and an increase in the relative importance of mortgage lenders, which not only arrange but also fund loans;
- increased investor and lender quality requirements for new loans; and
- regulatory reforms that have significantly increased the complexity and importance of regulatory compliance.

We are responding to these trends as follows:

Lower lending volume. Beginning in late 2009, we focused our marketing and sales efforts on our Encompass SaaS on-demand offering, and particularly our Encompass SaaS success-based pricing model, in contrast to our on-premise license model. In our Encompass SaaS 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 Encompass SaaS success-based pricing model builds on this value proposition by aligning the customers payments for our software solutions with their own receipts of revenues. The shift to this model resulted in a delay in our receipt of a significant portion of our revenues from the time of the initial sale until subsequent periods, which decreased our revenues in the first half of 2010. Encompass SaaS success-based pricing customers are composed of new Encompass customers and users that have converted from our licensed Encompass software or flat monthly per-user hosted offerings. At December 31, 2011 and 2010, we had 24,252 and 14,678 Active SaaS Encompass Users, respectively, which are mortgage origination professionals who have used our Encompass SaaS software at least once within the preceding 90 days, of which 19,186 and 8,704, respectively, subscribed to our success-based pricing model. SaaS Encompass Users generated $49.4 million and $38.8 million of our revenues for the years ended December 31, 2011 and 2010, respectively, of which $15.8 million and $4.9 million, respectively, was generated by users of our success-based pricing model. We typically generate greater revenues per user through our Encompass SaaS offering than through our license offering.

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Decreased profitability for mortgage originators as a result of reduced mortgage originations. By automating many of the functions of mortgage origination, we enable our users to more effectively process quality loans. This reduces the cost of originating a loan and lowers the risk of buy back from investors of poorly originated or documented loans.

Continued significant decline in the number of mortgage brokerages and an increase in the relative importance of mortgage lenders. We focus significant research and development effort on providing Encompass functionality for mortgage lenders. In addition, we have hired sales personnel focused on sales of our solutions to mortgage lenders rather than mortgage brokerages. We believe this shift toward lender users will provide us increased opportunities because mortgage lenders typically use more sophisticated and comprehensive software solutions to run their businesses and use more services and effect more transactions on the Ellie Mae Network.

Increased investor and lender quality requirements for new loans. Encompass software is designed to automate and streamline the process of originating mortgages to satisfy increased quality requirements of investors. Relevant features of Encompass software include enabling customers management to impose processing rules and formats, milestone and process reminders, automated population of forms with accurate data, accurate and automated transmission of loan files and data from originators to investors and lenders.

Regulatory reforms that have significantly increased the complexity and importance of regulatory compliance. 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 processes recommended by Encompass work flow comply with applicable rules and regulations.

Initial Public Offering

On April 20, 2011, we sold 5,000,000 newly issued shares of common stock, par value $0.0001 per share, at a price of $6.00 per share in our initial public offering, or IPO. We received net proceeds from the IPO of approximately $21.3 million after deducting underwriting discounts and commissions of $2.1 million and offering expenses of $6.6 million. Immediately prior to the consummation of the IPO on April 20, 2011, we effected the conversion of all of our outstanding shares of redeemable convertible preferred stock into shares of common stock on a 1-for-1 basis.

Acquisition of DMD

On August 15, 2011, we entered into a Stock Purchase Agreement and acquired all of the outstanding shares of DMD, a mortgage lending automation business, for a total purchase consideration of approximately $25.1 million in cash, of which $17.2 million was paid at closing and the remaining $8.0 million, net of $0.1 million closing settlement adjustments, will be paid without interest as follows: $3.0 million on August 15, 2012, $3.0 million on August 15, 2013 and $2.0 million on August 15, 2014. The operating results of DMD have been included in our consolidated financial statements commencing as of the acquisition date of August 15, 2011. In connection with the acquisition, we incurred related transaction expenses of approximately $0.4 million, which we expensed as incurred. For more information, see Note 5 of the Notes to Consolidated Financial Statements.

Operating Metrics

Encompass-related revenues per Average Active Encompass User is a key operational metric we use to evaluate our business, determine allocation of our resources and make decisions regarding corporate strategy. This metric is calculated by dividing Encompass-related revenues by the average number of Active Encompass Users during the period.

