

inContact, Inc.  
Form 10-Q  
August 05, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 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 June 30, 2016

Commission File No. 1-33762

inContact, Inc.

(Exact name of registrant as specified in its charter)

Delaware 87-0528557  
(State or other jurisdiction of (IRS Employer

incorporation or organization) Identification No.)  
75 West Towne Ridge Parkway, Tower 1, Sandy, UT 84070

(Address of principal executive offices and Zip Code)

(801) 320-3200

(Registrant's telephone number, including area code)

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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 definitions of "large accelerated filer," "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  
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:

| Class                            | Outstanding as of August 1, 2016 |
|----------------------------------|----------------------------------|
| Common Stock, \$0.0001 par value | 62,535,471 shares                |

# TABLE OF CONTENTS

## ITEM NUMBER AND CAPTION

### PART I – FINANCIAL INFORMATION

|                                                                                                                                                     | Page |
|-----------------------------------------------------------------------------------------------------------------------------------------------------|------|
| Item 1. Financial Statements                                                                                                                        |      |
| <u>Condensed Consolidated Balance Sheets as of June 30, 2016 and December 31, 2015 (unaudited)</u>                                                  | 3    |
| <u>Condensed Consolidated Statements of Operations and Comprehensive Loss for the Three and Six Months Ended June 30, 2016 and 2015 (unaudited)</u> | 4    |
| <u>Condensed Consolidated Statement of Stockholders' Equity for the Six Months Ended June 30, 2016 (unaudited)</u>                                  | 5    |
| <u>Condensed Consolidated Statements of Cash Flows for the Six Months Ended June 30, 2016 and 2015 (unaudited)</u>                                  | 6    |
| <u>Notes to Condensed Consolidated Financial Statements (unaudited)</u>                                                                             | 7    |

|                                                                                                      |    |
|------------------------------------------------------------------------------------------------------|----|
| Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 22 |
|------------------------------------------------------------------------------------------------------|----|

|                                                                           |    |
|---------------------------------------------------------------------------|----|
| Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u> | 32 |
|---------------------------------------------------------------------------|----|

|                                        |    |
|----------------------------------------|----|
| Item 4. <u>Controls and Procedures</u> | 32 |
|----------------------------------------|----|

### PART II – OTHER INFORMATION

|                                  |    |
|----------------------------------|----|
| Item 1. <u>Legal Proceedings</u> | 33 |
|----------------------------------|----|

|                              |    |
|------------------------------|----|
| Item 1A. <u>Risk Factors</u> | 33 |
|------------------------------|----|

|                                                                           |    |
|---------------------------------------------------------------------------|----|
| Item 2. <u>Unregistered Sale of Equity Securities and Use of Proceeds</u> | 35 |
|---------------------------------------------------------------------------|----|

|                         |    |
|-------------------------|----|
| Item 6. <u>Exhibits</u> | 36 |
|-------------------------|----|

|                   |    |
|-------------------|----|
| <u>Signatures</u> | 37 |
|-------------------|----|



## INCONTACT, INC.

## CONDENSED CONSOLIDATED BALANCE SHEETS—(Unaudited)

(in thousands, except per share data)

