

Financial Engines, Inc.  
Form 10-Q  
November 09, 2010

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549  
FORM 10-Q**

☒ **Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the quarterly period ended September 30, 2010**

**OR**

☐ **Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
Commission File No. 001-34636  
FINANCIAL ENGINES, INC.  
(Exact name of registrant as specified in its charter)**

**Delaware  
(State or other jurisdiction of  
incorporation or organization)**

**94-3250323  
(I.R.S. Employer  
Identification No.)**

**1804 Embarcadero Road  
Palo Alto, California 94303  
(Address of principal executive offices, Zip Code)  
(650) 565-4900**

**(Registrant's telephone number, including area code)**

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

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

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

Large accelerated filer ☐

Accelerated filer ☐

Non-accelerated filer ☒

Smaller reporting  
company ☐

(Do not check if a smaller  
reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes ☐ No ☒  
As of October 29, 2010, 41,935,403 shares of Common Stock, par value \$0.0001, were issued and outstanding.

**FINANCIAL ENGINES, INC.  
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QUARTERLY REPORT ON FORM 10-Q  
FOR THE QUARTER ENDED SEPTEMBER 30, 2010**

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## Condensed Consolidated Balance Sheets

(In thousands, except share and per share data)

(Unaudited)

	<b>December 31, 2009</b>	<b>September 30, 2010</b>
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 20,713	\$ 99,455
Accounts receivable, net	17,975	25,190
Deferred tax assets		9,079
Prepaid expenses	1,922	2,582
Other current assets	3,391	2,033
Total current assets	44,001	138,339
Property and equipment, net	2,558	3,390
Internal use software, net	8,743	10,858
Long-term deferred tax assets		40,825
Other assets	3,050	7,029
Total assets	\$ 58,352	\$ 200,441
<b>Liabilities and Stockholders Equity</b>		
Current liabilities:		
Accounts payable	\$ 7,579	\$ 7,477
Accrued compensation	9,101	10,902
Deferred revenue	7,354	10,681
Bank borrowings	3,333	
Other current liabilities	72	127
Total current liabilities	27,439	29,187
Long-term bank borrowings	4,722	
Long-term deferred revenue	1,487	1,561
Other liabilities	438	345
Total liabilities	34,086	31,093

Contingencies (see note 10)

Stockholders equity:

Convertible preferred stock, \$0.0001 par value 24,192,000 and 10,000,000  
authorized as of December 31, 2009 and September 30, 2010, respectively;  
22,441,623 and 0 shares issued and outstanding as of December 31, 2009  
and September 30, 2010, respectively; aggregate liquidation preference of  
\$139,404 and \$0 as of December 31, 2009 and September 30, 2010,  
respectively

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Common stock, \$0.0001 par value 47,650,000 and 500,000,000 authorized;  
10,647,223 and 41,810,049 shares issued and outstanding at December 31,  
2009 and September 30, 2010, respectively

	1	4
Additional paid-in capital	182,018	270,501
Deferred compensation	(394)	(81)
Accumulated deficit	(157,361)	(101,076)
Total stockholders' equity	24,266	169,348
Total liabilities and stockholders' equity	\$ 58,352	\$ 200,441

See accompanying notes to the unaudited condensed consolidated financial statements.

**Table of Contents****FINANCIAL ENGINES, INC. AND SUBSIDIARIES**

## Condensed Consolidated Statements of Operations

(In thousands, except per share data)

(Unaudited)

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2009</b>	<b>2010</b>	<b>2009</b>	<b>2010</b>
Revenue:				
Professional management	\$ 13,646	\$ 19,927	\$ 34,376	\$ 54,380
Platform	7,602	7,659	22,526	22,022
Other	762	1,176	1,945	2,276
Total revenue	22,010	28,762	58,847	78,678
Costs and expenses:				
Cost of revenue (exclusive of amortization of internal use software)	7,546	10,189	21,057	27,387
Research and development	3,967	4,678	11,366	14,138
Sales and marketing	5,328	6,862	16,689	19,734
General and administrative	1,744	2,849	5,359	8,298
Amortization of internal use software	815	974	2,126	2,694
Total costs and expenses	19,400	25,552	56,597	72,251
Income from operations	2,610	3,210	2,250	6,427
Interest expense	(159)	21	(514)	(101)
Interest and other income, net	45	8	304	15
Income before income taxes	2,496	3,239	2,040	6,341
Income tax expense (benefit)	442	(319)	359	(91)
Income tax benefit from release of valuation allowance		(49,853)		(49,853)
Net income	2,054	53,411	1,681	56,285
Less: Stock dividend (see note 5)				5,480
Net income attributable to holders of common stock	\$ 2,054	\$ 53,411	\$ 1,681	\$ 50,805
Net income per share attributable to holders of common stock				
Basic	\$ 0.20	\$ 1.30	\$ 0.17	\$ 1.55
Diluted	\$ 0.06	\$ 1.15	\$ 0.05	\$ 1.16
Shares used to compute net income per share attributable to holders of common stock				
Basic	10,080	41,205	9,748	32,695
Diluted	34,729	46,563	34,340	43,900

See accompanying notes to the unaudited condensed consolidated financial statements.

**Table of Contents****FINANCIAL ENGINES, INC. AND SUBSIDIARIES****Condensed Consolidated Statements of Stockholders' Equity and Comprehensive Income**

(In thousands, except share data)

(Unaudited)

	<b>Convertible</b>		<b>Common stock</b>		<b>Additional paid-in</b>		<b>Deferred</b>	<b>Accumulated</b>	<b>Total</b>
	<b>preferred stock</b>		<b>Shares</b>	<b>Amount</b>	<b>Shares</b>	<b>Amount</b>	<b>stock</b>	<b>compensation deficit</b>	<b>stockholders' equity</b>
	<b>Shares</b>	<b>Amount</b>	<b>Shares</b>	<b>Amount</b>	<b>capital</b>	<b>compensation</b>	<b>deficit</b>		
Balance, January 1, 2010	22,441,623	\$ 2	10,647,223	\$ 1	\$ 182,018	\$ (394)	\$ (157,361)	\$	24,266
Conversion of preferred stock to common stock effective upon initial public offering	(22,441,623)	(2)	22,441,623	2					
Stock dividend to Series E shareholders				456,643					
Issuance of common stock				871,477		4,564			4,564
Initial public offering of common stock, net of offering costs				7,458,100	1	78,953			78,954
Net share settlements for stock-based awards minimum tax withholdings				(65,017)		(921)			(921)
Amortization of deferred stock-based compensation under the intrinsic value method							313		313
Stock-based compensation under the fair value method						5,662			5,662
Nonemployee stock-based compensation expense						62			62
Income tax associated with stock-based compensation						163			163
Net income and comprehensive income								56,285	56,285
Balance, September 30, 2010		\$	41,810,049	\$ 4	\$ 270,501	\$ (81)	\$ (101,076)	\$	169,348

See accompanying notes to the unaudited condensed consolidated financial statements.



**Table of Contents****FINANCIAL ENGINES, INC. AND SUBSIDIARIES**

## Condensed Consolidated Statements of Cash Flows

(In thousands)

(Unaudited)

	<b>Nine Months Ended September 30,</b>	
	<b>2009</b>	<b>2010</b>
Cash flows from operating activities:		
Net income	\$ 1,681	\$ 56,285
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	1,317	1,350
Amortization of internal use software	2,053	2,557
Stock-based compensation	4,648	5,798
Amortization of deferred sales commissions	853	853
Amortization and impairment of direct response advertising	10	697
Income tax benefit from release of valuation allowance		(49,853)
Deferred income taxes		(51)
Repayment discount on note payable	(200)	
Fair value adjustment of convertible warrant	(96)	
Provision for doubtful accounts	2	128
Loss on fixed asset disposal	5	7
Excess tax benefit associated with stock-based compensation		(163)
Changes in operating assets and liabilities:		
Accounts receivable	(5,649)	(7,343)
Prepaid expenses	(20)	(622)
Other assets	(1,688)	(4,759)
Accounts payable	(235)	1,088
Accrued compensation	3,726	1,801
Deferred revenue	3,065	3,401
Other liabilities	26	(32)
Net cash provided by operating activities	9,498	11,142
Cash flows from investing activities:		
Purchase of property and equipment	(486)	(2,104)
Capitalization of internal use software	(3,355)	(4,474)
Restricted cash		(950)
Net cash used in investing activities	(3,841)	(7,528)
Cash flows from financing activities:		
Proceeds from term loan payable	9,950	
Payments on term loan payable	(1,111)	(8,055)
Repayment of note payable	(9,800)	
Repayment of bank borrowings	(3,500)	
Payments on capital lease obligations	(12)	(2)
Net share settlements for stock-based awards minimum tax withholdings	(300)	(921)
Excess tax benefit associated with stock-based compensation		163

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Proceeds from issuance of common stock, net of offering costs	57	83,943
Net cash provided by (used in) financing activities	(4,716)	75,128
Net increase in cash and cash equivalents	941	78,742
Cash and cash equivalents, beginning of period	14,857	20,713
Cash and cash equivalents, end of period	\$ 15,798	\$ 99,455
Supplemental cash flows information:		
Income taxes paid, net of refunds	\$ (89)	\$ 1,182
Interest paid	\$ 525	\$ 184
Non-cash investing and financing activities:		
Stock dividend	\$	\$ 5,480
Capitalized stock-based compensation for internal use software	\$ 279	\$ 337
Capitalized stock-based compensation for direct response advertising	\$	\$ 52
Accounts payable for purchases of property and equipment	\$ 69	\$ 235
Accounts payable for initial public offering issuance costs	\$ 6	\$

See accompanying notes to the unaudited condensed consolidated financial statements.

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**FINANCIAL ENGINES, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(Unaudited)**

**NOTE 1 Organization and Description of the Business**

***The Company***

Financial Engines, Inc. (the Company) was incorporated on May 13, 1996 under the laws of the state of California and is headquartered in Palo Alto, California. In February 2010, the Company was reincorporated under the laws of the State of Delaware.

The Company is a provider of independent, technology-enabled portfolio management services, investment advice and retirement help to participants in employer-sponsored defined contribution retirement plans such as 401(k) plans. The Company uses its proprietary advice technology platform to provide its services to retirement plan participants, regardless of personal wealth or account size, on a cost-efficient basis. The Company's business model is based on workplace delivery of its services. The Company targets three key constituencies in the retirement plan markets: plan participants (employees of companies offering defined contribution plans, collectively referred to as 401(k) plans), plan sponsors (employers offering 401(k) plans to their employees) and plan providers (companies providing administrative services to retirement plan sponsors).

The Company continues to devote the majority of its resources to the growth of the Company's business in accordance with its business plan. The Company's activities have been financed primarily through the sale of equity securities and more recently from cash provided by operating activities.

**NOTE 2 Basis of Presentation**

***Interim Financial Statements***

The accompanying condensed consolidated financial statements and notes thereto are unaudited. These unaudited interim condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (GAAP) and applicable rules and regulations of the Securities and Exchange Commission (SEC) regarding interim financial reporting. Certain information and note disclosures normally included in the financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations. Accordingly, these interim condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto contained in the Company's Prospectus filed under the Securities Act of 1933, as amended (the Securities Act) with the SEC on March 15, 2010 (the Prospectus). The condensed consolidated balance sheet as of December 31, 2009, included herein was derived from the audited financial statements as of that date, but does not include all disclosures including notes required by GAAP.

The unaudited interim condensed consolidated financial statements have been prepared on the same basis as the audited consolidated financial statements and include all adjustments necessary for the fair presentation of the Company's balance sheets as of December 31, 2009 and September 30, 2010, the Company's statements of operations for the three and nine months ended September 30, 2009 and 2010, the Company's statements of stockholders' equity and comprehensive income for the nine months ended September 30, 2010 and the Company's statements of cash flows for the nine months ended September 30, 2009 and 2010. The results for the three and nine months ended September 30, 2010 are not necessarily indicative of the results to be expected for the year ending December 31, 2010.

***Use of Estimates***

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expense during the reporting period. Significant items subject to such estimates and assumptions include revenue recognition, direct response advertising, deferred sales commissions, the carrying amount and useful lives of property, equipment and internal use software cost, valuation allowance for deferred income tax assets, and stock-based compensation. Actual results could differ from those estimates under different assumptions or conditions.

***Revenue Recognition***

The Company recognizes revenue when all of the following conditions are met:

There is persuasive evidence of an arrangement, as evidenced by a signed contract;

Delivery has occurred or the service has been made available to the customer, which occurs upon completion of implementation and connectivity services and acceptance by the customer;

The collectability of the fees is reasonably assured; and

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

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**FINANCIAL ENGINES, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)**

The Company generates its revenue through three primary sources: professional management, platform and other revenue.

**Professional Management.** The Company derives professional management revenue from management fees paid by plan participants for its Professional Management service. This discretionary investment management service includes a Retirement Plan analyzing investments, contribution rate and projected retirement income, and a Retirement Checkup designed to help plan participants to develop a strategy for closing the gap, if any, between the participant's retirement goal and current retirement income forecast. The services are generally made available to plan participants in a 401(k) plan by written agreements between the Company and the plan provider, plan sponsor and the plan participant; and may be provided on a subadvised basis. The arrangement generally provides for management fees based on the value of assets the Company manages for plan participants, and is generally payable quarterly in arrears. Revenue derived from Professional Management services is recognized as the services are performed. In order to encourage enrollment into the Professional Management service, the Company uses a variety of promotional techniques, some of which can potentially impact the amount of revenue recognized, the timing of revenue recognition or both.

In certain instances, fees payable by plan participants are deferred for a specified period, and are waived if the plan participant cancels within the specified period. Effective January 1, 2009, the Company commenced recognizing revenue during certain of these fee deferral periods based on the estimate of the expected retention and cancellation rates determined by historical experience of similar arrangements.

**Platform.** The Company derives platform revenue from recurring, subscription-based platform fees for access to either its full suite of services, including Professional Management, Online Advice and Retirement Evaluation, or its Online Advice service only, and to a lesser extent, from setup fees. Online Advice is a nondiscretionary Internet-based investment advisory service, which includes features such as: recommendations among the investment alternatives available in the employer sponsored retirement plan; a summary of the current value of the plan account; a forecast of how much the plan account investments might be worth at retirement; whether a change is recommended to the contribution rate, risk and diversification and/or unrestricted employer stock holdings; and a projection of how much the participant may spend at retirement. Plan participants may use the service as frequently as they choose to monitor progress toward their financial goals, receive forecasts and investment recommendations and access educational content at the Company's website. The arrangements generally provide for the Company's fees to be paid by the plan sponsor, plan provider or the retirement plan itself, depending on the plan structure. Platform revenue is generally paid annually in advance and recognized ratably over the term of the subscription period beginning after the completion of customer setup and data connectivity. Setup fees are recognized ratably over the estimated customer life, which is usually three to five years.