This metric has two subcategories: Encompass-related revenues per Average Active Lender Encompass User and Encompass-related revenues per Average Active Broker Encompass User. An Active Lender

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Encompass User is a mortgage origination professional working at a 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. An Active Broker Encompass User is a mortgage origination professional working for a mortgage brokerage which typically processes and submits loan files to a mortgage lender or mega lender that funds the loan. We believe it is important to evaluate these subcategories separately for two reasons. First, the percentage of the overall loan origination market represented by mortgage lenders, including mortgage banks, commercial banks, thrifts and credit unions continues to increase as the number of mortgage brokerages has declined. In addition, mortgage lenders normally require more software and other service functionality, providing potential leverage for revenue growth. We focus on these metrics to determine our success in leveraging our Encompass User base to increase our revenues. We also track each Active Encompass User subcategory at the end of a period to gauge the degree of our market penetration.

We believe that marketing Encompass through our Encompass SaaS offering on a success-based pricing model is at present our most important marketing method. Accordingly, we track the number of Active SaaS Success-Based Pricing Encompass Users at the end of each period to gauge the degree of market penetration. In addition, we track revenues generated by our Active SaaS Success-Based Pricing Encompass Users during each period.

The components used to calculate these metrics are defined below.

Active Encompass Users. An Active Encompass User is a mortgage origination professional who has used Encompass software at least once within a 90-day period preceding the measurement date. This metric represents the sum total of the subcategories of Active Lender Encompass Users and Active Broker Encompass Users.

Average Active Encompass Users. Average Active Encompass Users during a period is calculated by averaging the monthly Active Encompass Users or subcategory during a period.

Active SaaS Success-Based Pricing Encompass Users. An Active SaaS Success-Based Pricing Encompass User is a mortgage origination professional who has used the Encompass SaaS system under our success-based pricing model at least once within a 90-day period preceding the measurement date.

Encompass-related revenues and SaaS success-based pricing revenues for a period consists of revenues derived from such users as well as any other revenue derived from interactions between such users and third parties through the Ellie Mae Network during the period. These operating metrics exclude revenues from our legacy and acquired products to the extent it does not involve a sale to such users.

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The following table shows these operating metrics as of and for the three years ended December 31, 2011, 2010 and 2009 (unaudited):

	Year ended December 31,		
	2011	2010	2009
Active Encompass users (at end of period):			
Active lender Encompass users	46,238	39,687	33,221
Active broker Encompass users	7,529	11,014	21,806
Total active Encompass users	53,767	50,701	55,027
Average active Encompass users (during period):			
Average active lender Encompass users	42,442	36,625	32,836
Average active broker Encompass users	9,013	15,352	25,447
Average total active Encompass users	51,455	51,977	58,283
Encompass-related revenues (in thousands):			
Encompass-related revenues lenders	$ 46,034	$ 34,116	$ 26,386
Encompass-related revenues brokers	3,345	4,683	5,482
Total Encompass-related revenues	$ 49,379	$ 38,799	$ 31,868
Encompass-related revenues per average active Encompass user:			
Encompass-related revenues lenders per average active lender Encompass user	$ 1,085	$ 932	$ 804
Encompass-related revenues brokers per average active broker Encompass user	$ 371	$ 305	$ 215
Encompass-related revenues per average active Encompass user	$ 960	$ 746	$ 547
SaaS success-based pricing related data:			
Active SaaS success-based pricing Encompass users (at end of period)	19,186	8,704	1,261
SaaS success-based pricing-related revenues (in thousands)	$ 15,815	$ 4,944	$

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. Sales taxes assessed by a governmental authority are excluded from revenue.

Network 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 interoperability with, mortgage originators on the Ellie Mae Network. Under these agreements, we have the opportunity to earn transaction fees when transactions are processed through our 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. Associated set-up fees are recognized ratably, beginning upon completion of the integration and continuing over the remaining estimated life of the relationship with our customer, which generally is the remaining life of the contract.

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Software and Services Revenues

These revenues include:

(a) License and Maintenance Revenues. Revenue from the sale of software licenses is recognized in the month in which the required revenue recognition criteria are met, generally in the month in which the software is delivered. Revenue is recognized when persuasive evidence of an arrangement exists which is evidenced by a signed agreement, the product has been downloaded or delivered freight on board shipping point, the fee is fixed or determinable and collection of the resulting receivable is reasonably assured.