|                                                                                        | June 30,<br>2016 | December<br>31,<br>2015 |
|----------------------------------------------------------------------------------------|------------------|-------------------------|
| <b>ASSETS</b>                                                                          |                  |                         |
| Current assets:                                                                        |                  |                         |
| Cash and cash equivalents                                                              | \$37,864         | \$29,050                |
| Restricted cash                                                                        | -                | 81                      |
| Investments                                                                            | 54,812           | 75,109                  |
| Accounts and other receivables, net of allowance for uncollectible accounts of \$1,789 |                  |                         |
| and \$2,555, respectively                                                              | 37,384           | 37,185                  |
| Other current assets                                                                   | 8,365            | 9,243                   |
| Total current assets                                                                   | 138,425          | 150,668                 |
| Property and equipment, net                                                            | 52,542           | 42,569                  |
| Intangible assets, net                                                                 | 28,351           | 19,232                  |
| Goodwill                                                                               | 49,016           | 39,247                  |
| Other assets                                                                           | 3,184            | 2,421                   |
| Total assets                                                                           | \$271,518        | \$254,137               |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>                                            |                  |                         |
| Current liabilities:                                                                   |                  |                         |
| Trade accounts payable                                                                 | \$16,212         | \$11,607                |
| Accrued liabilities                                                                    | 15,757           | 12,828                  |
| Accrued commissions                                                                    | 4,581            | 4,615                   |
| Current portion of deferred revenue                                                    | 14,270           | 11,530                  |
| Total current liabilities                                                              | 50,820           | 40,580                  |
| Deferred revenue                                                                       | 6,824            | 6,082                   |
| Deferred rent and lease incentive obligation                                           | 6,381            | 3                       |
| Deferred tax liability, net                                                            | 348              | 230                     |
| Long-term debt                                                                         | 84,122           | 81,985                  |
| Total liabilities                                                                      | 148,495          | 128,880                 |
| Commitments and contingencies (see note 10)                                            |                  |                         |
| Stockholders' equity:                                                                  |                  |                         |
| Common stock, \$0.0001 par value; 100,000 shares authorized; 62,514 and 61,826         |                  |                         |
| shares issued and outstanding as of June 30, 2016 and December 31, 2015,               |                  |                         |
| respectively                                                                           | 6                | 6                       |
| Additional paid-in capital                                                             | 261,693          | 253,986                 |
| Accumulated deficit                                                                    | (138,687)        | (128,654)               |

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|                                               |           |           |
|-----------------------------------------------|-----------|-----------|
| Accumulated other comprehensive income (loss) | 11        | (81 )     |
| Total stockholders' equity                    | 123,023   | 125,257   |
| Total liabilities and stockholders' equity    | \$271,518 | \$254,137 |

See accompanying notes to Condensed Consolidated Financial Statements.

## INCONTACT, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS and COMPREHENSIVE LOSS

(Unaudited)

(in thousands, except per share data)

|                                             | Three Months<br>Ended June 30, |            | Six Months<br>Ended June 30, |             |
|---------------------------------------------|--------------------------------|------------|------------------------------|-------------|
|                                             | 2016                           | 2015       | 2016                         | 2015        |
| Net revenue:                                |                                |            |                              |             |
| Software                                    | \$42,360                       | \$34,052   | \$83,908                     | \$66,518    |
| Network connectivity                        | 21,438                         | 19,019     | 42,277                       | 37,891      |
| Total net revenue                           | 63,798                         | 53,071     | 126,185                      | 104,409     |
| Costs of revenue:                           |                                |            |                              |             |
| Software                                    | 17,274                         | 14,360     | 33,939                       | 28,057      |
| Network connectivity                        | 13,486                         | 11,983     | 26,922                       | 23,794      |
| Total costs of revenue                      | 30,760                         | 26,343     | 60,861                       | 51,851      |
| Gross profit                                | 33,038                         | 26,728     | 65,324                       | 52,558      |
| Operating expenses:                         |                                |            |                              |             |
| Selling and marketing                       | 18,117                         | 16,264     | 36,327                       | 31,739      |
| Research and development                    | 9,220                          | 7,040      | 17,829                       | 13,693      |
| General and administrative                  | 11,274                         | 8,871      | 19,949                       | 17,949      |
| Total operating expenses                    | 38,611                         | 32,175     | 74,105                       | 63,381      |
| Loss from operations                        | (5,573 )                       | (5,447 )   | (8,781 )                     | (10,823 )   |
| Other income (expense):                     |                                |            |                              |             |
| Interest expense                            | (1,819 )                       | (1,768 )   | (3,582 )                     | (2,202 )    |
| Interest income                             | 172                            | 58         | 326                          | 58          |
| Other expense                               | (5 )                           | (1 )       | (6 )                         | -           |
| Total other expense                         | (1,652 )                       | (1,711 )   | (3,262 )                     | (2,144 )    |
| Loss before income taxes                    | (7,225 )                       | (7,158 )   | (12,043 )                    | (12,967 )   |
| Income tax benefit (expense)                | (194 )                         | (132 )     | 2,396                        | (311 )      |
| Net loss                                    | \$(7,419 )                     | \$(7,290 ) | \$(9,647 )                   | \$(13,278 ) |
| Other comprehensive loss, net of taxes:     |                                |            |                              |             |
| Net change in unrealized gain (loss) in     |                                |            |                              |             |
| available for sale investments              | (60 )                          | (20 )      | 11                           | (20 )       |
| Comprehensive loss                          | \$(7,479 )                     | \$(7,310 ) | \$(9,636 )                   | \$(13,298 ) |
| Net loss per common share:                  |                                |            |                              |             |
| Basic and diluted                           | \$(0.12 )                      | \$(0.12 )  | \$(0.15 )                    | \$(0.22 )   |
| Weighted average common shares outstanding: |                                |            |                              |             |
| Basic and diluted                           | 62,649                         | 61,501     | 62,456                       | 61,263      |