**Other.** Other revenue includes reimbursement for marketing and member materials from certain subadvisory relationships and reimbursement for providing personal statements to participants from a limited number of plan sponsors. A small portion of other revenue is derived from a defined benefit consulting business. Revenue is recognized as the related services are performed, in accordance with the specific terms of the contract with the customers.

***Restricted Cash***

Restricted cash is in the form of a money market account pledged as collateral for letters of credit issued in connection with certain operating lease contracts. Upon signing the pledge agreement in August 2010, the Company classified \$950,000 of restricted cash in the other assets section in the accompanying condensed consolidated balance sheet as of September 30, 2010. As of December 31, 2009 and September 30, 2010 the balance of restricted cash was \$0 and \$950,000, respectively.

***Deferred Sales Commissions***

Deferred sales commissions consist of incremental costs paid to the Company's sales force associated with the execution of noncancelable customer contracts. The deferred sales commission amounts are recoverable through future revenue streams under the noncancelable customer contracts. The Company believes this is the preferable

method of accounting as the commission charges are so closely related to the revenue from the noncancelable customer contracts that they should be recorded as an asset and charged to expense over the life of the related noncancelable customer contracts, which is typically three years. Amortization of deferred sales commissions is included in marketing and sales expense in the accompanying condensed consolidated statements of operations.

The Company capitalized sales commissions of \$16,000 and \$0.5 million during the three months ended September 30, 2009 and 2010, and \$0.5 million and \$1.0 million during the nine months ended September 30, 2009 and 2010, respectively. The Company amortized \$0.3 million and \$0.3 million of deferred sales commissions during the three months ended September 30, 2009 and 2010, respectively and \$0.9 million and \$0.9 million of deferred sales commissions during the nine months ended September 30, 2009 and 2010, respectively.

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**FINANCIAL ENGINES, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)**

***Direct Response Advertising***

The Company's advertising costs consist primarily of print materials associated with new customer solicitations. Print materials costs relate primarily to either Active Enrollment campaigns, where marketing materials are sent to solicit enrollment in the Company's Professional Management service, or Passive Enrollment campaigns, where the plan sponsor defaults all eligible members into the Professional Management service unless they decline. Advertising costs relating to Passive Enrollment campaigns and other general marketing materials sent to participants do not qualify as direct response advertising and are expensed to sales and marketing in the period the advertising activities first take place. Fulfillment costs relating to subadvisory campaigns do not qualify as direct response advertising and are expensed to cost of revenue in the period the expenses are incurred. Advertising costs associated with direct advisory Active Enrollment campaigns qualify for capitalization as direct response advertising. The capitalized costs are amortized over the estimated three-year period of probable future benefits following the enrollment of a member into the Professional Management service based on the ratio of current period net revenue for the direct response advertising cost pool as compared to the total estimated net revenue expected for the direct response advertising cost pool over future periods.

Effective July 1, 2009, the Company commenced capitalization of direct response advertising costs associated with direct advisory Active Enrollment campaigns on a prospective basis as the Company first concluded it had sufficient and verifiable historical patterns over a reasonable period of time to demonstrate the probable future benefits of such campaigns. As of December 31, 2009 and September 30, 2010, \$1.4 million and \$4.3 million, respectively, of net advertising costs associated with direct response advertising were reported in other assets in the accompanying condensed consolidated balance sheet. Advertising expense was \$0.5 million and \$0.6 million for the three months ending September 30, 2009 and 2010, respectively, and \$2.0 million and \$1.4 million for the nine months ending September 30, 2009 and 2010, respectively, of which direct advisory Active Enrollment campaign expense was \$0.4 million and \$0.3 million respectively, for the three months ending September 30, 2009 and 2010, and \$1.8 million and \$0.8 million for the nine months ending September 30, 2009 and 2010, respectively.

***Valuation of Long-Lived Assets***

Long-lived assets, such as property, equipment and capitalized internal use software subject to amortization, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset group may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset group to estimated undiscounted future cash flows expected to be generated by the asset group. If the carrying amount of an asset group exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset group exceeds the fair value of the asset group.

Management evaluates the useful lives of these assets on an annual basis and tests for impairment whenever events or changes in circumstances occur that could impact the recoverability of these assets. There were no impairments to long-lived assets during the nine months ended September 30, 2009 and 2010.

***Stock-based Compensation***

Employee stock-based compensation expense is based on the following: (1) the grant date fair value of stock option awards granted or modified after January 1, 2006 and (2) the balance of deferred stock-based compensation related to stock option awards granted prior to January 1, 2006, which was calculated using the intrinsic value method.

The Company estimates the fair value of stock options granted using the Black-Scholes option pricing model. The Company amortizes stock-based compensation expense using a graded vesting method over the requisite service periods of the awards, which is generally the vesting period. The expected term represents the period that stock-based awards are expected to be outstanding, giving consideration to the contractual terms of the stock-based awards, vesting schedules and expectations of future employee behavior as influenced by changes to the terms of the Company's stock-based awards. The Company uses the simplified method in developing an estimate of expected term of stock options. The computation of expected volatility is based on a combination of the historical and implied volatility of comparable companies from a representative peer group based on industry and market capitalization data.

Management estimates expected forfeitures and recognizes compensation costs only for those stock-based awards expected to vest. Amortization of stock-based compensation is presented in the same line item as the cash compensation to those employees in the accompanying condensed consolidated statement of operations.

The Company's current practice is to issue new shares to settle stock option exercises.



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**FINANCIAL ENGINES, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(Unaudited)**

***Deferred Income Taxes***

Deferred tax assets and liabilities are determined based on temporary differences between financial reporting and the tax bases of assets and liabilities. Deferred tax assets are also recognized for tax net operating loss carryforwards. These deferred tax assets and liabilities are measured using the enacted tax rates and laws that are expected to be in effect when such amounts are expected to reverse or be utilized. The realization of total deferred tax assets is contingent upon the generation of future taxable income. Valuation allowances are provided to reduce such deferred tax assets to amounts more likely than not to be ultimately realized. The Company recognizes interest and penalties related to unrecognized tax benefits as a component of income tax expense. See Note 8 for additional information.

The Company's assumptions, judgments and estimates relative to the value of a deferred tax asset take into account predictions of the amount and character of future taxable income, such as income from operations or capital gains income. Actual operating results and the underlying amount and character of income in future years could render the Company's current assumptions, judgments and estimates of recoverable net deferred taxes inaccurate. Any of the assumptions, judgments and estimates mentioned above could cause the Company's actual income tax obligations to differ from its estimates, thus materially impacting its financial position and results of operations.

***Recent Accounting Pronouncements***

In October 2009, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2009-13 Revenue Recognition (Topic 605): *Multiple-Deliverable Revenue Arrangements* a consensus of the FASB Emerging Issues Task Force (ASU 2009-13). ASU 2009-13 addresses how to measure and allocate arrangement consideration to one or more units of accounting within a multiple-deliverable arrangement. ASU 2009-13 modifies the requirements for determining whether a deliverable can be treated as a separate unit of accounting by removing the criteria that objective evidence of fair value exists for the undelivered elements in order to account for those undelivered elements as a single unit of accounting and also proscribes use of the residual method. ASU 2009-13 is effective for the Company prospectively for revenue arrangements entered into or materially modified beginning January 1, 2011. Early adoption is permitted. The Company has determined that the adoption of ASU 2009-13 will not have a material impact on its financial condition and results of operations.

**NOTE 3 Cash and Cash Equivalents**

Cash and cash equivalents consist of the following:

	<b>December 31, 2009</b>	<b>September 30, 2010</b>
	<b>(In thousands)</b>	
Cash	\$ 285	\$ 686
Money market fund	20,428	98,769
Total cash and cash equivalents	\$ 20,713	\$ 99,455

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**FINANCIAL ENGINES, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(Unaudited)**

**NOTE 4 Concentration of Credit Risk and Fair Value of Financial Instruments**

The following table summarizes the Company's financial assets measured at fair value on a recurring basis:

	<b>Total Fair Value</b>	<b>Quoted Prices in Active Markets for Identical Assets (Level 1) <sup>(1)</sup></b>	<b>Significant Other Observable Inputs (Level 2) <sup>(2)</sup></b>	<b>Significant Other Unobservable Inputs (Level 3) <sup>(3)</sup></b>
		<b>(In thousands)</b>		
Assets:				
Money Market Funds				
December 31, 2009	\$20,428	\$ 20,428	\$	\$
September 30, 2010 <sup>(4)</sup>	\$99,719	\$ 99,719	\$	\$

- (1) Level 1: Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets.
- (2) Level 2: Inputs reflect quoted prices for identical assets or liabilities in markets that are not active; quoted prices for similar assets or liabilities in active markets; inputs other than quoted prices that are observable for the assets or liabilities; or inputs that are derived principally from or corroborated by observable market data by correlation or other means.
- (3) Level 3: Unobservable inputs reflecting the Company's own assumptions incorporated in valuation techniques used to determine fair value. These assumptions are required to be consistent with market participant assumptions that are reasonably available.
- (4) Included in this balance is \$950,000 of restricted cash being held in a money market account pledged as collateral for letters of credit issued in connection with certain operating lease contracts.

Financial instruments that potentially subject the Company to significant concentrations of credit risk consist principally of cash, cash equivalents and accounts receivable. The Company deposits its cash and cash equivalents primarily with a major bank, in which deposits may exceed federal deposit insurance limits.

The Company's customers are concentrated in the United States of America. The Company performs ongoing credit evaluations of its customers and does not require collateral. The Company reviews the need for allowances for potential credit losses and such losses have been insignificant to date.

Significant customer information is as follows:

	<b>December 31, 2009</b>	<b>September 30, 2010</b>
Percentage of accounts receivable:		
JPMorgan	20%	28%
	<b>Three Months Ended September 30,</b>	<b>Nine Months Ended September 30,</b>

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Percentage of revenue:	<b>2009</b>	<b>2010</b>	<b>2009</b>	<b>2010</b>
JPMorgan	20%	20%	19%	19%

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**FINANCIAL ENGINES, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(Unaudited)**

**NOTE 5 Stockholders Equity****Common Stock**

On March 16, 2010, the Company completed its initial public offering whereby the Company sold 7,458,100 shares of common stock for a price of \$12.00 per share, which resulted in proceeds before underwriters discounts and offering costs of \$89.5 million. Approximately \$10.5 million in offering costs, including underwriters commissions, were incurred and have been deducted from additional paid-in capital.

**Preferred Stock**

Prior to the initial public offering, the Company had 22,441,623 shares of preferred stock outstanding. Each share of preferred stock was convertible into one share of common stock. The conversion of all the shares of preferred stock into 22,441,623 shares of common stock occurred automatically upon the completion of the Company's initial public offering on March 16, 2010.

Upon the closing of the initial public offering on March 16, 2010, the Company issued 456,643 shares of common stock as a dividend to the holders of Series E preferred stock so that each share of preferred stock would maintain the one-to-one conversion ratio to common stock. The fair value of the dividend at \$12.00 per share was determined to be \$5.5 million.

**NOTE 6 Stock-based Compensation**

The following table summarizes the stock-based compensation by functional area as presented on the statement of operations:

	Three Months Ended September 30, 20092010		Nine Months Ended September 30, 20092010	
	(In thousands)			
Stock-based compensation:				
Cost of revenue	\$ 244	\$ 209	\$ 818	\$ 655
Research and development	400	501	1,227	1,589
Sales and marketing	447	514	1,422	1,543
General and administrative	364	637	1,108	1,873
Amortization of internal use software	33	53	73	138
Total stock-based compensation	\$ 1,488	\$ 1,914	\$ 4,648	\$ 5,798

**NOTE 7 Net Income Per Common Share**

Basic net income per common share is computed by dividing net income attributable to holders of common stock by the weighted average number of common shares outstanding during the period less the weighted average number of unvested restricted common shares subject to the right of repurchase. Diluted net income per common share is computed by giving effect to all potential dilutive common shares, including options, unvested restricted common stock subject to repurchase, warrants and convertible preferred stock.

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**FINANCIAL ENGINES, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(Unaudited)**

The following table sets forth the computation of basic and diluted net income per share attributable to holders of common stock:

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2009</b>	<b>2010</b>	<b>2009</b>	<b>2010</b>
	<b>(In thousands, except per share data)</b>			
Numerator (basic and diluted):				
Net income	\$ 2,054	\$ 53,411	\$ 1,681	\$ 56,285
Less: Stock dividend				5,480
Net income attributable to holders of common stock	\$ 2,054	\$ 53,411	\$ 1,681	\$ 50,805
Denominator (basic):				
Weighted average common shares outstanding	10,430	41,512	10,090	33,021
Less: Weighted average unvested restricted common shares subject to repurchase	(350)	(307)	(342)	(326)
Net weighted average common shares outstanding	10,080	41,205	9,748	32,695
Denominator (diluted):				
Weighted average common shares outstanding	10,080	41,205	9,748	32,695
Dilutive stock options and awards outstanding	1,949	5,051	1,900	4,714
Less: Weighted average unvested restricted common shares subject to repurchase	350	307	342	326
Weighted average common shares from preferred stock	22,350		22,350	6,165
Net weighted average common shares outstanding	34,729	46,563	34,340	43,900
Net income per share attributable to holders of common stock:				
Basic	\$ 0.20	\$ 1.30	\$ 0.17	\$ 1.55
Diluted	\$ 0.06	\$ 1.15	\$ 0.05	\$ 1.16

Diluted net income per share does not include the effect of the following antidilutive common equivalent shares:

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2009</b>	<b>2010</b>	<b>2009</b>	<b>2010</b>
	<b>(In thousands)</b>			
Stock options and awards outstanding	6,133	149	6,310	784
Common equivalent shares from preferred stock warrant	108		108	

Total antidilutive common equivalent shares	6,241	149	6,418	784
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**FINANCIAL ENGINES, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)**

**NOTE 8 Income Taxes**

The Company recorded an income tax provision of \$0.4 million and an income tax benefit of \$50.2 million for the three months ended September 30, 2009 and 2010, respectively, and an income tax provision of \$0.4 million and an income tax benefit of \$49.9 million for the nine months ended September 30, 2009 and 2010, respectively.