For arrangements with multiple elements (e.g., undelivered maintenance and support contracts bundled with licenses), when vendor specific objective evidence, or VSOE, is determinable, we allocate revenue to the delivered elements of the arrangement using the residual value method based on objective evidence of the fair value of the undelivered elements, which is specific to us. When VSOE is not determinable, we allocate all revenue to the undelivered elements and the entire arrangement is recognized ratably over the term of the contract. We recognize revenue under this model upon receipt of cash payment from the customer, if collectability is not reasonably assured. 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 contract. License revenues include the nominal shipping and handling charges associated with most license orders. Actual shipping costs incurred by us are included in cost of revenues.

(b) 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, product updates and support services. These revenues generally include the following:

Encompass SaaS Revenues. We offer web-based access to our Encompass software for a monthly recurring fee. We provide the right to access our loan origination software and handle the responsibility of managing the servers, providing robust security, backing-up the data and applying updates; however, customers under these arrangements may not take possession of the software at any time during the term of the agreement. Associated set-up fees are recognized ratably over the life of the relationship with our customers, which is generally the life of the contract. Contracts generally range from one to three years. Alternatively, customers can elect to pay on a per closed loan, or success, basis subject to monthly base fees. The success basis contracts generally have a term of two to three years. Monthly base fees are recognized as the service is performed and additional amounts arising from closed loans are recognized when the loans close. This offering also includes CenterWise for Encompass as an integrated component, which is a combined element of the arrangement that is delivered in conjunction with the Encompass SaaS offering and therefore is not accounted for separately.

CenterWise for Encompass Licensees. We provide a bundled offering of electronic document management and websites used for customer relationship management. We recognize revenue for CenterWise as the service is performed. It is also automatically included as an integrated component of the Encompass SaaS offering, and the associated revenue is recognized as indicated above.

Services Revenues. We have entered into agreements with customers that provide other automated mortgage related and other business services, including automated documentation preparation and compliance reports. Revenue is recognized only when the price is fixed or determinable, persuasive evidence of an arrangement exists, the service is performed, and collectability of the resulting receivable is reasonably assured.

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; allocated facilities costs; customer support; data centers; depreciation on computer equipment used in supporting the Ellie Mae Network, Encompass SaaS and CenterWise offerings; amortization of acquired intangible assets; professional services associated with implementation of our software; and allocated facilities costs.

Operating Expenses

Sales and Marketing

Our sales and marketing expenses consist primarily of: salaries, benefits and incentive compensation, including stock-based compensation, and allocated facilities costs; expenses for trade shows, public relations and other promotional and marketing activities, including travel and entertainment expenses; and amortization of acquired intangible assets such as customer lists and contracts. We have hired sales personnel to focus on sales of our solutions to mortgage lenders in light of the increasing percentage of potential customers which are mortgage lenders rather than mortgage brokerages. We also intend to increase marketing activities focused on Encompass Banker Edition, our Ellie Mae Network offerings and our compliance 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.

General and Administrative

Our general and administrative expenses consist primarily of: salaries and benefits, including 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 due to costs associated with being a public company.

Other Income, Net

Other income, net consists primarily of interest income earned on our cash accounts and notes receivables, net of interest expense paid on equipment and software lease lines and imputed interest related to the DMD acquisition holdback payments.

Income Taxes

We are subject to income tax in the United States. As of December 31, 2011, for federal and state tax purposes, we had $15.6 million of federal and $16.3 million of state net operating loss, or NOL, carryforwards available to reduce future taxable income. These NOL carryforwards begin to expire in 2020 and 2013 for federal and state tax purposes, respectively. As of December 31, 2011, we also had federal and state research and development tax credit carryforwards of approximately $2.5 million each. The federal tax credit carryforwards will expire commencing in 2021. The state tax credit may be carried forward indefinitely. Our ability to use our NOL and tax credit carryforwards to offset any future taxable income will be subject to limitations attributable to equity transactions that result in a change of ownership as defined by Section 382 of the Internal Revenue Code. They also may be subject to suspension by government authority. For example, the State of California tax authority suspended taxpayers ability to use NOL carryforwards in 2008 through 2011.