See accompanying notes to Condensed Consolidated Financial Statements.



## INCONTACT, INC.

## CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY—(Unaudited)

(in thousands)

|                                                                              | Common Stock |        | Additional      | Treasury Stock |        | Accumulated   | Accumulated   | Other  |            |
|------------------------------------------------------------------------------|--------------|--------|-----------------|----------------|--------|---------------|---------------|--------|------------|
|                                                                              | Shares       | Amount | Paid-in Capital | Shares         | Amount | Deficit       | Comprehensive | Income | Total      |
|                                                                              |              |        |                 |                |        |               | (Loss)        |        |            |
| Balance at December 31, 2015                                                 | 61,826       | \$ 6   | \$ 253,986      | -              | \$ -   | \$ (128,654 ) | \$ (81 )      |        | \$ 125,257 |
| Common stock received for settlement of taxes and forfeited restricted stock | -            | -      | -               | (119)          | (986 ) | -             | -             |        | (986 )     |
| Common stock issued for options exercised                                    | 346          | -      | 2,165           | 86             | 742    | (308 )        | -             |        | 2,599      |
| Common stock issued under the employee stock purchase plan                   | 97           | -      | 753             | 10             | 129    | (56 )         | -             |        | 826        |
| Issuance of common stock for acquisition of a business                       | 64           | -      | 344             | -              | -      | -             | -             |        | 344        |
| Stock-based compensation                                                     | -            | -      | 4,538           | -              | -      | -             | -             |        | 4,538      |
| Vesting of restricted stock units                                            | 181          | -      | (93 )           | 23             | 115    | (22 )         | -             |        | -          |
| Other comprehensive income                                                   | -            | -      | -               | -              | -      | -             | 92            |        | 92         |
| Net loss                                                                     | -            | -      | -               | -              | -      | (9,647 )      | -             |        | (9,647 )   |
| Balance at June 30, 2016                                                     | 62,514       | \$ 6   | \$ 261,693      | -              | \$ -   | \$ (138,687 ) | \$ 11         |        | \$ 123,023 |

See accompanying notes to Condensed Consolidated Financial Statements.