Prior to September 30, 2010, the Company maintained a full valuation allowance for their net deferred tax assets, since the likelihood of the realization of those assets had not become more likely than not. The Company continuously evaluated additional facts representing positive and negative evidence in the determination of the realizability of the deferred tax assets. As of September 30, 2010, the Company believes that sufficient positive evidence exists from historical operations and future projections to conclude that it is more likely than not to fully realize its federal deferred tax assets and partially realize a portion of its state of California deferred tax assets. The Company continues to apply a valuation allowance on certain deferred tax assets in the amount of \$2.8 million relating to the state of California as it is not more likely than not that the Company will be able to realize these assets prior to their expiration. Therefore, during the three months ended September 30, 2010, the Company released valuation allowances of \$49.9 million as a discrete benefit for income taxes, related primarily to federal income taxes.

The Company's effective tax rate, excluding the effect of the valuation allowance release, was 17.6% and (1.4%) for the nine months ended September 30, 2009 and 2010, respectively. The income tax provision for the three and nine months ended September 30, 2009 was due primarily to state income taxes and local taxes. The income tax benefit for the three and nine months ended September 30, 2010 was due primarily to the release of the valuation allowance offset by federal and state income taxes and local taxes. The effective tax rate, excluding the effect of the valuation allowance release, for the three and nine months ended September 30, 2010, differs from the statutory federal rate of 35% due primarily to state taxes and non-deductible stock-based compensation expense.

The Company is subject to income taxes in the U.S. federal jurisdiction and various state jurisdictions. All tax years since inception are open and may be subject to examination in one or more jurisdictions. The Company has undergone a federal tax examination for fiscal years 2006 and 2007. As a result, the Company received a Notice of Proposed Adjustment ( NOPA ) dated August 24, 2010 from the Internal Revenue Service ( IRS ) which reduced its gross unrecognized tax benefits associated with research credits related to prior returns. The Company has determined that the NOPA will not have a material impact on its financial condition and results of operations.

At September 30, 2010, the Company had net operating loss carryforwards of approximately \$138 million that expire at varying dates from 2012 to 2026. Of that \$138 million, approximately \$12 million relates to excess tax benefits related to stock options. When realized, the excess tax benefits will be credited to additional paid-in capital. The timing and manner in which the Company may utilize the net operating loss carryforwards in subsequent tax years will be limited to the Company's ability to generate future taxable income and, potentially, by the application of the ownership change rules under Section 382 of the Internal Revenue Code.

As of December 31, 2009 and September 30, 2010, the Company had gross unrecognized tax benefits for income taxes associated with uncertain tax positions of \$9.6 million and \$5.9 million, respectively. During the three and nine months ended September 30, 2010, the Company recorded a decrease in unrecognized tax benefits and deferred tax assets related to research credits of \$3.7 million. As of December 31, 2009 and September 30, 2010, \$9.6 million and \$5.9 million, respectively, of unrecognized tax benefits, including penalties and interest, would affect the Company's effective tax rate if realized. The balance of the gross unrecognized tax benefits is not expected to materially change in the next twelve months.

The Company recognizes accrued interest and penalties related to unrecognized tax benefits as a component of income tax expense. During the three and nine months ended September 30, 2009 and 2010, the accrued interest and penalties were immaterial.

**NOTE 9 Savings Plan**

The Company maintains a savings plan under Section 401(k) of the Internal Revenue Code ( 401(k) Plan ). Under the plan, employees may contribute up to 75% of their pre-tax salaries per year, but not more than the statutory limits.

The Company may, at its discretion, make matching contributions to the 401(k) Plan. There were no matching contributions for the nine months ended September 30, 2009. For the three months and nine months ended September 30, 2010, the Company made matching contributions of 50% of employee contributions into the 401(k) plan up to 3% of salary (including commissions), which totaled \$0.2 million and \$0.6 million, respectively.



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**FINANCIAL ENGINES, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(Unaudited)**

**NOTE 10 Contingencies**

The Company is a party to certain consulting agreements pursuant to which it may be obligated to indemnify the other party with respect to certain matters. Typically, these obligations arise in the context of contracts entered into by the Company under which the Company customarily agrees to hold the other party harmless against losses arising from a breach of representation and covenants. To date, the Company has not incurred any costs as a result of such commitments and has not accrued any liabilities related to such obligations.

The Company includes service level commitments to its customers warranting certain levels of reliability and performance. To date, the Company has not incurred any material costs as a result of such commitments and has not accrued any liabilities related to such obligations.

**Table of Contents****Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

This Report on Form 10-Q contains forward-looking statements that involve risks and uncertainties. In some cases, you can identify forward-looking statements by terms such as may, might, will, objective, intend, should, could, continue, can, would, expect, believe, design, estimate, predict, potential, plan, or the negative of these terms or similar expressions intended to identify forward-looking statements. These forward-looking statements include, but are not limited to, statements about our plans for future services and enhancements of existing services; our expectations regarding our costs and expenses and revenue; enrollment metrics, AUM, AUC and equity exposures; our net deferred tax asset; the percentage of revenue derived from fees based on the market value of AUM and the impact of AUM on our operating results, our anticipated cash needs and our estimates regarding our capital requirements and our needs for additional financing; our anticipated growth strategies; our ability to retain and attract customers; our regulatory environment; our legal proceedings; intellectual property; our expectations regarding competition; use of proceeds; market risk; and sources of new revenue. These statements involve known and unknown risks, uncertainties and other factors which may cause actual results, performance or achievements to differ materially from those expressed or implied by such forward-looking statements. These risks and uncertainties include, but are not limited to, the risks set forth throughout this Report, including under Item 1A in Part II, Risk Factors. Given these risks and uncertainties, you should not place undue reliance on these forward-looking statements. These forward-looking statements speak only as of the date hereof. We expressly disclaim any obligation or undertaking to release publicly any updates or revisions to any forward-looking statements contained herein to reflect any change in our expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based.

Our investment advisory and management services are provided through our subsidiary, Financial Engines Advisors L.L.C., a federally registered investment adviser. References in this Report to Financial Engines, our company, the Company, we, us and our refer to Financial Engines, Inc. and its consolidated subsidiaries during the periods presented unless the context requires otherwise.

**Overview**

We are a leading provider of independent, technology-enabled portfolio management, investment advice and retirement help to participants in employer-sponsored defined contribution retirement plans, such as 401(k) plans. We use our proprietary advice technology platform to provide our services to millions of retirement plan participants on a cost-efficient basis. Our business model is based on workplace delivery of our services. We target three key constituencies in the retirement plan market: plan participants, plan sponsors and plan providers.

**Revenue**

We generate revenue primarily from management fees on Assets Under Management, or AUM, as well as from platform fees by providing portfolio management services, investment advice and retirement help to plan participants of employer-sponsored retirement plans.

**Professional Management.** We derive professional management revenue from management fees paid by plan participants for our Professional Management service. Our Professional Management service is a discretionary investment management service, that includes a Retirement Plan analyzing investments, contribution rate and projected retirement income, and a Retirement Checkup designed to help plan participants develop a strategy for closing the gap, if any, between the participant's retirement goal and current retirement income forecast. The services are generally made available to plan participants in a 401(k) plan by written agreements between us and the plan provider, plan sponsor and the plan participant.

The arrangement generally provides for management fees based on the value of assets we manage for plan participants and is generally payable quarterly in arrears. Our professional management revenue has generally been the product of managed accounts fee rates and the value of AUM at the end of each quarter. Effective October 1, 2010, we anticipate changing our method of calculating fees for substantially all members with which we have a direct advisory relationship from quarterly to monthly, thereby calculating fees as the product of managed account fee rates and the value of AUM at the end of each month for members. We expect this new methodology to reduce the impact of financial market volatility on our professional management revenue. In order to encourage enrollment into our Professional Management service, we use a variety of promotional techniques, some of which can potentially impact

the amount of revenue recognized, the timing of revenue recognition or both.

*Enrollment Metrics*

We measure enrollment in our Professional Management service by members as a percentage of eligible plan participants and by AUM as a percentage of Assets Under Contract, or AUC, in each case across all plans where the Professional Management service is available for enrollment, including plans where enrollment campaigns are not yet concluded or have not commenced.

AUM is defined as the amount of retirement plan assets that we manage as part of our Professional Management service. Our quarter-end AUM is the value of assets under management as reported by plan providers at or near the end of each quarter. Our members are the plan participants who are enrolled in our Professional Management service as reported by plan providers at or near the end of each quarter.

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AUC is defined as the amount of assets in retirement plans under contract for which the Professional Management service has been made available to eligible participants. Our AUC and eligible participants do not include assets or participants in plans where we have signed contracts but for which we have not yet made the Professional Management service available. Eligible participants are reported by plan providers as of various points in time. The value of assets under contract is reported by plan providers as of various points in time and is not always updated or marked to market. If markets have declined since the reporting date, or if assets have left the plan, our AUC may be overstated. If markets have risen since the reporting date, or if assets have been added to the plan, our AUC may be understated. Some plan participants may not be eligible for our services due to plan sponsor limitations on employees treated as insiders for purposes of securities laws or other characteristics of the plan participant. Certain securities within a plan participant's account may be ineligible for management by us, such as employer stock subject to trading restrictions, and we do not manage or charge a fee for that portion of the account. In both of these circumstances, assets of the relevant participants may be included in AUC but cannot be converted to AUM. We believe that AUC is a useful approximation of the additional plan assets available for enrollment efforts that, if successful, would result in these assets becoming AUM, and also indicates the benefit of increasing our enrollment rates since this will lead to additional AUM. We believe that the total eligible participants provides a useful approximation of the number of participants available for enrollment into the Professional Management service.

In addition to measuring enrollment in all plans where the Professional Management service is available, we measure enrollment in plans where the Professional Management service has been available for at least 14 months and in plans where it has been available for at least 26 months.

	<b>Members as a Percentage of Eligible Participants</b>	<b>AUM as a Percentage of AUC</b>
<b>All plans as of September 30, 2010</b>		
Professional Management available	10.2%	9.9%
Professional Management available 14 months or more	11.3%	11.1%
Professional Management available 26 months or more	12.6%	11.9%
As of September 30, 2010, the aggregate style exposure of the portfolios we managed was approximately as follows:		
Cash		5%
Bonds		25%
Domestic Equity		47%
International Equity		23%
<b>Total</b>		<b>100%</b>

We estimate the aggregate percentage of equity exposures have ranged from a low of approximately 56% to a high of approximately 78% since we began managing assets on a discretionary basis in September 2004. These percentages can be affected by the asset exposures of the overall market portfolio, the demographics of our member population, the number of members who have told us that they want to assume greater or lesser investment risk, and, to a lesser extent given the amount of assets we have under management, the proportion of our members for whom we have completed the transition from their initial portfolio.

**Table of Contents***Changes in AUM*

The following table illustrates changes in our AUM from over the last four quarters:

	Q4 09	Q1 10	Q2 10	Q3 10
	(In billions)			
<b>AUM, beginning of period</b>	\$ 23.5	\$ 25.7	\$ 29.9	\$ 29.4
AUM from net enrollment (1)	1.1	2.8	0.6	1.7
Other (2)	1.1	1.4	(1.1)	2.9
<b>AUM, end of period</b>	<b>\$ 25.7</b>	<b>\$ 29.9</b>	<b>\$ 29.4</b>	<b>\$ 34.0</b>

- (1) The aggregate amount of assets under management, at the time of enrollment, of new members who enrolled in our Professional Management service within the period less the aggregate amount of assets, at the time of cancellation, for voluntary cancellations from the Professional Management service within the period, less the aggregate amount of assets, as of the last available positive account balance, for involuntary cancellations occurring when the member's 401(k) plan account balance has been reduced to zero or when the cancellation of a plan sponsor contract for the Professional Management service has become effective within the period.
- (2) Other factors affecting assets under management include employer and employee contributions, market movement, plan administrative fees as well as participant loans and hardship withdrawals. We cannot separately quantify the impact of these factors as the information we receive from the plan providers does not separately identify these transactions or the changes in balances due to market movement.

Our AUM increases or decreases based on several factors, including new asset enrollment rates, asset cancellation rates due to members proactively terminating their membership, members rolling their assets out of the retirement plan and sponsors canceling the Professional Management service, as well as other factors, such as employee and employer contributions into their 401(k) accounts and market fluctuations. If any of these factors reduces our AUM, the amount of fees we would earn for managing those assets would decline, which in turn could negatively impact our revenue. As noted in the prospectus, due to the current fee structure with one of our plan providers we currently recognize the difference between annual earned professional management revenue and annual contractual minimums in the fourth quarter each year.

**Platform.** We derive our platform revenue from recurring, annual subscription-based platform fees for access to either our full suite of services, including Professional Management, Online Advice and Retirement Evaluation, or our Online Advice service only. Platform fees are paid by the plan sponsor, plan provider or the retirement plan itself, depending on the plan structure, and vary depending on the type of service provided. Our Online Advice service is a nondiscretionary Internet-based investment advisory service, that includes features such as recommendations among the investment alternatives available in the employer-sponsored retirement plan, a summary of the current value of the plan account, a forecast of how much the plan account investments might be worth at retirement, whether a change is recommended to the contribution rate, risk and diversification and/or unrestricted employer stock holdings and a projection of how much the participant may be able to spend at retirement. Plan participants may use the service as frequently as they choose to monitor progress toward their financial goals, receive forecasts and investment recommendations and access educational content at our website. Setup fees are recognized ratably over the estimated customer life, which is usually three to five years.

**Other Revenue.** Other revenue includes reimbursement for marketing and member materials from certain subadvisory relationships and reimbursement for providing personal statements to participants from a limited number of plan sponsors. A small portion of other revenue is derived from a defined benefit consulting business.

**Costs and Expenses**

Employee compensation and related expenses represent our largest expense. We allocate compensation and other related expenses including stock-based compensation, to our cost of revenue, research and development, sales and

marketing, general and administrative as well as amortization of internal use software expense categories. While we expect our headcount to increase over time, we believe that the economies of scale in our business model will allow us to grow our compensation and related expenses at a lower rate than revenue.

Other costs and expenses include the costs of fees paid to plan providers related to the exchange of plan and plan participant data as well as implementing our transaction instructions for member accounts, marketing materials and postage, and amortization and depreciation for hardware and software purchases and support.