We have determined that we have sufficient NOL and tax credit carryforwards to offset our federal taxable income for 2011 and preceding periods.

Our net deferred tax assets consist primarily of NOL and research and development credit carryforwards generated before we achieved profitability. Due to the uncertainty surrounding the realization of the deferred tax assets in future tax returns, we have placed a full valuation allowance against our net deferred tax assets. Our effective tax rate differs from the statutory federal rate principally due to changes in the valuation allowance in 2009, 2010 and 2011. The valuation allowance decreased by $0.4 million in 2009, which is net of a $0.3 million increase associated with an acquisition that did not affect the effective tax rate, decreased by $0.4 million in 2010, and decreased by $2.0 million in 2011. During 2011, we recorded a change in our tax valuation allowance resulting from our acquisition of DMD in August 2011 and, accordingly, we recognized an income tax benefit of approximately $1.7 million in our 2011 consolidated statement of income. We will continue to assess the need for a valuation allowance on deferred tax assets by evaluating both positive and negative evidence that may exist. Any adjustment to the deferred tax asset valuation allowance will be recorded in the income statement for the periods that the adjustment is determined to be required.

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 and goodwill and intangible assets have the greatest potential impact on our consolidated financial statements. Therefore, we consider these to be our critical accounting policies and estimates. For further information on all of our significant accounting policies, please see Note 2 of the Notes to Consolidated Financial Statements.

Revenue Recognition

We generate revenue primarily from transaction-based fees and fees for software and related services. Sales taxes assessed by a governmental authority are excluded from revenue.

Network 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 interoperability with, mortgage originators on the Ellie Mae Network. Under these agreements, we have the opportunity to earn transaction fees when transactions are processed through our 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. Associated set-up fees are recognized ratably, beginning upon completion of the integration and continuing over the remaining estimated life of the relationship with our customer, which generally is the remaining life of the contract.

Software and Services Revenues

These revenues include:

(a) License and Maintenance Revenues. Revenue from the sale of software licenses is recognized in the month in which the required revenue recognition criteria are met, generally in the month in which the software is delivered. Revenue is recognized when persuasive evidence of an arrangement exists which is evidenced by a signed agreement, the product has been downloaded or delivered freight on board shipping point, the fee is fixed or determinable and collection of the resulting receivable is reasonably assured.

For arrangements with multiple elements (e.g., undelivered maintenance and support contracts bundled with licenses), when vendor specific objective evidence, or VSOE, is determinable, we allocate revenue to the delivered elements of the arrangement using the residual value method based on objective evidence of the fair value of the undelivered elements, which is specific to us. When VSOE is not determinable, we allocate all revenue to the undelivered elements and the entire arrangement is recognized ratably over the term of the contract. We recognize revenue under this model upon receipt of cash payment from the customer, if collectability is not reasonably assured. 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 contract. License revenues include the nominal shipping and handling charges associated with most license orders. Actual shipping costs incurred by us are included in cost of revenues.

(b) 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, product updates and support services. These revenues generally include the following:

Encompass SaaS Revenues. We offer web-based access to our Encompass software for a monthly recurring fee. We provide the right to access our loan origination software and handle the responsibility of managing the servers, providing robust security, backing-up the data and applying updates; however, customers under these arrangements may not take possession of the software at any time during the term of the agreement. Associated set-up fees are recognized ratably over the life of the relationship with our customers, which is generally the life of the contract. Contracts generally range from one to three years. Alternatively, customers can elect to pay on a per closed loan, or success, basis subject to monthly base fees. The success-basis contracts generally have a term of two to three years. Monthly base fees are recognized as the service is performed and additional amounts arising from closed loans are recognized when the loans close. This offering also includes CenterWise for Encompass as an integrated component, which is a combined element of the arrangement that is delivered in conjunction with the Encompass SaaS offering and therefore is not accounted for separately.

CenterWise for Encompass Licensees. We provide a bundled offering of electronic document management and websites used for customer relationship management. We recognize revenue for CenterWise as the service is performed. It is also automatically included as an integrated component of the Encompass SaaS offering, and the associated revenue is recognized as indicated above.