## INCONTACT, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

(in thousands)

|                                                                            | Six Months Ended June 30, |              |
|----------------------------------------------------------------------------|---------------------------|--------------|
|                                                                            | 2016                      | 2015         |
| Cash flows from operating activities:                                      |                           |              |
| Net loss                                                                   | \$ (9,647 )               | \$ (13,278 ) |
| Adjustments to reconcile net loss to net cash from operating activities:   |                           |              |
| Depreciation of property and equipment                                     | 6,472                     | 4,877        |
| Amortization of software development costs                                 | 4,042                     | 3,192        |
| Amortization of intangible assets                                          | 2,506                     | 2,599        |
| Amortization of deferred debt issuance costs                               | 193                       | 296          |
| Stock-based compensation                                                   | 4,538                     | 4,210        |
| Loss on disposal of property and equipment                                 | 1,296                     | 72           |
| Interest accretion                                                         | 1,944                     | 921          |
| Amortization of investment premium                                         | 476                       | -            |
| Deferred income taxes                                                      | (2,548 )                  | -            |
| Changes in operating assets and liabilities, net of business acquisitions: |                           |              |
| Accounts and other receivables, net                                        | (100 )                    | (2,311 )     |
| Other current assets                                                       | 943                       | (1,400 )     |
| Other non-current assets                                                   | (763 )                    | 192          |
| Trade accounts payable                                                     | 4,029                     | 1,144        |
| Accrued liabilities                                                        | 2,877                     | 1,253        |
| Accrued commissions                                                        | (34 )                     | 441          |
| Deferred rent and lease incentive obligation                               | 6,382                     | (185 )       |
| Deferred revenue                                                           | 3,226                     | 3,166        |
| Net cash provided by operating activities                                  | 25,832                    | 5,189        |
| Cash flows from investing activities:                                      |                           |              |
| Decrease in restricted cash                                                | 81                        | -            |
| Sales and maturities of available for sale investments                     | 50,781                    | 986          |
| Purchases of available for sale investments                                | (30,868 )                 | (64,122 )    |
| Capitalized software development costs                                     | (7,159 )                  | (4,418 )     |
| Purchases of property and equipment                                        | (13,846 )                 | (8,196 )     |
| Business acquisitions, net of cash acquired                                | (18,446 )                 |              |
| Payments made on deposits                                                  | -                         | (19 )        |
| Net cash used in investing activities                                      | (19,457 )                 | (75,769 )    |
| Cash flows from financing activities:                                      |                           |              |
| Proceeds from exercise of options                                          | 2,599                     | 2,294        |
| Proceeds from sale of stock under employee stock purchase plan             | 826                       | 806          |
| Principal payments under debt and capital lease obligations                | -                         | (11,824 )    |
| Purchase of treasury stock                                                 | (986 )                    | (538 )       |
| Payments under revolving credit agreement                                  | -                         | (11,000 )    |
| Proceeds from issuance of convertible notes, net                           | -                         | 111,190      |
| Net cash provided by financing activities                                  | 2,439                     | 90,928       |

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|                                                          |           |           |
|----------------------------------------------------------|-----------|-----------|
| Net increase in cash and cash equivalents                | 8,814     | 20,348    |
| Cash and cash equivalents at the beginning of the period | 29,050    | 32,414    |
| Cash and cash equivalents at the end of the period       | \$ 37,864 | \$ 52,762 |

Supplemental schedule of non-cash investing and financing activities:

|                                                                            |        |          |
|----------------------------------------------------------------------------|--------|----------|
| Payments due for property and equipment included in trade accounts payable | \$ 842 | \$ 149   |
| Unrealized gains (losses) on available for sale investments, net           | \$ 92  | \$ (20 ) |
| Investments payable in accrued liabilities                                 | \$ -   | \$ 1,536 |
| Issuance of common stock for acquisition of a business                     | \$ 344 | \$ -     |

See accompanying notes to Condensed Consolidated Financial Statements.