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The following summarizes our cost of revenue and certain significant operating expenses:

**Cost of Revenue.** Cost of revenue excludes amortization of internal use software and includes expenses from portfolio management, operations, advisor call center operations, technical operations including information technology, customer support, installation and set-up costs, data connectivity fees and printed materials fulfillment costs for certain subadvisory relationships for which we are reimbursed. These expenses are shared across the different revenue categories, and we are not able to meaningfully allocate such costs between separate categories of revenue. Consequently, all costs and expenses applicable to our revenue are included in the category cost of revenue in our statements of operations. Costs in this area are related primarily to employee compensation and related expenses, payments to third parties and purchased materials. Amortization of internal use software, a portion of which relates to our cost of revenue, is reflected as a separate line item in our statement of operations.

**Research and Development.** Research and development expense includes costs associated with defining and specifying new features and ongoing enhancement to our Advice Engines and other aspects of our service offerings, financial research, quality assurance, related administration and other costs that do not qualify for capitalization. Costs in this area are related primarily to employee compensation for our investment research, product development and engineering personnel and related expenses and, to a lesser extent, related external consulting expenses.

**Sales and Marketing.** Sales and marketing expense includes costs associated with plan provider and plan sponsor relationship management, marketing our services, plan provider and plan sponsor marketing, direct sales, printing of, and postage for marketing materials for direct advisory relationships and amortization of direct response advertising. Costs in this area are related primarily to employee compensation for sales and marketing personnel and related expenses, which include commissions, printed materials and general marketing programs.

**General and Administrative.** General and administrative expense includes costs for finance, legal, compliance and administration. Costs in this area include employee compensation and related expenses and fees for consulting and professional services. We expect that we will incur additional expenses as a result of becoming a public company for, among other things, SEC reporting and compliance, including compliance with the Sarbanes-Oxley Act of 2002, director fees, insurance, transfer agent fees and other similar expenses. General and administrative expenses are also expected to continue to increase due to incremental headcount increases, the general growth of our business and the costs associated with being a public company.

**Amortization of Internal Use Software.** Amortization expense includes engineering costs associated with (1) enhancing our advisory service platform and (2) developing internal systems for tracking member data, including AUM, member cancellations and other related member statistics. Associated direct development costs are capitalized and amortized using the straight-line method over the estimated lives, typically 3-5 years, of the underlying technology. Costs in this area include employee compensation and related expenses and fees for external consulting services.

## **Critical Accounting Estimates**

There have been no changes in the matters for which we make critical accounting estimates in the preparation of our condensed consolidated financial statements during the nine months ended September 30, 2010, as compared to those disclosed in Management's Discussion and Analysis of Financial Condition and Results of Operations for the fiscal year ended December 31, 2009 included in our Prospectus dated March 15, 2010.

**Table of Contents****Results of Operations**

The following tables set forth our results of operations. The period to period comparison of financial results is not necessarily indicative of future results.

	<b>Three Months Ended</b>		<b>Three Months Ended</b>		<b>Increase (Decrease)</b>	
	<b>September 30,</b>	<b>September 30,</b>	<b>September 30,</b>	<b>September 30,</b>	<b>Amount</b>	<b>%</b>
	<b>2009</b>	<b>2010</b>	<b>2009</b>	<b>2010</b>		
	<b>(As a percentage of revenue)</b>		<b>(In thousands, except percentages)</b>			
Revenue:						
Professional management	62%	69%	\$ 13,646	\$ 19,927	\$ 6,281	46%
Platform	35	27	7,602	7,659	57	1
Other	3	4	762	1,176	414	54
Total revenue	100	100	22,010	28,762	6,752	31
Costs and expenses:						
Cost of revenue (exclusive of amortization of internal use software)	34	35	7,546	10,189	2,643	35
Research and development	18	16	3,967	4,678	711	18
Sales and marketing	24	24	5,328	6,862	1,535	29
General and administrative	8	10	1,744	2,849	1,105	63
Amortization of internal use software	4	3	815	974	158	19
Total costs and expenses	88	89	19,400	25,552	6,152	32
Income from operations	12	11	2,610	3,210	600	23
Interest expense	(1)		(159)	21	180	n/a
Interest and other income, net			45	8	(37)	(82)
Income before income tax expense	11	11	2,496	3,239	743	30
Income tax expense (benefit)	2	(1)	442	(319)	(761)	n/a
Benefit from release of valuation allowance		(173)		(49,853)	(49,853)	n/a
Net income	9%	186%	\$ 2,054	\$ 53,411	\$ 51,357	2,500%

	<b>Nine Months Ended</b>		<b>Nine Months Ended</b>		<b>Increase (Decrease)</b>	
	<b>September 30,</b>	<b>September 30,</b>	<b>September 30,</b>	<b>September 30,</b>	<b>Amount</b>	<b>%</b>
	<b>2009</b>	<b>2010</b>	<b>2009</b>	<b>2010</b>		
	<b>(As a percentage of revenue)</b>		<b>(In thousands, except percentages)</b>			
Revenue:						
Professional management	58%	69%	\$ 34,376	\$ 54,380	\$ 20,004	58%
Platform	38	28	22,526	22,022	(504)	(2)



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Other	3	3	1,945	2,276	331	17
Total revenue	100	100	58,847	78,678	19,831	34
Costs and expenses:						
Cost of revenue (exclusive of amortization of internal use software)	36	35	21,057	27,387	6,330	30
Research and development	19	18	11,366	14,138	2,772	24
Sales and marketing	28	25	16,689	19,734	3,046	18
General and administrative	9	11	5,359	8,298	2,939	55
Amortization of internal use software	4	3	2,126	2,694	567	27
Total costs and expenses	96	92	56,597	72,251	15,654	28
Income from operations	4	8	2,250	6,427	4,177	186
Interest expense	(1)		(514)	(101)	413	(80)
Interest and other income, net	1		304	15	(289)	(95)
Income before income tax expense	3	8	2,040	6,341	4,301	211
Income tax expense (benefit)	1		359	(91)	(450)	n/a
Benefit from release of valuation allowance		(63)		(49,853)	(49,853)	n/a
Net income	3%	72%	\$ 1,681	\$ 56,285	\$ 54,604	3,248%

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***Comparison of Three Months and Nine Months Ended September 30, 2009 and 2010***

***Revenue***

Total revenue increased \$6.8 million, or 31%, from \$22.0 million for the three months ended September 30, 2009 to \$28.8 million for the three months ended September 30, 2010 and increased \$19.8 million, or 34%, from \$58.8 million for the nine months ended September 30, 2009 to \$78.7 million for the nine months ended September 30, 2010. The increase was due primarily to growth in professional management revenue of \$6.3 million for the three months ended September 30, 2010 compared to the three months ended September 30, 2009 and \$20.0 million for the nine months ended September 30, 2010 compared to the nine months ended September 30, 2009. Professional management revenue and platform revenue comprised 69% and 27%, respectively, of total revenue for the three months ended September 30, 2010 and 69% and 28%, respectively, of total revenue for the nine months ended September 30, 2010.

***Professional Management Revenue***

Professional management revenue increased \$6.3 million, or 46%, from \$13.6 million for the three months ended September 30, 2009 to \$19.9 million for the three months ended September 30, 2010 and increased \$20.0 million, or 58%, from \$34.4 million for the nine months ended September 30, 2009 to \$54.4 million for the nine months ended September 30, 2010. The increase in professional management revenue for the three months ended September 30, 2010 was due primarily to an increase in AUM from \$23.5 billion as of September 30, 2009 to \$34.0 billion as of September 30, 2010. The increase in professional management revenue for the nine months ended September 30, 2010 was due primarily to an increase in the average quarter-end AUM between the comparative periods, which was \$19.7 billion for the nine months ended September 30, 2009 and \$31.1 billion for the nine months ended September 30, 2010. This increase in AUM for both periods was driven primarily by increased net new enrollment resulting from marketing campaigns and other ongoing member acquisitions, market appreciation and contributions.

***Platform Revenue***

Platform revenue increased \$0.1 million, or 1%, from \$7.6 million for the three months ended September 30, 2009 to \$7.7 million for the three months ended September 30, 2010, and decreased \$0.5 million, or 2%, from \$22.5 million for the nine months ended September 30, 2009 to \$22.0 million for the nine months ended September 30, 2010. The increase in platform revenue for the three months ended September 30, 2010 was due primarily to service availability at new sponsors. The decrease for the nine months ended September 30, 2010 was due to a reduction in platform fees from sponsor cancellations and contractual reductions, offset by service availability at new sponsors.

***Other Revenue***

Other revenue increased \$0.4 million, or 54%, from \$0.8 million for the three months ended September 30, 2009 to \$1.2 million for the three months ended September 30, 2010 and increased \$0.3 million, or 17%, from \$1.9 million for the nine months ended September 30, 2009 to \$2.3 million for the nine months ended September 30, 2010. The increase for both periods was due primarily to reimbursement for marketing materials from certain subadvisory relationships.

***Cost of Revenue***

Cost of revenue, exclusive of amortization of internal use software, increased \$2.6 million, or 35%, from \$7.5 million for the three months ended September 30, 2009 to \$10.2 million for the three months ended September 30, 2010 and increased \$6.3 million, or 30%, from \$21.1 million for the nine months ended September 30, 2009 to \$27.4 million for the nine months ended September 30, 2010. This increase was due primarily to an increase of \$1.9 million for the three months and \$4.9 million for the nine months ended September 30, 2010 in fees paid to plan providers for connectivity to plan and plan participant data due primarily to an increase in professional management revenue, as well as contractual increases in plan provider fees as a result of achieving an AUM milestone. In addition, headcount growth, annual compensation increases effective April 1, 2010 and related overhead expenses resulted in higher wages, bonus, benefits and payroll tax expenses of \$0.3 million for the three months ended September 30, 2010 and \$1.1 million for the nine months ended September 30, 2010. There was also an increase in printed member materials and marketing materials for subadvisory relationships of \$0.5 million for the three months ended September 30, 2010 and \$0.5 million for the nine months ended September 30, 2010, as well as a \$0.1 million increase in capitalized labor associated with direct response advertising for the nine months ended September 30,

2010. As a percentage of revenue, cost of revenue increased from 34% for the three months ended September 30, 2009 to 35% for the three months ended September 30, 2010 due primarily to an increase in data connectivity fees. As a percentage of revenue, cost of revenue decreased from 36% for the nine months ended September 30, 2009 to 35% for the nine months ended September 30, 2010 due primarily to a slower increase in employee-related expense relative to the increase in revenue during the same period, offset by increases in fees paid to plan providers for connectivity to plan and plan participant data.

**Table of Contents***Research and Development*

Research and development expense increased \$0.7 million, or 18%, from \$4.0 million for the three months ended September 30, 2009 to \$4.7 million for the three months ended September 30, 2010 and increased \$2.8 million, or 24%, from \$11.4 million for the nine months ended September 30, 2009 to \$14.1 million for the nine months ended September 30, 2010. This increase was due primarily to headcount growth, annual compensation increases effective April 1, 2010 and related overhead expenses which resulted in higher wages, bonus, stock-based compensation, benefits and payroll tax expenses of \$1.3 million for the three months ended September 30, 2010 and \$3.6 million for the nine months ended September 30, 2010. In addition, there was a \$0.3 million increase related to consulting expenses, equipment related expenses and travel expenses for the nine months ended September 30, 2010. These increases were offset by an increase in capitalized costs related to development of internal use software of \$0.7 million for the three months ended September 30, 2010 and \$1.2 million for the nine months ended September 30, 2010. As a percentage of revenue, research and development expense decreased from 18% for the three months ended September 30, 2009 to 16% for the three months ended September 30, 2010 and decreased from 19% for the nine months ended September 30, 2009 to 18% for the nine months ended September 30, 2010.

*Sales and Marketing*

Sales and marketing expense increased \$1.5 million, or 29%, from \$5.3 million for the three months ended September 30, 2009 to \$6.9 million for the three months ended September 30, 2010 and increased \$3.0 million, or 18%, from \$16.7 million for the nine months ended September 30, 2009 to \$19.7 million for the nine months ended September 30, 2010. This increase was due primarily to headcount growth, annual compensation increases effective April 1, 2010 and related overhead expenses which resulted in higher wages, bonus, benefits and payroll tax expenses of \$1.6 million for the three months ended September 30, 2010 and \$3.2 million for the nine months ended September 30, 2010. Additionally, there was a \$0.3 million increase for the three months ended September 30, 2010 and a \$1.1 million increase for the nine months ended September 30, 2010 in marketing expenses, including printed materials for passive campaigns, creative development consulting and other general marketing efforts. There was also an increase in travel expense of \$0.2 million and an increase in consulting expenses of \$0.1 million for the nine months ended September 30, 2010. These increases were offset by additional net capitalization of direct response advertising costs of \$0.4 million for the three months ended September 30, 2010 and \$1.6 million for the nine months ended September 30, 2010. As a percentage of revenue, sales and marketing expense remained flat at 24% for the three months ended September 30, 2009 compared to the three months ended September 30, 2010 and decreased from 28% for the nine months ended September 30, 2009 to 25% for the nine months ended September 30, 2010. The decrease as a percentage of revenue for the nine months ended September 30, 2010 was due primarily to commencing capitalization of direct response advertising costs associated with direct advisory Active Enrollment campaigns on a prospective basis effective July 1, 2009.

*General and Administrative*

General and administrative expense increased \$1.1 million, or 63%, from \$1.7 million for the three months ended September 30, 2009 to \$2.8 million for the three months ended September 30, 2010 and increased \$2.9 million, or 55%, from \$5.4 million for the nine months ended September 30, 2009 to \$8.3 million for the nine months ended September 30, 2010. This increase was due primarily to headcount growth and annual compensation increases effective April 1, 2010 which resulted in higher wages, bonus, stock-based compensation, benefits and payroll tax expenses of \$0.8 million for the three months ended September 30, 2010 and \$2.1 million for the nine months ended September 30, 2010. There was also an increase in expenses to support operations as a public company of \$0.4 million for the three months ended September 30, 2010 and \$0.9 million for the nine months ended September 30, 2010. As a percentage of revenue, general and administrative expense increased from 8% for the three months ended September 30, 2009 to 10% for the three months ended September 30, 2010 and increased from 9% for the nine months ended September 30, 2009 to 11% for the nine months ended September 30, 2010.

*Amortization of Internal Use Software*

Amortization of internal use software increased \$0.2 million, or 19%, from \$0.8 million for the three months ended September 30, 2009 to \$1.0 million for the three months ended September 30, 2010 and increased \$0.6 million, or 27%, from \$2.1 million for the nine months ended September 30, 2009 to \$2.7 million for the nine months ended

September 30, 2010. There was a higher rate of amortization expense for both periods due primarily to the completion of an internal use software project in March 2010 which incurred greater development costs as compared to projects amortized in 2009.