Services Revenues. We have entered into agreements with customers that provide mortgage related and other business services, including automated documentation preparation and compliance reports. Revenue is recognized only when the price is fixed or determinable, persuasive evidence of an arrangement exists, the service is performed, and collectability of the resulting receivable is reasonably assured.

Effective January 1, 2011, we adopted Accounting Standards Update 2009-13, *Multiple-Deliverable Revenue Arrangements,* (amendments to ASC Topic 605, *Revenue Recognition*), or ASU 2009-13. The new standard changes the requirements for establishing separate units of accounting in a multiple-element arrangement and requires the allocation of arrangement consideration to each deliverable to be based on the relative selling price. We adopted this new standard on a prospective basis; therefore, it applies only to revenue arrangements entered into or materially modified beginning January 1, 2011. For revenue arrangements that were entered into or materially modified after the adoption of this standard, implementation of this new authoritative guidance has not had a significant impact on our reported revenue in the year ended December 31, 2011 as compared to revenue if the related arrangements entered into or modified after the effective date were subject to the accounting requirements in effect during the prior year periods. We do not expect the adoption of this new accounting standard will have significant impact on our revenue recognition in the future.

When subscription services and usage-based fee arrangements involve multiple elements that qualify as separate units of accounting, we allocate arrangement consideration in multiple-deliverable revenue arrangements 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) VSOE if available; (ii) the 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.

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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.

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 stand-alone basis. As a result, we have not been able to establish selling price 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 were sold on a stand-alone basis. We determine BESP for deliverables by considering multiple factors including, but not limited to, prices we charge for similar offerings, market conditions, competitive landscape and pricing practices.

Arrangement consideration is allocated using the relative selling price method. We have not historically priced our subscription services and usage-based fee arrangements within a narrow range and have limited standalone sales or renewals for these arrangements. As a result, we have determined that neither VSOE nor TPE are available and use BESP to allocate the selling price to subscription services and usage-based fee deliverables.

In general, we recognize revenue for monthly fees, including monthly base fees, on a straight-line basis over the contractual subscription period commencing on the date the services are made available to the customer. Usage-based fees, that are determined monthly based on closed loans or other metrics, are recognized when the loans close. In general, upfront non-refundable fees received at the inception of an arrangement are deferred and recognized over the longer of the contractual term or the estimated customer relationship period.

Income Taxes

We record income taxes using the asset and liability method, which requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been recognized in our financial statements or tax returns. In estimating future tax consequences, generally all expected future events other than enactments or changes in the tax law or rates are considered. Valuation allowances are provided when necessary to reduce deferred tax assets to the amount expected to be realized. 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.

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. The tax effects of a position are recognized only when they are considered 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 foreign and 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 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.

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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 income.

Stock-based Compensation

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

We estimate potential forfeitures of stock grants and adjust stock-based compensation expense accordingly. The estimate of forfeitures 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 are recognized in the period of change and impact the amount of stock compensation expenses 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 generally accounted for at the fair value of the equity instrument issued on the date of grant, 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 over which services are received.

The following table summarizes the assumptions used in the Black-Scholes option-pricing model relating to stock options in 2011, 2010 and 2009:

	Year ended December 31,		
	2011	**2010**	**2009**
Stock option plans:			
Risk-free interest rate	1.17% - 2.20%	1.18% - 3.12%	1.87% - 3.21%
Expected life of options (in years)	5.27 - 6.08	5.00 - 6.08	5.00 - 6.08
Expected dividend yield	0%	0%	0%
Volatility	53% - 55%	55% - 56%	47% - 48%
Employee Stock Purchase Plan:(1)			
Risk-free interest rate	0.05%		
Expected life of options (in years)	0.5		
Expected dividend yield	0%		
Volatility	52%		

(1) Employee Stock Purchase Plan established in 2011.

We recorded non-cash stock-based compensation expense related to employee stock options granted of approximately $1.5 million, $2.1 million and $1.1 million for the years ended December 31, 2011, 2010 and 2009, respectively. We also recorded non-cash stock-based compensation expense of approximately $0.2 million for the year ended December 31, 2011 related to our employee stock purchase plan, adopted in March 2011.