INCONTACT, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

NOTE 1. ORGANIZATION AND BASIS OF PRESENTATION

Organization

inContact, Inc. (“inContact,” “we,” “us,” “our,” or the “Company”) is incorporated in the state of Delaware. We provide cloud contact center software solutions through our inContact® Customer Interaction Cloud, an advanced contact handling and performance management software application. Our services also provide a variety of connectivity options for carrying inbound calls and linking agents to our inContact applications. We provide customers the ability to monitor agent effectiveness through our user survey tools and the ability to efficiently monitor their agent needs. We are also an aggregator and provider of network connectivity services. We contract with a number of third party providers for the right to resell the various telecommunication services and products they provide, and then offer all of these services to the customers. These services and products allow customers to buy only the network connectivity services they need, combine those services in a customized enhanced contact center package, receive one bill for those services, and call a single point of contact if a service problem or billing issue arises.

Proposed Merger by NICE-Systems Ltd.

On May 17, 2016, we entered into an Agreement and Plan of Merger (the “Merger Agreement”) with NICE-Systems Ltd., a company organized under the laws of the State of Israel (“Parent” or “NICE”), and Victory Merger Sub Inc. (“Merger Sub”), a wholly owned indirect subsidiary of NICE, providing for the merger of Merger Sub with and into the Company (the “Merger”), with the Company surviving the Merger as a wholly owned indirect subsidiary of NICE.

In the Merger, each issued and outstanding share of our common stock will be cancelled and extinguished and automatically converted into the right to receive cash in an amount equal to \$14.00, without interest thereon. Each outstanding and vested restricted stock unit or option to purchase Company’s common stock will be cancelled and extinguished and automatically converted into the right to receive an amount in cash equal to \$14.00 per share less, in the case of options, the exercise price per share underlying such option. Each outstanding and unvested restricted stock unit, share or restricted stock and option to purchase Company stock or other right to purchase or receive Company stock will be converted into an option to purchase or right to purchase or receive American Depositary Shares of Parent, with the same vesting schedule of such equity award continuing after the Merger, subject to existing vesting conditions and the exercise price of options adjusted in accordance with applicable tax law.

The transaction is subject to approval by the Company’s stockholders, certain regulatory approvals and other customary closing conditions. The Merger Agreement contains certain termination rights for each of the Parent, Merger Sub and the Company and provides certain circumstances as described in the Merger Agreement under which we may be required to pay NICE a termination fee of \$34.1 million.

See Note 8, “Long-Term Debt and Capital Lease Obligations” for discussion of the treatment of the Company’s 2.5% Convertible Senior Notes due 2022 in connection with the pending acquisition of inContact by NICE.

The transaction is expected to close in the second half of 2016. The pending acquisition of inContact by NICE does not impact the basis of presentation in the accompanying financial statements. Following completion of the Merger, the Company will become a wholly-owned subsidiary of NICE, the Company's common stock will be delisted from The NASDAQ Stock Market and deregistered under the Securities Exchange Act of 1934, as amended, and as such, the Company will no longer file periodic reports with the SEC.

In connection with the proposed Merger, we have incurred certain costs related to professional services, regulatory fees and employee-related expenses.

#### Basis of Presentation

These unaudited Condensed Consolidated Financial Statements of inContact and its subsidiaries have been prepared in accordance with accounting principles generally accepted in the United States ("GAAP") and the rules and regulations of the United States Securities and Exchange Commission ("SEC"). Such rules and regulations allow the omission of certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP, so long as the statements are not misleading. In the opinion of management, these financial statements and accompanying notes contain all adjustments (consisting of normal recurring adjustments) necessary to present fairly the financial position and results of operations for the periods presented herein. These Condensed Consolidated Financial Statements should be read in conjunction with the consolidated audited financial statements and notes thereto contained in the Annual Report on Form 10-K for the year ended December 31, 2015, filed with the SEC on March 4, 2016. The results of operations for the three and six months ended June 30, 2016 are not necessarily indicative of the

results to be expected for the year ending December 31, 2016. Our significant accounting policies are set forth in Note 1 to the Consolidated Financial Statements in the 2015 Annual Report on Form 10-K and changes, if any, are included below.