*Interest Expense*

Interest expense decreased \$0.2 million from \$0.2 million for the three months ended September 30, 2009 to a \$21,000 credit for the three months ended September 30, 2010 and decreased \$0.4 million, or 80%, from \$0.5 million for the nine months ended September 30, 2009 to \$0.1 million for the nine months ended September 30, 2010. This decrease for both periods was due primarily to a \$10.0 million term loan entered into in April 2009 with an effective interest rate lower than our previously outstanding \$10.0 million promissory note. On May 10, 2010 we repaid the outstanding term loan balance.

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### *Interest and Other Income, Net*

Interest and other income, net, decreased \$37,000, or 82%, from \$45,000 for the three months ended September 30, 2009 to \$8,000 for the three months ended September 30, 2010 and decreased \$0.3 million, or 95%, from \$0.3 million for the nine months ended September 30, 2009 to \$15,000 for the nine months ended September 30, 2010. This decrease was due primarily an adjustment of \$44,000 to the fair value of a warrant recorded to other income for the three months ended September 30, 2010, and due to a one-time \$0.2 million discount for early loan repayment, as well as an adjustment of \$0.1 million to the fair value of a warrant recorded to other income for the nine months ended September 30, 2010. The warrant expired in October 2009.

### *Income Taxes*

Income tax expense decreased \$0.8 million from a \$0.4 million income tax expense for the three months ended September 30, 2009 to a \$0.3 million income tax benefit for the three months ended September 30, 2010 and decreased \$0.5 million from a \$0.4 million income tax expense for the nine months ended September 30, 2009 to a \$0.1 million income tax benefit for the nine months ended September 30, 2010.

Prior to September 30, 2010, we maintained a full valuation allowance on the deferred tax asset resulting from our net operating loss carryforwards, because the likelihood of the realization of that asset had not become more likely than not as of those balance sheet dates. At September 30, 2010, we determined that our recent experience generating taxable income balanced against our history of losses, along with our projection of future taxable income, constituted significant positive evidence for partial realization of the deferred tax asset and, therefore, a partial release of the valuation allowance against that asset. Therefore, we released valuation allowances of \$49.9 million against our total of \$52.7 million in gross deferred tax assets, creating a \$49.9 million deferred tax asset as of September 30, 2010 and a \$49.9 million income tax benefit to our earnings for the nine months ended September 30, 2010.

As a result of releasing a significant portion of our valuation allowance the Company would expect to see, on a go-forward basis, an effective tax rate of approximately 38%, excluding the effect of disqualified stock dispositions.

### **Non-GAAP Adjusted EBITDA and Adjusted Net Income**

Adjusted EBITDA represents net income before net interest (income) expense, income tax expense (benefit), depreciation, withdrawn offering expense, amortization of internal use software, amortization of direct response advertising, amortization of deferred sales commissions and amortization of stock-based compensation. Adjusted Net Income represents net income before stock-based compensation expense, net of tax and certain non-recurring items.

Our management uses Adjusted EBITDA and Adjusted Net Income as measures of operating performance, for planning purposes (including the preparation of annual budgets), to allocate resources to enhance the financial performance of our business, to evaluate the effectiveness of our business strategies and in communications with our board of directors concerning our financial performance. Adjusted EBITDA, among other factors, will be used when determining incentive compensation for employees, including management, for 2010.

We also present Adjusted EBITDA and Adjusted Net Income as supplemental performance measures because we believe that these measures provide our board of directors, management and investors with additional information to measure our performance. Adjusted EBITDA provides comparisons from period to period by excluding potential differences caused by variations in the age and book depreciation of fixed assets (affecting relative depreciation expense) and amortization of internal use software, direct response advertising and commissions, and changes in interest expense and interest income that are influenced by capital structure decisions and capital market conditions. Management also believes it is useful to exclude stock-based compensation expense from Adjusted EBITDA and Adjusted Net Income because non-cash equity grants made at a certain price and point in time do not necessarily reflect how our business is performing at any particular time.

Adjusted EBITDA and Adjusted Net Income are not measurements of our financial performance under U.S. GAAP and should not be considered as an alternative to net income, operating income or any other performance measures derived in accordance with U.S. GAAP, or as an alternative to cash flows from operating activities as a measure of our profitability or liquidity.

We understand that, although Adjusted EBITDA and Adjusted Net Income are frequently used by securities analysts, lenders and others in their evaluation of companies, Adjusted EBITDA and Adjusted Net Income have limitations as an analytical tool, and you should not consider them in isolation, or as a substitute for an analysis of our

results as reported under U.S. GAAP. In particular you should consider:

Adjusted EBITDA and Adjusted Net Income do not reflect our cash expenditures, or future requirements for capital expenditures or contractual commitments;

Adjusted EBITDA and Adjusted Net Income do not reflect changes in, or cash requirements for, our working capital needs;

Adjusted Net Income does not reflect the interest expense or the cash requirements necessary to service interest or principal payments on our debt;

Adjusted EBITDA and Adjusted Net Income do not reflect the non-cash component of employee compensation;

Although depreciation and amortization are non-cash charges, the assets being depreciated and amortized often will have to be replaced in the future, and Adjusted EBITDA does not reflect any cash requirements for such replacements; and

Other companies in our industry may calculate Adjusted EBITDA and Adjusted Net Income differently than we do, limiting their usefulness as a comparative measure.

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Management compensates for the inherent limitations associated with using Adjusted EBITDA and Adjusted Net Income measures through disclosure of such limitations, presentation of our financial statements in accordance with U.S. GAAP and reconciliation of Adjusted EBITDA and Adjusted Net Income to the most directly comparable U.S. GAAP measure, net income. Further, management also reviews U.S. GAAP measures and evaluates individual measures that are not included in Adjusted EBITDA, such as our level of capital expenditures, equity issuance and interest expense, among other measures.

The table below sets forth a reconciliation of net income to Adjusted EBITDA based on our historical results:

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2009</b>	<b>2010</b>	<b>2009</b>	<b>2010</b>
	<b>(In thousands)</b>			
Net income	\$ 2,054	\$ 53,411	\$ 1,681	\$ 56,285
Interest expense, net	157	(29)	506	86
Income tax expense (benefit)	442	(50,172)	359	(49,944)
Depreciation	412	481	1,317	1,350
Amortization of internal use software	783	921	2,053	2,557
Amortization and impairment of direct response advertising	10	307	10	697
Amortization of deferred sales commissions	298	274	853	853
Stock-based compensation	1,488	1,913	4,648	5,798
Non-GAAP Adjusted EBITDA	\$ 5,644	\$ 7,106	\$ 11,427	\$ 17,682

The table below sets forth a reconciliation of net income to Adjusted Net Income on our historical results:

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2009</b>	<b>2010</b>	<b>2009</b>	<b>2010</b>
	<b>(In thousands)</b>			
Net income	\$ 2,054	\$ 53,411	\$ 1,681	\$ 56,285
Stock-based compensation, net of tax (1)	920	1,182	2,872	3,583
Income tax benefit from release of valuation allowance		(49,853)		(49,853)
Non-GAAP Adjusted Net Income	\$ 2,974	\$ 4,740	\$ 4,553	\$ 10,015

- (1) Effective with this filing, we are applying our expected statutory tax rate of 38.2% to stock-based compensation for all periods presented.



**Table of Contents****Non-GAAP Adjusted Earnings Per Share**

Non-GAAP Adjusted Earnings Per Share is defined as non-GAAP Adjusted Net Income divided by all weighted-average dilutive common share equivalents outstanding. For all periods, the dilutive common share equivalents outstanding also include on a non-weighted basis the conversion of all preferred stock to common stock, the shares associated with the stock dividend and the shares sold in the initial public offering. This differs from the weighted average diluted shares outstanding used for purposes of calculating GAAP earnings per share. The following table sets forth the computation of Adjusted Earnings Per Share:

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2009</b>	<b>2010</b>	<b>2009</b>	<b>2010</b>
	<b>(In thousands, except per share amounts)</b>			
Non-GAAP Adjusted Net Income	\$ 2,974	\$ 4,740	\$ 4,553	\$ 10,015
Shares of common stock outstanding	40,695	41,512	40,657	41,333
Dilutive restricted stock and stock options	1,949	5,051	1,900	4,714
Non-GAAP adjusted common shares outstanding	42,644	46,563	42,557	46,047
Non-GAAP Adjusted Earnings Per Share	\$ 0.07	\$ 0.10	\$ 0.11	\$ 0.22

**Liquidity and Capital Resources***Sources of Liquidity*

To date, our operations have been financed through the sale of equity securities, including net cash proceeds in connection with our initial public offering of common stock completed March 16, 2010 of approximately \$79.0 million, after deducting underwriting discounts and offering costs, and more recently from cash provided by operating activities.

*Consolidated Cash Flow Data*

	<b>Nine Months Ended September 30,</b>	
	<b>2009</b>	<b>2010</b>
	<b>(In thousands)</b>	
Net cash provided by operating activities	\$ 9,498	\$ 11,142
Net cash used in investing activities	(3,841)	(7,528)
Net cash provided by (used in) financial activities	(4,716)	75,128
Net increase in cash and cash equivalents	941	78,742
Cash and cash equivalents, end of period	\$ 15,798	\$ 99,455

*Net Cash Provided By Operating Activities*

Net cash provided by operating activities for the nine months ended September 30, 2010 was \$11.1 million compared to net cash provided by operating activities of \$9.5 million for the nine months ended September 30, 2009. The increase in cash provided by operating activities for the nine months ended September 30, 2010 compared to the nine months ended September 30, 2009 was due to a increase in operating results of \$7.5 million adjusted for non-cash expenses related primarily to the income tax benefit from the release of the valuation allowance, stock-based compensation and amortization and impairment of direct response advertising between the comparable periods, offset by excess tax benefits associated with stock-based compensation of \$0.2 million and a net change in operating assets and liabilities of \$5.7 million.



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### *Investing Activities*

Net cash used in investing activities was \$7.5 million for the nine months ended September 30, 2010 compared to \$3.8 million for the nine months ended September 30, 2009. For the nine months ended September 30, 2010, we capitalized \$4.5 million of internal use software costs compared to \$3.4 million for the nine months ended September 30, 2009. For the nine months ended September 30, 2010, we used \$0.5 million for the purchase of property and equipment compared to \$2.1 million for the nine months ended September 30, 2009. For the nine months ended September 30, 2010, \$1.0 million of restricted cash is being held in a money market account pledged as collateral for letters of credit issued in connection with certain operating lease contracts.

### *Financing Activities*

Net cash provided by financing activities was \$75.1 million for the nine months ended September 30, 2010 compared to net cash used in financing activities of \$4.7 million for the nine months ended September 30, 2009. For the nine months ended September 30, 2010, we received \$83.9 million of net proceeds from the issuance of common stock net of offering costs, which includes both proceeds from our initial public offering as well as the exercise of stock options. We made additional payments of \$3.6 million on our debt instruments, which included complete repayment of the outstanding balance with respect to our term loan, and we also incurred increased cash payments of \$0.6 million associated with net share settlements for stock-based awards minimum tax withholdings between the comparable periods.

### **Off-Balance Sheet Arrangements**

We have no off-balance sheet arrangements.

### **Recent Accounting Pronouncements**

For a discussion of recent accounting pronouncements, refer to Note 2 to the Condensed Consolidated Financial Statements.

### **Item 3. Quantitative and Qualitative Disclosures about Market Risk**

*Market Risk.* Our exposure to market risk is directly related to our role as an investment advisor for the professionally managed accounts for which we provide portfolio management services. For the nine months ended September 30, 2010, 64% of our revenue was derived from fees based on the market value of AUM. We expect this percentage to increase over time. A decrease in the aggregate value of AUM would generally be expected to cause our revenue and income to decline.

### **Item 4. Controls and Procedures**

#### *Evaluation of Disclosure Controls and Procedures*

We maintain disclosure controls and procedures, as such term is defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, or the Exchange Act, that are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Commission's rules and forms and that such information is communicated to our management, including our principal executive and principal financial officers, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating our disclosure controls and procedures, management recognizes that disclosure controls and procedures, no matter how well conceived and operated, can provide only reasonable, but not absolute, assurance that the objectives of the disclosure controls and procedures are met. Our disclosure controls and procedures have been designed to meet the reasonable assurance standards. Additionally, in designing disclosure controls and procedures, our management necessarily is required to apply its judgment in evaluating the cost-benefit relationship of possible disclosure controls and procedures. The design of any disclosure controls and procedures is also based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions.

Based on their evaluation, our principal executive officer and our principal financial officer concluded that as of September 30, 2010, our disclosure controls and procedures were effective.

#### *Changes in Internal Control Over Financial Reporting*

There were no changes in internal control over financial reporting during the quarter ended September 30, 2010 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.



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**PART II OTHER INFORMATION**

**Item 1A. Risk Factors**

This Report contains forward-looking statements that are subject to risks and uncertainties that could cause actual results to differ materially from those projected. These risks and uncertainties include, but are not limited to, the risk factors set forth below, and this Report should be read in conjunction with such risk factors. The risks and uncertainties described in this Report are not the only ones we face. Additional risks and uncertainties not presently known to us or that we currently believe are immaterial may also affect our business. If any of these known or unknown risks or uncertainties actually occurs and has material adverse effects on our business, financial condition and results of operations could be seriously harmed.

***Our revenue and operating results can fluctuate from period to period, which could cause our share price to fluctuate.***

Our revenue and operating results have fluctuated in the past and may fluctuate from period to period in the future due to a variety of factors, many of which are beyond our control. Factors relating to our business that may contribute to these fluctuations include the following factors, as well as other factors described elsewhere in this report:

- a decline or slowdown of the growth in the value of financial market assets, which may reduce the value of assets we have under management and therefore our revenue and cash flows;

- variations in expected enrollment rates for our Professional Management service;

- unanticipated delays of when we expect the service to made available;

- unanticipated changes to economic terms in contracts with plan providers or plan sponsors, including renegotiations;

- downward pressure on fees we charge for our portfolio management, investment advisory and retirement planning services;

- changes in laws or regulatory policy that could impact our ability to offer services to plan providers as a subadvisor;

- failure to enter into contracts with new plan sponsors;

- cancellations or non-renewal of existing contracts with plan providers or plan sponsors;

- changes in fees paid by Professional Management members based on performance incentives in contract terms;

- changes in fees paid by us to plan providers for whom we are not acting as a subadvisor for data retrieval, transaction processing and fee deduction interfaces based on performance incentives in contract terms;

- mix in plan sponsors that choose our Active Enrollment or Passive Enrollment options;

- changes in the number of Professional Management members who withdraw all assets from their 401(k) plan, effectively terminating their relationship with us, or who decide to cancel their Professional Management service participation;

- elimination or reduction of sponsor matching contributions into members' 401(k) plans, which could reduce the growth rate of assets under management;

unanticipated changes in the timing or cost of our enrollment and member materials or mix of subadvised, advised, Active and Passive Enrollment materials sent to our Professional Management members and postage costs;

unanticipated delays in recognizing revenue based on timing of meeting specified milestones under contracts with customization and consulting services;

changes in our pricing policies or the pricing policies of our competitors to which we have to adapt; and

negative public perception and reputation of the financial services industry.