Repricing of Stock Options

In December 2001, we made offers to replace employee options with an exercise price of $13.83 with options having an exercise price of $3.75 per share. Options for a total of 757,989 shares were cancelled and repriced at $3.75 by December 31, 2001. In accordance with the applicable accounting guidance, the replacement options are being accounted for using variable plan accounting. We recognized stock-based compensation (benefit) expense of $(411,000), $622,000 and $514,000 for the years ended December 31, 2011, 2010 and 2009, respectively, related to the variable plan accounting for these options.

At December 31, 2010, we had outstanding stock options to purchase an aggregate of 133,244 shares of common stock remaining that were repriced pursuant to the stock option repricing that occurred in December 2001. Under the variable accounting rules, we recognized stock-based compensation expense or benefit with respect to the remaining shares through the earlier of the date the options were exercised or December 16, 2011, the date the options expired, in an amount equal to the number of shares of common stock underlying such options that remain outstanding as of the end of the period multiplied by the difference between the fair value of our common stock at the end of the period and the fair value of our common stock at the end of the immediately preceding period. For this purpose, the deemed fair value of our common stock at December 31, 2010 was $10.05 per share.

All options subject to variable accounting have been exercised or were expired as of December 31, 2011.

In February 2009, we made offers to replace employee options with exercise prices of $5.40 and $5.94 with options having an exercise price of $1.38 and which included new vesting periods in accordance with the terms of the repricing plan. Options for a total of 1,993,923 shares were cancelled and repriced at $1.38 in April 2009. The Replacement Options are being accounted for as a modification to the original option grants and resulted in incremental stock-based compensation expense of approximately $717,000, which is being recognized as the awards vest. As of December 31, 2011 and December 31, 2010, 883,122 shares and 1,454,784 shares, respectively, of these replacement options remained outstanding.

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, tradenames 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 and intangible assets with indefinite useful lives are 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 2011, 2010 and 2009 and determined that our goodwill was not impaired for those years. The estimated fair value of the reporting unit exceeded carrying value for each of these periods.

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.

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Results of Operations

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

	Year ended December 31,		
	2011	2010	2009
		(in thousands)	
Revenues	$ 55,494	$ 43,234	$ 37,707
Cost of revenues (1)	15,784	12,505	12,163
Gross profit	39,710	30,729	25,544
Operating expenses			
Sales and marketing (1)	12,126	9,555	7,532
Research and development (1)	12,975	10,468	7,945
General and administrative (1)	12,900	9,823	8,213
Total operating expenses	38,001	29,846	23,690
Income from operations	1,709	883	1,854
Other income, net	76	119	72
Income before income taxes	1,785	1,002	1,926
Income tax provision (benefit)	(1,835)	225	264
Net income	$ 3,620	$ 777	$ 1,662

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

	Year ended December 31,		
	2011	2010	2009
		(in thousands)	
Cost of revenues	$ 103	$ 192	$ 144
Sales and marketing	201	303	145
Research and development	406	443	271
General and administrative	970	1,130	563
	$ 1,680	$ 2,068	$ 1,123

	Year ended December 31,		
	2011	2010	2009
		(as percentage of revenues)	
Revenues	100.0%	100.0%	100.0%
Cost of revenues	28.4	28.9	32.3
Gross profit	71.6	71.1	67.7
Operating expenses			
Sales and marketing	21.9	22.1	20.0

Research and development	23.4	24.2	21.0
General and administrative	23.2	22.7	21.8
Total operating expenses	68.5	69.0	62.8
Income from operations	3.1	2.1	4.9
Other income, net	0.1	0.2	0.2
Income before income taxes	3.2	2.3	5.1
Income tax provision (benefit)	(3.3)	0.5	0.7
Net income	6.5%	1.8%	4.4%

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Revenues

	Year ended December 31, 2011	2010 (in thousands)	2009
Revenue by type:			
Software and Services	$ 45,378	$ 33,880	$ 29,195
Network Transactions	10,116	9,354	8,512
Total	$ 55,494	$ 43,234	$ 37,707

	Year ended December 31, 2011	2010 (as percentage of revenues)	2009
Revenue by type:			
Software and Services	81.8%	78.4%	77.4%
Network Transactions	18.2	21.6	22.6
Total	100.0%	100.0%	100.0%