## Revenue Recognition

Revenue is recognized when all of the following four criteria are met: (1) persuasive evidence of an arrangement exists, (2) the fee is fixed or determinable, (3) collection is reasonably assured, and (4) delivery has occurred or services have been rendered. Determining whether and when some of these criteria have been satisfied often involves assumptions and judgments that can have a significant impact on the timing and amount of revenue we report.

Our revenue is reported and recognized based on the type of services provided to the customer as follows:

Software Revenue. Software revenue includes two main sources of revenue:

(1) Software delivery and support of our inContact cloud software solutions that are provided on a monthly subscription basis and associated professional services. Because our customers purchasing software and support services on a monthly recurring basis do not have the right to take possession of the software, we consider these arrangements to be service contracts and are not within the scope of Industry Topic 985, Software. We generally bill monthly recurring subscription charges in arrears and recognize these charges in the period in which they are earned. In addition to the monthly recurring revenue, revenue is also received on a non-recurring basis for professional services or on a recurring basis related to improving a customer's contact center efficiency and effectiveness as it relates to utilization of the inContact cloud software solutions.

For subscription service contracts with multiple elements (hosted software, training, installation and long distance services), we follow the guidance provided in Accounting Standards Codification ("ASC") 605-25, Revenue Recognition for Multiple Element Arrangements. In addition to the monthly recurring subscription revenue, we also derive revenue on a non-recurring basis for professional services included in implementing or improving a customer's inContact cloud software solutions experience. Because our professional services, such as training and implementation, are not considered to have standalone value, we defer revenue for upfront fees received for professional services in multiple element arrangements and recognize such fees as revenue over the estimated life of the customer. Fees for network connectivity services in multiple element arrangements within the inContact cloud software solutions are based on usage and recognize as revenue in the same manner as fees for telecommunication services discussed in the "Network Connectivity Services Revenue" below.

(2) Perpetual product and services revenues are primarily derived from the sale of licenses to our Workforce Optimization on-premise software products and services. For software license arrangements that do not require significant modification or customization of the underlying software, revenue is recognized when all revenue recognition criteria are met.

Many of our customers purchase a combination of software, service, hardware, post contract customer support ("PCS") and hosting. For software and software related multiple element arrangements that fall within the scope of the software revenue guidance in Topic 985, Software, we allocate revenue to the delivered elements of the arrangement using the residual method, whereby revenue is allocated to the undelivered elements based on vendor-specific objective evidence of fair value ("VSOE") of the undelivered elements with the remaining arrangement fee allocated to

the delivered elements and is recognized as revenue assuming all other revenue recognition criteria are met. If we are unable to establish VSOE for the undelivered elements of the arrangement, including PCS, revenue recognition is deferred for the entire arrangement until all elements of the arrangement are delivered. PCS provided to our customers includes technical software support services and unspecified software upgrades to customers on a when-and-if available basis. PCS revenue is recognized ratably over the term of the maintenance period, which is typically 15 months. When PCS is included within a multiple element arrangement, we utilize the bell-shaped curve approach to establish VSOE for the PCS. Under the bell-shaped curve approach of establishing VSOE, we perform a VSOE compliance test on a quarterly basis to ensure that a substantial majority of our actual PCS renewals are within a sufficiently narrow range.

Product revenue from customers who purchase our products for resale is generally recognized when such products are released (on a “sell-through” basis). Periodically we review our reseller arrangements as our business and products change.

Network Connectivity Service Revenue. Network Connectivity Services revenue is derived from network connectivity, such as dedicated transport, switched long distance and data services. These services are provided over our network or through third party network connectivity providers. Our network is the backbone of our subscription software and allows us to provide the all-in-one inContact cloud software solutions. Revenue for network connectivity usage is derived based on customer specific rate plans and the customer’s call usage and is recognized in the period the call is initiated. Customers are also billed monthly charges in arrears and revenue is recognized for such charges over the billing period. If the billing period spans more than one month, earned but unbilled revenues are recognized as revenue for incurred usage to date.