As a result of these and other factors, the results of any prior quarterly or annual periods should not be relied upon as indications of our future revenue or operating performance.

***We have an accumulated deficit and have incurred net losses in the past. We may incur net losses in the future.***

As of September 30, 2010, we had an accumulated deficit of approximately \$101.1 million. We have incurred net losses in each year through 2008. We may incur net losses in the future.

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***A substantial portion of our revenue is based on fees earned on the value of assets we manage. Our revenue and earnings could suffer if the financial markets experience a downturn or a slowdown in growth that reduces the value, or slows the growth, of our Assets Under Management.***

We derive a significant and growing portion of our revenue from asset management fees based on the assets in the retirement accounts we manage, which we refer to as AUM. We allocate these assets among the investments available to each particular plan participant. The investment alternatives for a particular plan are selected by the plan's fiduciary, not by us, and may include retail mutual funds, institutional funds, exchange-traded funds, fixed-income investments and potentially higher volatility employer stock, if it is an investment alternative in a particular plan. In addition, our business is highly concentrated in the 401(k) plans of plan sponsors in the United States and the United States subsidiaries of international companies. The value of these investments can be affected by the performance of the financial markets globally, currency fluctuations, interest rate fluctuations and other factors. Currently, our fees are generally based on AUM on a day within the last 10 days of a quarter. The exact date is agreed to in advance with the plan provider, but varies by plan provider. As a result, a decline in the financial markets at the end of a quarter could have an adverse effect on our revenue, even if the financial markets had performed well earlier in the quarter. In addition, an economic downturn or slowdown in growth could cause plan participants or their employers to contribute less to their 401(k) plans and cause fewer eligible employees to participate in 401(k) plans, which could adversely affect the amount of AUM. If plan participants are not satisfied with the performance of their retirement portfolios due to a decline in the financial markets or otherwise, our cancellation rates could increase, which in turn would cause our AUM to decline. If any of these factors reduces the value of assets we have under management, the amount of fees we would earn for managing those assets would decline, which in turn would harm our revenue, operating results and financial condition.

***Our revenue could be harmed if we experience unanticipated delays in expected service availability.***

We generally do not earn platform fees from a plan sponsor until our services are available to plan participants, and we do not earn fees for our Professional Management service until we begin to manage a participant's account. If service availability is delayed, our receipt of revenue would be delayed. This in turn would affect our operating results for a particular period.

***Our revenue could suffer if we experience unanticipated variations in new enrollment campaigns or if we fail to enroll plan participants.***

Unanticipated variations in the number, size or timing of enrollment campaigns could also affect our revenue for a particular period.

***Our revenue could be harmed if we do not grow enrollment in our Professional Management service.***

Our enrollment rate, and therefore our revenue, depend on plan participants signing up for or, in the case of a Passive Enrollment campaign, not declining, the Professional Management service. If we are unable to continue to grow our enrollment, our business may not grow as we anticipate. Increasing plan participant enrollment in our Professional Management service increases the AUM on which we earn fees. We may not be able to generate expected enrollment under a particular contract, which would negatively affect our revenue growth. For example, we have found that if plan sponsors do not use our standard enrollment campaign, enrollment rates tend to be lower. If fewer plan sponsors elect Passive Enrollment for their plan participants, which typically generates higher enrollment rates, our revenue may not grow at anticipated rates. Even when we have rolled out our Professional Management service at a particular plan sponsor, some plan participants may not be eligible for our services due to plan sponsor limitations on employees treated as insiders for purposes of securities laws or other characteristics of the plan participant. Certain securities within a plan participant's account may be ineligible for management by us, such as employer stock subject to trading restrictions, and we do not manage or charge a fee for that portion of the account. Further, individual plan participants whose accounts we manage may choose at any time to stop having us manage those accounts. If large numbers of plan participants choose to stop using or are not able to continue using our Professional Management service, our revenue, operating results and financial condition would suffer.

**Table of Contents*****We plan to extend and expand our services and may not accurately estimate the impact of developing and introducing these services on our business.***

We plan to extend our services into new areas, including helping investors turn their retirement assets into retirement income. For example, we intend to work within the existing 401(k) plans we service to help our Professional Management members manage their defined contribution assets and maintain their retirement goals while directing payouts from their retirement accounts. We also recently introduced the Financial Engines Retirement Evaluation, a personalized retirement assessment designed to let plan participants know how close they are to reaching their retirement income goals based on their current savings and investments. We intend to invest significant resources to the research, development, sales and marketing of these new services. We have limited experience determining and executing income payments from defined contribution accounts. If our assessments or forecasts with respect to the expected duration and sufficiency of assets to support retirement income payments to participants are inaccurate, or if we fail to ensure that payouts are made at the times expected, our business and reputation could suffer. We may not be able to anticipate or manage new risks and obligations or legal, compliance or other requirements that may arise if we offer investment management or retirement income payout services for accounts other than 401(k) accounts. We may not be able to accurately estimate the impact of these future services on our business or how the benefits of these services will be perceived by our clients. In addition, the anticipated benefits of these services on our business may not outweigh the resources and costs associated with their development. If we do not realize the anticipated benefits of these services, our business would suffer.

***Our revenue is highly dependent upon a small number of plan providers with whom we have relationships, and the renegotiation or termination of our relationship with any of these plan providers could significantly impact our business.***

Our relationships and data connections with plan providers allow us to effectively manage plan participant accounts and integrate our services into plan providers' current service platforms. These relationships also provide us with an advantage in trying to sign potential plan sponsors. If a plan provider were to terminate our contract, reduce its volume of business, or substantially renegotiate the terms of its contract with us, our revenue could be reduced.

Of our eight primary retirement plan provider relationships, we refer to three as subadvisory relationships. For the full suite of services offered in these subadvisory relationships, we generally act as subadvisor to the plan provider acting as investment advisor, even though we may contract directly with the plan sponsor to act as investment advisor for online-only service offerings. However, among the plan sponsors that work with these three providers, in those cases where we act as subadvisor, we do not have a direct relationship with the plan sponsors and therefore may be less able to influence decisions by those plan sponsors to use or continue to use our services, and for online-only sponsors, we may be less able to influence plan sponsor decisions to add our full suite of services. We have historically earned, and expect to continue to earn on a combined basis, a significant portion of our revenue through these three retirement plan providers. The renegotiation or termination of our relationship with any of these plan providers could negatively impact our business. For the three months ended September 30, 2010, 20%, 7% and 6% and for the nine months ended September 30, 2010, 20%, 7% and 6% of our total revenue was attributable to JP Morgan, ING and Vanguard, respectively, the three retirement plan providers with whom we have subadvisory relationships. Revenue attributable to these three plan providers includes subadvisory fees they pay to us directly, as well as revenue from certain plan sponsors that work with these plan providers but pay us directly. JPMorgan, Vanguard and ING directly accounted for approximately 19%, 6% and 6%, respectively, of our total revenue for the three months ended September 30, 2010 and 20%, 6% and 6%, respectively, of our total revenue for the nine months ended September 30, 2010.

Our contracts with plan providers generally have terms ranging from three to five years, and have successive automatic renewal terms of one year unless terminated in accordance with prior notice requirements. Certain of the plan provider agreements are in or will soon be in renewal periods. A plan provider may also terminate its contract with us at any time for specified breaches. In addition, there are unpredictable factors, other than our performance, that could cause the loss of a plan provider. If we lose one of our plan providers with whom we have a relationship or if one of those plan providers significantly reduces its volume of business with us or renegotiates the economic terms of its contract with us, our revenue, operating results and financial condition could be harmed.



***Some plan providers with whom we have relationships also provide or may provide competing services.***

Some plan providers with whom we have relationships, such as Fidelity, offer or may offer directly competing investment guidance, advice and portfolio management services to plan participants. We also face indirect competition from products that could potentially substitute for our portfolio management, investment advisory and retirement planning services, most notably target-date retirement funds, which are offered by a number of plan providers with whom we have relationships, including J.P. Morgan, Fidelity and Vanguard.

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***Our revenue is highly dependent upon the plan sponsors with whom we have relationships, and the renegotiation or termination of our relationship with any of these plan sponsors could significantly impact our business.***

A substantial portion of our revenue is generated as a result of contracts with plan sponsors. Under these contracts, we earn annual platform fees that are paid by the plan sponsor, plan provider or the retirement plan itself as well as fees based on AUM that are generally paid by plan participants. Our contracts with plan sponsors typically have initial terms of three years and evergreen clauses that extend the initial term until terminated by either party after a specified notice period. At any time during the initial term or thereafter, a plan sponsor can cancel a contract for fiduciary reasons or breach of contract. A plan sponsor can generally terminate a contract after the initial term upon 90 days notice. If a plan sponsor cancels or does not renew a contract, we would no longer earn platform fees under that contract. In addition, we would no longer manage any assets in that plan and consequently would no longer earn fees based on AUM in that plan. If a significant number of plan sponsors were to cancel their contracts with us or fail to renew those contracts, our revenue, operating results and financial condition would be adversely affected.

***Our Professional Management service makes up a significant and growing part of our revenue base. Our business could suffer if fees we can charge for these services decline.***

We earn fees for our Professional Management service based on the value of assets in the accounts we manage. We believe that these services will continue to make up a substantial and growing portion of our revenue for the foreseeable future. There are many investment advisory and management services and other financial products available in the marketplace, which could result in downward pressure on fees for our Professional Management service. Government regulation, such as legislative constraints on fees, could also limit the fees we can charge for our Professional Management service. Performance incentives in contract terms may reduce the fees we charge for our Professional Management service. If we are forced to lower the fees we charge for our Professional Management service, it could harm our revenue, operating results and financial condition.

***Our failure to increase the number of plan sponsors with whom we have relationships could harm our business.***

Our future success depends on increasing the number of plan sponsors with whom we have relationships. If the market for our services declines or develops more slowly than we expect, or the number of plan sponsors that choose to provide our services to their plan participants declines or fails to increase as we expect, our revenue, operating results or financial condition could suffer.

***We rely on plan providers and plan sponsors to provide us with accurate and timely plan and plan participant data in order for us to provide our portfolio management services, investment advice and retirement help, and we rely on plan providers to execute transactions in the accounts we manage.***

Our ability to provide high-quality portfolio management services, investment advice and retirement help depends on plan sponsors and plan providers supplying us with accurate and timely data. Errors or delays in the data we receive from plan providers or plan sponsors, or missing data, could lead us to make advisory or transaction errors that could harm our reputation or lead to financial liability, or may prevent us from providing our services to, or earning revenue from, otherwise eligible plan participants. In addition, when we make changes in an account we manage, we instruct the plan provider to execute the transactions. If a plan provider fails to execute transactions in an accurate and timely manner, it could harm our reputation or lead to financial liability.

***We may be liable to our plan sponsors, plan participants or plan providers for damages caused by system failures, errors or unsatisfactory performance of services.***

If we fail to prevent, detect or resolve errors in our services, our business and reputation could suffer. Errors in inputs or processing, such as plan set-ups, transaction instructions or plan participant data, could be magnified across many accounts. Concentrated positions held by many plan participants, particularly in employer stock, could result in a large liability if a systematic input or processing error was to cause us to make errors in transactions relating to those positions. We may not be able to identify or resolve these errors in a timely manner. In addition, failure to perform our services for Professional Management members on a timely basis could result in liability. We may also have liability to the plan provider where we have a subadvisory relationship with the plan provider. After an error is identified, resolving the error and implementing remedial measures would likely divert the attention and resources of our management and key technical personnel from other business concerns. Any errors in the performance of services for a plan sponsor or plan provider, or poor execution of these services, could result in a plan sponsor or plan provider

terminating its agreement. Although we attempt to limit our contractual liability for consequential damages in rendering our services, these limitations on liability may be unenforceable in some cases, or may be insufficient to protect us from liability for damages. ERISA and other applicable laws require that we meet a fiduciary obligation to plan participants. We maintain general liability insurance coverage, including coverage for errors or omissions; however, this coverage may not continue to be available on reasonable terms or may be unavailable in sufficient amounts to cover one or more large claims. An insurer might disclaim coverage as to any future claim. A successful assertion of one or more large claims against us that exceeds our available insurance coverage or changes in our insurance policies, including premium increases or the imposition of a large deductible or co-insurance requirement, could harm our operating results and financial condition.

**Table of Contents*****If our reputation is harmed, we could suffer losses in our business and revenue.***

Our reputation, which depends on earning and maintaining the trust and confidence of plan providers, plan sponsors and plan participants that are current and potential customers, is critical to our business. Our reputation is vulnerable to many threats that can be difficult or impossible to control, and costly or impossible to remediate. Regulatory inquiries or investigations, lawsuits initiated by other plan fiduciaries or plan participants, employee misconduct, perceptions of conflicts of interest and rumors, among other developments, could substantially damage our reputation, even if they are baseless or satisfactorily addressed. In addition, any perception that the quality of our investment advice may not be the same or better than that of other providers can also damage our reputation. Any damage to our reputation could harm our ability to attract and retain plan providers, plan sponsor customers and key personnel. This damage could also cause plan participants to stop using or enrolling in our Professional Management service, which would adversely affect the amount of AUM on which we earn fees.

***Any failure to ensure and protect the confidentiality of plan provider, plan sponsor or plan participant data could lead to legal liability, adversely affect our reputation and have a material adverse effect on our business, financial condition or results of operations.***

Our services involve the exchange of information, including detailed information regarding plan participants provided by plan providers and plan sponsors, through a variety of electronic and non-electronic means. In addition, plan participants routinely input personal investment and financial information, including portfolio holdings and, in some instances, credit card data, into our systems. We rely on a complex network of process and software controls to protect the confidentiality of data provided to us or stored on our systems. If we do not maintain adequate internal controls or fail to implement new or improved controls, this data could be misappropriated or confidentiality could otherwise be breached. We could be subject to liability if we inappropriately disclose any plan participant's personal information, or if third parties are able to penetrate our network security or otherwise gain access to any plan participant's name, address, portfolio holdings, credit card number or other personal information. Any such event could subject us to claims for unauthorized credit card purchases, identity theft or other similar fraud claims or claims for other misuses of personal information, such as unauthorized marketing or unauthorized access to personal information.