Total revenues increased $12.3 million, or 28.4%, from 2010 to 2011. This increase was primarily due to a $11.5 million increase in Software and Services revenues, comprised of a $10.8 million increase in success-based pricing revenues due to the continued focus of our selling effort on the success-based pricing model, a $0.9 million increase in license and maintenance revenue as a result of our DMD acquisition in August 2011, a $1.0 million increase in revenues attributable to our income verification service, which we began offering in the first quarter of 2011, a $0.5 million increase in revenues attributable to our product and pricing service, which we began offering in the first quarter of 2011 with our acquisition of MPS in January 2011, and a $0.6 million increase in revenues attributable to our compliance service, WebCenter and other services as a result of increased usage by our customer base. These increases were partially offset by a $1.5 million decrease in document preparation services due to lower loan volume and our bundling of that service into the success-based pricing offering, and a $0.8 million decrease in standard hosted Encompass revenues due to existing customers having converted to the success-based pricing model.

Network Transaction revenues increased $0.8 million, or 8.1%, from 2010 to 2011 primarily as a result of a $0.3 million increase in title insurance revenue and a $0.4 million increase due to increased loan activity from certain new customers added during 2010.

Total revenues increased $5.5 million, or 14.7%, from 2009 to 2010. This increase was primarily due to an increase in Software and Services revenues, consisting of a $4.9 million increase in success-based pricing revenues in its first full year on the market, a $2.2 million increase in compliance service revenues from our Mavent acquisition in December 2009, and a $0.6 million increase in CenterWise revenues. These increases were partially offset by a $1.6 million decrease in document preparation services revenues arising from a decline in refinancing activities from the elevated level of refinancing activity in the first half of 2009 that arose from government incentives, a $0.5 million decrease in self-hosted software revenues attributable to our focus on our Encompass SaaS offering, which led to conversions of existing users of our license model and fewer new license sales, and a $1.0 million decrease in standard hosted Encompass revenues due to clients converting to the success-based pricing model.

Network Transaction revenues increased $0.8 million, or 9.9%, from 2009 to 2010 primarily due to a $1.2 million increase in appraisal transaction revenues reflecting a full year of appraisal transaction services in 2010 after its introduction in late 2009, partially offset by a decline in the volume of loan activity on the Ellie Mae Network from overall industry declines.

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The number of Active Lender Encompass Users increased by 16.5% from 39,687 users at December 31, 2010 to 46,238 users at December 31, 2011, primarily due to new lender customers adopting our Encompass SaaS success-based pricing offering. The number of overall Active Encompass Users increased by 6.0% from 50,701 users at December 31, 2010 to 53,767 users at December 31, 2011 as the 16.5% increase in Active Lender Encompass Users was partially offset by a 31.6% decrease in Active Broker Encompass Users as a result of continued industry-wide decline in the number of mortgage brokerages. Encompass-related Revenues per Average Active Broker Encompass User increased by 21.6% from $305 in 2010 to $371 in 2011 due to the significant reduction in the number of Active Broker Encompass Users that had previously provided only minimal revenues. Encompass-related revenues per Average Active Lender Encompass User increased by 16.4% from $932 in 2010 to $1,085 in 2011 due to the growth in the number of Active Lender Encompass Users using our success-based pricing offering.

The number of Active Lender Encompass Users increased by 19.5% from 33,221 users at December 31, 2009 to 39,687 users at December 31, 2010 primarily due to new lender customers adopting our Encompass SaaS success-based pricing offering. However, the number of Active Encompass Users decreased 7.9% from 55,027 at the end of 2009 to 50,701 at the end of 2010 due to the 49.5% decline in Active Broker Encompass Users from 21,806 at the end of 2009 to 11,014 at the end of 2010. Encompass-related Revenues per Average Active Broker Encompass User increased by 41.9% from $215 in 2009 to $305 in 2010 due to the significant loss of Active Broker Encompass Users that had previously provided only minimal revenues. Encompass-related revenues per Average Active Lender Encompass User increased by 15.9% from $804 in 2009 to $932 in 2010 due to the growth in the number of Active Lender Encompass Users subscribing to our success-based pricing offering.

Gross Profit

	Year ended December 31,		
	2011	**2010**	**2009**
	(dollars in thousands)		
Gross profit	$ 39,710		