## Long-term Debt

We record debt issuance costs as a direct deduction from the carrying amount of our long-term borrowings, as well as costs incurred for subsequent modification of debt, incurred in connection with our long-term borrowings and credit facilities. We amortize these costs as an adjustment to interest expense over the remaining contractual life of the associated long-term borrowing or credit facility using the effective interest method for term loans and convertible debt borrowings, and the straight-line method for revolving credit facilities. When unscheduled principal payments are made, we adjust the amortization of our deferred debt-related costs to reflect the expected remaining terms of the borrowing.

## Operating Leases

Rent expense and lease incentives, including landlord construction allowances, are recognized on a straight-line basis over the lease term, commencing generally on the date the Company takes possession of the leased property. The unamortized portion of deferred rent is included in deferred rent and lease incentive obligation.

## Recently Issued Accounting Standards

In May 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2014-09, “Revenue from Contracts with Customers.” The guidance in the ASU supersedes existing revenue recognition guidance and the core principle behind ASU 2014-09 is that an entity should recognize revenue to depict the transfer of promised goods and services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for delivering those goods and services. This model involves a five-step process that includes identifying the contract with the customer, identifying the performance obligations in the contract, determining the transaction price, allocating the transaction prices to the performance obligations in the contract and recognizing revenue when (or as) the entity satisfies the performance obligations. In July 2015, the FASB ratified a one-year delay in the effective date of ASU 2014-09, which makes the effective date for the Company the first quarter of 2018. The ASU allows two methods of adoption; a full retrospective approach where three years of financial information are presented in accordance with the new standard, and a modified retrospective approach where the ASU is applied to the most current period presented in the financial statements with a cumulative effect recognized as of the date of initial application. This update could impact the timing and amounts of revenue recognized. In May 2016, the FASB issued ASU No. 2016-12, Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients. The amendment provides clarifying guidance in certain narrow areas and adds some practical expedients. We are currently evaluating which transition approach to use and assessing the impact of adopting the new revenue standard on our consolidated financial statements and related disclosures.

In March 2016, the FASB issued ASU No. 2016-08, “Principal versus Agent Considerations (Reporting Revenue Gross versus Net)” that amends the principal versus agent guidance in ASU 2014-09. The guidance in this ASU clarifies that the analysis must focus on whether the entity has control of the goods or services before they are transferred to the customer. Additional guidance is also provided about how to apply the control principle when services are provided and when goods or services are combined with other goods or services. The effective date for the Company is the first quarter of fiscal 2018. We are currently evaluating the transition method that will be used and assessing the impact the updated standard will have on our consolidated financial statements and related disclosures.

In April 2016, the FASB issued ASU No. 2016-10, “Identifying Performance Obligations and Licensing” that amends the revenue guidance in ASU 2014-09 on identifying performance obligations and accounting for licenses of intellectual property. The update allows an entity to exclude immaterial promised good and services from the assessment of performance obligations and also permits certain treatment of shipping and handling costs related to providing goods and services to a customer. Additionally, this ASU provides guidance on determining if promised goods or services are separately identifiable or whether the promise is to transfer a combined item to which promised goods and/or services are inputs. This ASU includes implementation guidance on determining whether an entity’s promise to grant a license provides a customer with either a right to use the entity’s intellectual property (which is satisfied at a point in time) or a right to access the entity’s intellectual property (which is satisfied over time). The effective date of the standard for the Company will coincide with ASU 2014-09 during the first quarter 2018. The Company is currently evaluating the effect that the updated standard will have on its consolidated financial statements and related disclosures.

In January 2016, the FASB issued ASU 2016-01, “Recognition and Measurement of Financial Assets and Liabilities.” This pronouncement will change the income statement impact of equity investments held by an entity, financial liabilities under the fair value option and the presentation and disclosure requirements for financial instruments. This ASU is effective in fiscal years beginning after December 15, 2017 and early adoption of some provisions are permitted. The Company is currently assessing the impact of this new standard on our consolidated financial statements and related disclosures.