Many of our agreements with plan sponsors and plan providers do not limit our potential liability for breaches of confidentiality and consequential damages. If any person, including any of our employees, penetrates our network security, misappropriates or mishandles sensitive data, inadvertently or otherwise, we could be subject to significant liability from our plan sponsors and plan providers for breaching contractual confidentiality provisions or privacy laws. In addition, our agreements with plan sponsors and plan providers require us to meet specified minimum system security and privacy standards. Given the growing concern over privacy and identity theft, we have been and expect to continue to be subject to increased scrutiny by both plan providers and plan sponsors, which have increased the frequency and thoroughness of their audits. If we fail to meet these standards, our plan sponsors and plan providers may seek to terminate their agreements with us. Unauthorized disclosure of sensitive or confidential data, whether through breach of our computer systems, systems failure or otherwise, could damage our reputation, expose us to litigation, cause us to lose business, harm our revenue, operating results or financial condition and subject us to regulatory action, which could include sanctions and fines.

***Privacy concerns could require us to modify our operations.***

As part of our business, we use plan participants' personal data. For privacy or security reasons, privacy groups, governmental agencies and individuals may seek to restrict or prevent our use of this data. We have incurred, and will continue to incur, expenses to comply with privacy and security standards and protocols imposed by law, regulation, industry standards or contractual obligations. Increased domestic or international regulation of data utilization and distribution practices, including self-regulation, could require us to modify our operations and incur significant additional expense, which could have an adverse effect on our business, financial condition and results of operations.

***Acquisition activity involving plan providers or plan sponsors could adversely affect our business.***

Acquisitions or similar transactions involving our plan providers or plan sponsors could negatively affect our business in a number of ways. After such a transaction, the plan provider or plan sponsor might terminate, not renew or seek to renegotiate the economic terms of its contract with us. Companies involved in these transactions may

experience integration difficulties that could increase the risk of providing us inaccurate or untimely data or delay in service availability. Any of our existing plan sponsors may be acquired by an organization or a plan sponsor with no relationship with us, effectively terminating our relationship, or be acquired by a plan sponsor with an online services-only relationship rather than a Professional Management relationship which might cause us to lose business and harm our revenue, operating results or financial condition. Plan providers could be acquired by a company offering competing services to ours, which could increase the risk that they terminate their relationship with us, or be acquired by an organization with no relationship with us which might cause us to lose that plan provider, have to renegotiate the economic terms of their contract with us and harm our revenue, operating results or financial condition. We cannot predict the impact, if any, that these corporate actions may have on our revenue, operating results or financial condition.

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***Our ability to compete, succeed and generate profits depends, in part, on our ability to obtain accurate and timely data from third-party vendors on commercially reasonable terms.***

We currently obtain market and other financial data we use to generate our investment advice from a number of third-party vendors. Termination of one or more of our agreements or exclusion from, or restricted use of a data provider's information could decrease the information available for us to use and offer our clients and may have a material adverse effect on our business, financial condition or results of operations. We do not currently have secondary sources or other suppliers for some of these data items. If these data feed agreements were terminated, backup services would take time to set up and our business and results of operations could be harmed. We rely on these data suppliers to provide timely and accurate information, and their failure to do so could harm our business.

In addition, some data suppliers may seek to increase licensing fees for providing content to us. If we are unable to renegotiate acceptable licensing arrangements with these data suppliers or find alternative sources of equivalent content, we may experience a reduction in our profit margins or market share.

***Our portfolio management and investment advisory operations may subject us to liability for losses that result from a breach of our fiduciary duties.***

Our portfolio management and investment advisory operations involve fiduciary obligations that require us to act in the best interests of the plan participants to whom we provide advice or for whom we manage accounts. We may face liabilities for actual or claimed breaches of our fiduciary duties. We may not be able to prevent plan participants, plan sponsors or the plan providers to or through whom we provide investment advisory services from taking legal action against us for an actual or claimed breach of a fiduciary duty. Because we currently provide investment advisory services on substantial assets, we could face substantial liability to plan participants or plan sponsors if we breach our fiduciary duties. In addition, we may face liabilities for actual or claimed deficiencies in the quality or outcome of our investment advisory recommendations, investment management and other services, even in the absence of an actual or claimed breach of fiduciary duty. While we believe that we would have substantial and meritorious defenses against such a claim, we cannot predict the outcome or consequences of any such potential litigation.

***Competition could reduce our share of the portfolio management, investment advisory and retirement planning market and hurt our financial performance.***

We operate in a highly competitive industry, with many investment advice providers competing for business from individual investors, financial advisors and institutional customers. Direct competitors that offer independent portfolio management and investment advisory services to plan participants in the workplace include Morningstar, Inc., GuidedChoice and ProManage LLC. Plan providers that offer directly competing portfolio management and investment advisory services to investors in the workplace include Fidelity and Merrill Lynch. We currently have a relationship with Fidelity that allows us to provide our services to plan sponsors that elect to hire us for which Fidelity is the plan provider. We also face indirect competition from products that could potentially substitute for our portfolio management services, investment advice and retirement help, most notably target-date retirement funds. Target-date funds are offered by multiple financial institutions, including BlackRock (formerly Barclays Global Investors), T. Rowe Price, Fidelity and Vanguard. These funds provide generic asset allocation based on the investment horizon of the investor. Target-date funds, managed accounts and balanced funds have been granted Qualified Default Investment Alternative, or QDIA, status by the Department of Labor. Plan providers offer or may choose to offer directly and indirectly competitive products in the future. The plan providers with which we do not have contractually exclusive relationships may enter into similar relationships with our competitors. This in turn may harm our business.

Many of our competitors have larger customer bases and significantly greater resources than we do. This may allow our competitors to respond more quickly to new technologies and changes in demand for services, to devote greater resources developing and promoting their services and to make more attractive offers to potential plan providers, plan sponsors and plan participants. Industry consolidation may also lead to more intense competition. Increased competition could result in price reductions or loss of market share, either of which could hurt our business.

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***Our future success depends on our ability to recruit and retain qualified employees, including our executive officers.***

Our ability to provide portfolio management services, investment advice and retirement help and maintain and develop relationships with plan participants, plan providers and plan sponsors depends largely on our ability to attract, train, motivate and retain highly skilled professionals, particularly professionals with backgrounds in sales, technology and financial and investment services. We believe that success in our business will continue to be based upon the strength of our intellectual capital. For example, due to the complexity of our services and the intellectual capital invested in our investment methodology and technology, the loss of personnel integral to our investment research, product development and engineering efforts would harm our ability to maintain and grow our business. Consequently, we must hire and retain employees with the technical expertise and industry knowledge necessary to continue to develop our services and effectively manage our growing sales and marketing organization to ensure the growth of our operations. We believe there is significant competition for professionals with the skills necessary to perform the services we offer. We experience competition for analysts and other employees from financial institutions and financial services organizations such as hedge funds and investment management companies that generally have greater resources than we do and therefore may be able to offer higher compensation packages. Competition for these employees is intense, and we may not be able to retain our existing employees or be able to recruit and retain other highly qualified personnel in the future. If we cannot hire and retain qualified personnel, our ability to continue to expand our business would be impaired and our revenue could decline.

***If our intellectual property and technology are not adequately protected to prevent use or appropriation by our competitors, our business and competitive position could suffer.***

Our future success and competitive position depend in part on our ability to protect our proprietary technology and intellectual property. We rely and expect to continue to rely on a combination of trademark, copyright, patent and trade secret protection laws to protect our proprietary technology and intellectual property. We also require our employees, consultants, vendors, plan sponsors and plan providers to enter into confidentiality agreements with us. We currently have 12 issued U.S. patents which relate to novel aspects of our financial advisory platform, including user interface features, our pricing module, load-aware optimization, advice palatability, financial goal planning and other key technologies of our outcomes-based investing methodologies. We also have several additional pending U.S. patent applications. In addition, we have issued patents and pending patent applications in foreign jurisdictions. One or more of our issued patents or pending patent applications may be deemed to be directed to methods of doing or conducting business, and may therefore be categorized as so-called "business method" patents. The general validity of software patents and business method patents has been challenged in a number of jurisdictions, including the United States. Changes in patent laws or case law may impact the scope of patent-eligible subject matter. Our patents may become less valuable if software or business methods are found to be a non-patentable subject matter or if additional requirements are imposed that our patents do not meet.

The steps we have taken may be inadequate to prevent the misappropriation of our proprietary technology. Our patent and trademark applications may not lead to issued patents and registered trademarks. There can be no assurance that others will not develop or patent similar or superior technologies, products or services, or that our patents, trademarks and other intellectual property will not be challenged, invalidated or circumvented by others. The legal standards relating to the validity, enforceability and scope of protection of intellectual property rights are uncertain and still evolving. Unauthorized copying or other misappropriation of our proprietary technologies could enable third parties to benefit from our technologies without paying us for doing so, which could harm our business. Policing unauthorized use of proprietary technology is difficult and expensive and our monitoring and policing activities may not be sufficient to identify any misappropriation and protect our proprietary technology. In addition, third parties may knowingly or unknowingly infringe our patents, trademarks and other intellectual property rights, and litigation may be necessary to protect and enforce our intellectual property rights. If litigation is necessary to protect and enforce our intellectual property rights, any such litigation could be very costly and could divert management attention and resources.

We also expect that the more successful we are, the more likely it becomes that competitors will try to develop products that are similar to ours, which may infringe on our proprietary rights. If we are unable to protect our

proprietary rights or if third parties independently develop or gain access to our or similar technologies, our business, revenue, reputation and competitive position could be harmed.



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### ***Third parties may assert intellectual property infringement claims against us, or our services may infringe the intellectual property rights of third parties, which may subject us to legal liability and harm our reputation.***

Assertion of intellectual property infringement claims against us, plan providers or plan sponsors could result in litigation. We might not prevail in any such litigation or be able to obtain a license for the use of any infringed intellectual property from a third party on commercially reasonable terms, or at all. Even if obtained, we may be unable to protect such licenses from infringement or misuse, or prevent infringement claims against us in connection with our licensing efforts. We expect that the risk of infringement claims against us will increase if more of our competitors are able to obtain patents for software products and business processes, and if we hire employees who possess third party proprietary information. Any such claims, regardless of their merit or ultimate outcome, could result in substantial cost to us, divert management's attention and our resources away from our operations and otherwise harm our reputation. Our process for controlling employees' use of third party proprietary information may not be sufficient to prevent assertions of intellectual property infringement claims against us.

### ***Any inability to manage our growth could disrupt our business and harm our operating results.***

We expect our growth to place significant demands on our management and other resources. Our success will depend in part upon the ability of our senior management to manage growth effectively. Expansion creates new and increased management and training responsibilities for our employees. In addition, continued growth increases the challenges involved in:

recruiting, training and retaining sufficient skilled technical, marketing, sales and management personnel;

preserving our culture, values and entrepreneurial environment;

successfully expanding the range of services offered to our plan sponsors and plan participants;

developing and improving our internal administrative infrastructure, particularly our financial, operational, compliance, recordkeeping, communications and other internal systems; and

maintaining high levels of satisfaction with our services among plan sponsors and plan participants.

### ***Our ability to raise capital in the future may be limited, and our failure to raise capital when needed could prevent us from executing our growth strategy.***

We believe that our existing cash and cash equivalents will be sufficient to fund our planned capital expenditures and other anticipated cash needs for the foreseeable future. If our capital resources are insufficient to satisfy our liquidity requirements, we may seek to sell additional equity or debt securities or obtain debt financing. If we decide to seek additional financing, it may result in additional dilution to existing stockholders or, in the case of debt, may result in additional operating or financial covenants. We have not made arrangements to obtain additional financing and there is no assurance that financing, if required, will be available in amounts or on terms acceptable to us, if at all.

### ***We will be subject to additional regulatory compliance requirements, including Section 404 of the Sarbanes-Oxley Act of 2002, as a result of becoming a public company and our management has limited experience managing a public company.***

We will incur significant legal, accounting and other expenses as a public company. The individuals who constitute our management team have limited experience managing a publicly traded company and limited experience complying with the increasingly complex and changing laws pertaining to public companies. Our management team and other personnel will need to devote a substantial amount of time to new compliance initiatives, and we may not successfully or efficiently manage our transition into a public company. We expect rules and regulations such as the Sarbanes-Oxley Act of 2002 and the Investor Protection and Securities Reform Act of 2010 to increase our legal and finance compliance costs and to make some activities more time-consuming and costly. We will need to hire a number of additional employees with public accounting and disclosure experience in order to meet our ongoing obligations as a public company. For example, Section 404 of the Sarbanes-Oxley Act of 2002 requires that our management report on, and our independent auditors attest to, the effectiveness of our internal control structure and procedures for financial reporting in our annual report on Form 10-K for the fiscal year ending December 31, 2011. Section 404

compliance may divert internal resources and will take a significant amount of time and effort to complete. We may not be able to successfully complete the procedures and certification and attestation requirements of Section 404 by the time we will be required to do so. If we fail to do so, or if in the future our chief executive officer, chief financial officer or independent registered public accounting firm determines that our internal controls over financial reporting are not effective as defined under Section 404, we could be subject to sanctions or investigations by The NASDAQ Stock Market, the SEC, or other regulatory authorities. Furthermore, investor perceptions of our company may suffer, and this could cause a decline in the market price of our stock. Irrespective of compliance with Section 404, any failure of our internal controls could have a material adverse effect on our stated results of operations and harm our reputation. If we are unable to implement these changes effectively or efficiently, it could harm our operations, financial reporting or financial results and could result in an adverse opinion on internal controls from our independent auditors.

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***Our insiders who are significant stockholders may control the election of our board and may have interests that conflict with those of other stockholders.***

Our directors and executive officers, together with members of their immediate families, beneficially own, in the aggregate, a significant portion of our outstanding capital stock. As a result, acting together, this group has the ability to exercise significant control over most matters requiring our stockholders' approval, including the election and removal of directors and significant corporate transactions.

***We could face liability for certain information we disclose, including information based on data we obtain from other parties.***

We may be subject to claims for securities law violations, negligence, or other claims relating to the information we disclose, such as the mutual fund assessments we call "scorecards." Individuals who use our services may take legal action against us if they rely on information that contains an error, or a company may claim that we have made a defamatory statement about it or its employees. We could also be subject to claims based upon the content that is accessible from our website through links to other websites. We rely on a variety of outside parties as the original sources for the information we use in our published data. These sources include securities exchanges, fund companies and transfer agents. Accordingly, in addition to possible exposure for publishing incorrect information that results directly from our own errors, we could face liability based on inaccurate data provided to us by others. Defending claims based on the information we publish could be expensive and time-consuming and could adversely impact our business, operating results and financial condition.

***If our operations are interrupted as a result of service downtime or interruptions, our business and reputation could suffer.***

The success of our business depends upon our ability to obtain and deliver time-sensitive, up-to-date data and information. Our operations and those of our plan providers and plan sponsors are vulnerable to interruption by technical breakdowns, computer hardware and software malfunctions, software viruses, infrastructure failures, fire, earthquake, power loss, telecommunications failure, terrorist attacks, wars, Internet failures and other events beyond our control. Any disruption in our services or operations could harm our ability to perform our services effectively which in turn could result in a reduction in revenue or a claim for substantial damages against us, regardless of whether we are responsible for that failure. We rely on our computer equipment, database storage facilities and other office equipment, which are located primarily in the seismically active San Francisco Bay Area. We maintain off-site back-up facilities in Phoenix, Arizona for our database and network equipment, but these facilities could be subject to the same interruptions that may affect our headquarters. If we suffer a significant database or network facility outage, our business could experience disruption until we fully implement our back-up systems. We also depend on certain significant vendors for facility storage and related maintenance of our main technology equipment and data at these locations. Any failure by these vendors to perform those services, any temporary or permanent loss of our equipment or systems or any disruptions to basic infrastructure like power and telecommunications could impede our ability to provide services to our plan participants, harm our reputation, cause plan participants to stop using our investment advisory or Professional Management services, reduce our revenue and harm our business. Our agreements with our plan providers or plan sponsors also require us to meet specified minimum system security and privacy standards. If we fail to meet these standards, our plan sponsors and plan providers may seek to terminate their agreements with us. This in turn could damage our reputation and harm our market position and business.

### **Risks Related to Our Industry**

***Changes in laws applicable to our portfolio management, investment advisory and retirement planning services may adversely affect our business.***

We may be adversely affected as a result of new or revised legislation or regulations imposed by the SEC, Department of Labor or other U.S. regulatory authorities or self-regulatory organizations that supervise the financial markets and retirement industry, such as the Investor Protection and Securities Reform Act of 2010. In addition, we may be adversely affected by changes in the interpretation of existing laws and rules by these governmental authorities and self-regulatory organizations. It is impossible to determine the extent of the impact of any new laws, regulations or initiatives that may be proposed, or whether any of the proposals will become law. It is difficult to predict the future impact of the broad and expanding legislative and regulatory requirements affecting our business.

For example, legislation or regulation regarding fees may affect our business. Future legislation or regulation could change or eliminate certain existing restrictions relating to conflicts of interest, which might lower the relative value of our independence. Changes to laws or regulations could increase our potential liability for offering portfolio management services, investment advice and retirement help, affect our ability to offer our Passive Enrollment option or invalidate pre-dispute arbitration clauses in our agreements, leading to increased costs to litigate any claims against us. Changes to laws or regulations could also increase our legal compliance costs, divert internal resources and make some activities more time-consuming and costly. The laws, rules and regulations applicable to our business may change in the future, and we may not be able to comply with any such changes. If we fail to comply with any applicable law, rule or regulation, we could be fined, sanctioned or barred from providing investment advisory services in the future, which could materially harm our business and reputation.

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### ***We are subject to complex regulation, and any compliance failures or regulatory action could adversely affect our business.***

The financial services industry is subject to extensive regulation at the federal and state levels. It is very difficult to predict the future impact of the legislative and regulatory requirements affecting our business. The securities laws and other laws that govern our activities as a registered investment advisor are complex and subject to rapid change. The activities of our investment advisory and management operations are subject primarily to provisions of the Investment Advisers Act of 1940, referred to as the Investment Advisers Act, and the Employee Retirement Income Security Act of 1974, as amended, referred to as ERISA, as well as certain state laws. We are a fiduciary under ERISA. Our investment advisory services are also subject to state laws including anti-fraud laws and regulations. The Investment Advisers Act addresses, among other things, fiduciary duties, recordkeeping and reporting requirements and disclosure requirements and also includes general anti-fraud prohibitions. If we fail to comply with any applicable law, rule or regulation, we could be fined, sanctioned or barred from providing investment advisory services in the future, which could materially harm our business and reputation. We may also become subject to additional regulatory and compliance requirements as a result of any expansion or enhancement of our existing services or any services we may offer in the future. For example, we may be subject to insurance licensing or other requirements in connection with our retirement planning services, even if our activities are limited to describing regulated products. Compliance with any new regulatory requirements may divert internal resources and take significant time and effort. Any claim of noncompliance, regardless of merit or ultimate outcome, could subject us to investigation by the SEC or other regulatory authorities. This in turn could result in substantial cost to us and divert management's attention and other resources away from our operations. Furthermore, investor perceptions of us may suffer, and this could cause a decline in the market price of our common stock. Our compliance processes may not be sufficient to prevent assertions that we failed to comply with any applicable law, rule or regulation.

### ***We face additional scrutiny when we act as subadvisor, and any failure to comply with regulations or meet expectations could harm our business.***

Some of the plan providers to whom we are subadvisors are broker-dealers registered under the Securities Exchange Act of 1934, referred to as the Exchange Act, and are subject to the rules of the Financial Industry Regulatory Authority, or FINRA. When we act as a subadvisor, we may be subject to the oversight by regulators of another advisor. We may be affected by any regulatory examination of that plan provider.

In addition, our subadvisory arrangements are structured to follow Advisory Opinion 2001-09A, a Department of Labor opinion provided to SunAmerica Retirement Markets. Although an advisory opinion provides guidance about the Department of Labor's interpretation of ERISA, it is directly applicable only to the entity to which it is issued. SunAmerica Retirement Markets is an entity unrelated to us or the plan providers to which we act as subadvisor. We could be adversely affected if the Department of Labor increases examination of these subadvisory arrangements or changes the interpretive positions described in the Advisory Opinion. We could be adversely affected if ERISA is amended in a way that overturns or materially changes the Department of Labor's position in Advisory Opinion 2001-09A, such as the imposition of additional requirements relating to conflicts of interest on the plan providers to which we act as a subadvisor. Future legislation or regulation could impose additional requirements relating to conflicts of interest on some of the plan providers to which we act as a subadvisor. These plan providers may not be able to comply with these requirements, and we may therefore not be able to continue to provide our services on a subadvised basis. In such event, we could incur additional costs to transition our services for affected plan providers and their plan sponsors to another structure. Legislation has been introduced in Congress and there have been several Congressional hearings addressing these issues, although final versions of these bills have not been adopted and signed into law, and the final scope and wording of the legislation, or the implementing rules and regulations, are not yet known.

### ***If government regulation of the Internet or other areas of our business changes or if consumer attitudes toward use of the Internet change, we may need to change the manner in which we conduct our business or incur greater operating expenses.***

The adoption, modification or interpretation of laws or regulations relating to the Internet or other areas of our business could adversely affect the manner in which we conduct our business or the overall popularity or growth in

use of the Internet. Such laws and regulations may cover sales and other procedures, tariffs, user privacy, data protection, pricing, content, copyrights, distribution, electronic contracts, consumer protection, broadband residential Internet access and the characteristics and quality of services. It is not clear how existing laws governing issues such as property ownership, sales and other taxes, libel and personal privacy apply to the Internet. If we are required to comply with new regulations or legislation or new interpretations of existing regulations or legislation, this compliance could cause us to incur additional expenses, make it more difficult to renew subscriptions automatically, make it more difficult to attract new subscribers or otherwise alter our business model. Any of these outcomes could have a material adverse effect on our business, financial condition or results of operations.

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***Our business will suffer if we do not keep up with rapid technological change, evolving industry standards or changing requirements of plan sponsors and plan participants.***

We expect technological developments to continue at a rapid pace in our industry. Our success will depend, in part, on our ability to:

- continue to develop our technology expertise;
- recruit and retain skilled investment and technology professionals;
- enhance our current services;
- develop new services that meet changing plan sponsor and plan participant needs;
- advertise and market our services; and

influence and respond to emerging industry standards and other technological changes.

In addition, we must continue to meet changing plan provider and plan sponsor expectations and requirements, including addressing plan complexities and meeting plan provider and plan sponsor demands for specific features and delivery dates. We must accomplish all of these tasks in a timely and cost-effective manner, and our failure to do so could harm our business, including materially reducing our revenue and operating results. Further, a key aspect of our growth strategy is to expand our investment research capabilities and introduce new services. We expect that our research and development expense will continue to represent a meaningful percentage of our revenue in the future. A viable market for our new service offerings may not exist or develop, and our offerings may not be well received by potential plan sponsor customers or individual plan participants or investors.

**Risks Related to our Common Stock**

***Our share price may be volatile, and the value of an investment in our common stock may decline.***

An active, liquid and orderly market for our common stock may not be sustained, which could depress the trading price of our common stock. The price of our common stock has been, and is likely to continue to be, volatile, which means that it could decline substantially within a short period of time. For example, since shares of our common stock were sold in our initial public offering in March 2010 at a price of \$12.00 per share, our closing stock price has ranged from \$12.27 to \$18.96 for the period March 16, 2010 to September 30, 2010. The market price of shares of our common stock could be subject to wide fluctuations in response to many risk factors listed in this section, many of which are beyond our control, including:

- actual or anticipated fluctuations in our financial condition and operating results;
- changes in the economic performance or market valuations of other companies engaged in providing portfolio management services, investment advice and retirement help;
- loss of a significant amount of existing business;
- actual or anticipated changes in our growth rate relative to our competitors;
- actual or anticipated fluctuations in our competitors' operating results or changes in their growth rates;
- issuance of new or updated research or reports by securities analysts;
- our announcement of actual results for a fiscal period that are higher or lower than projected results or our announcement of revenue or earnings guidance that is higher or lower than expected;
- regulatory developments in our target markets affecting us, our plan sponsors or our competitors;

fluctuations in the valuation of companies perceived by investors to be comparable to us;

share price and volume fluctuations attributable to inconsistent trading volume levels of our shares;

sales or expected sales of additional common stock;

terrorist attacks or natural disasters or other such events impacting countries where we or our plan sponsors have operations; and

general economic and market conditions.



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Furthermore, the stock markets have experienced extreme price and volume fluctuations that have affected and continue to affect the market prices of equity securities of many companies. These fluctuations often have been unrelated or disproportionate to the operating performance of those companies. These broad market and industry fluctuations, as well as general economic, political and market conditions such as recessions, interest rate changes or international currency fluctuations, may cause the market price of shares of our common stock to decline. In the past, companies that have experienced volatility in the market price of their stock have been subject to securities class action litigation. We may be the target of this type of litigation in the future. Securities litigation against us could result in substantial costs and divert our management's attention from other business concerns, which could seriously harm our business.

***If securities or industry analysts do not publish research or reports about our business, or if they change their recommendations regarding our stock adversely, our stock price and trading volume could decline.***

The trading market for our common stock will be influenced by the research and reports that industry or securities analysts publish about us or our business. If one or more of the analysts who cover us downgrade our stock, our stock price would likely decline. If one or more of these analysts cease coverage of our company or fail to regularly publish reports on us, we could lose visibility in the financial markets, which in turn could cause our stock price or trading volume to decline.

***The future sale of shares of our common stock may negatively impact our stock price.***

If our stockholders sell substantial amounts of our common stock, the market price of our common stock could fall. A reduction in ownership by a large stockholder could cause the market price of our common stock to fall. In addition, the average daily trading volume in our stock is relatively low. The lack of trading activity in our stock may lead to greater fluctuations in our stock price. Low trading volume may also make it difficult for a stockholder to make transactions in a timely fashion.

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

### **Unregistered Sales of Equity Securities**

In the three months ended September 30, 2010, we issued 498,619 shares of unregistered common stock for an aggregate purchase price of \$3.2 million upon the exercise of previously granted options which was paid in cash. These transactions were effected under Rule 701 of the Securities Act of 1933, applicable to our 1998 Stock Option Plan. All recipients either received adequate information about us or had access, through employment or other relationships, to such information. There were no underwriters employed in connection with these transactions.

## **Item 5. Other Information**

## **Item 6. Exhibits**

### **Exhibit**

#### **Number Description**

- |         |  |
|---------|--|
| 31.1    | Certificate of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. Section 1350). |
| 31.2    | Certificate of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. Section 1350). |
| 32.1(1) | Certificate of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. Section 1350). |
| 32.2(1) | Certificate of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. Section 1350). |

- (1) The material contained in Exhibit 32.1 and Exhibit 32.2 is not deemed filed with the SEC and is not to be incorporated by reference into any filing of the Company under the Securities Act of 1933 or the Securities Exchange Act of 1934, whether made before or after the date hereof and irrespective of any general incorporation

language contained in such filing, except to the extent that the registrant specifically incorporates it by reference.

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**SIGNATURES**

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

Date: November 9, 2010

FINANCIAL ENGINES, INC.

/s/ Jeffrey N. Maggioncalda

Jeffrey N. Maggioncalda

President and Chief Executive Officer

(Duly authorized officer and principal executive officer)

/s/ Raymond J. Sims

Raymond J. Sims

Executive Vice President and Chief Financial Officer

(Duly authorized officer and principal financial officer)

/s/ Jeffrey C. Grace

Jeffrey C. Grace

Vice President and Corporate Controller

(Duly authorized officer and principal accounting officer)

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**Exhibit Index**

**Exhibit**

**Number    Description**

31.1        Certificate of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. Section 1350).

31.2        Certificate of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. Section 1350).

32.1<sup>(1)</sup>      Certificate of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. Section 1350).

32.2<sup>(1)</sup>      Certificate of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. Section 1350).

(1) The material contained in Exhibit 32.1 and Exhibit 32.2 is not deemed filed with the SEC and is not to be incorporated by reference into any filing of the Company under the Securities Act of 1933 or the Securities Exchange Act of 1934, whether made before or after the date hereof and irrespective of any general incorporation language contained in such filing, except to the extent that the registrant specifically incorporates it by reference.