In February 2016, the FASB issued ASU 2016-02, "Leases (Topic 842)," which requires recognition on the balance sheet of assets and liabilities related to the rights and obligations created by leases with a term of more than 12 months. Consistent with current GAAP, the recognition, measurement and presentation of expenses and cash flows arising from a lease will depend on its classification as a finance or operating lease. However, the new guidance differs from current GAAP in that it requires both types of leases to be recognized on the balance sheet. Related disclosures will include both qualitative and quantitative requirements to help investors better understand the amounts recorded in the financial statements. This ASU is effective in fiscal years beginning after December 15, 2018 and early adoption is permitted. The Company is currently assessing the impact of this new standard on our consolidated financial statements.

In March 2016, the FASB issued ASU No. 2016-09, "Improvements to Employee Share-Based Payment Accounting." The objective of this update is to simplify several aspects of accounting for employee share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. This update is effective in fiscal years beginning after December 15, 2016 and early adoption is permitted. The Company is currently evaluating the effect that the updated standard will have on its consolidated financial statements and related disclosures.

In June 2016, the FASB issued ASU No. 2016-13: Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. This update adds to U.S. GAAP a current expected credit loss impairment model that is based on expected losses rather than incurred losses, requiring consideration of a broader range of reasonable and supportable information to inform credit loss estimates. Under the new guidance, an entity recognizes as an allowance its estimate of expected credit losses, which the FASB believes will result in more timely recognition of such losses. This update is also intended to reduce the complexity of U.S. GAAP by decreasing the number of credit impairment models that entities use to account for debt instruments. This ASU is effective in fiscal years beginning after December 15, 2019 and early adoption is permitted after December 15, 2018. The Company is currently evaluating the impact of this update on the consolidated financial statements.

We reviewed all other recently issued accounting standards in order to determine their effects, if any, on the consolidated financial statements. Based on that review, we believe that none of these standards will have a significant effect on current or future results of operations.

## NOTE 2. BASIC AND DILUTED NET LOSS PER COMMON SHARE

Basic earnings per common share is computed by dividing the net loss applicable to common shareholders by the weighted-average number of common shares outstanding during the period. Diluted earnings per common share is computed by dividing the net loss by the sum of the weighted-average number of common shares outstanding plus the weighted average common stock equivalents, which would have been outstanding if the potentially dilutive securities had been issued. Potentially dilutive securities include outstanding options, unvested restricted stock awards, and potential shares from Convertible Notes. The dilutive effect of potentially dilutive securities is reflected in diluted earnings per common share by application of the treasury method.

As a result of incurring a net loss for the three and six months ended June 30, 2016 and 2015, no potentially dilutive securities are included in the calculation of diluted earnings per share because such effect would be anti-dilutive. The following table summarizes potentially dilutive securities, using the above security classifications (in thousands):

|                                         | June 30, |        |
|-----------------------------------------|----------|--------|
|                                         | 2016     | 2015   |
| Stock options                           | 2,527    | 2,781  |
| Restricted stock awards                 | 1,812    | 1,314  |
| Potential shares from Convertible Notes | 8,082    | 8,082  |
| Total potentially dilutive shares       | 12,421   | 12,177 |

## NOTE 3. FAIR VALUE OF FINANCIAL INSTRUMENTS

The accounting guidance for fair value measurements defines fair value, establishes a market-based framework or hierarchy for measuring fair value and expands disclosures about fair value measurements. The guidance is applicable whenever assets and liabilities are measured and included in the Condensed Consolidated Financial Statements at fair value. The fair value of a financial instrument is the amount that could be received upon the sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Financial assets are marked to bid prices and financial liabilities are marked to offer prices. Fair value measurements do not include transaction costs. The fair value hierarchy prioritizes the quality and reliability of the information used to determine fair values. Categorization within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement. The fair value hierarchy is defined into the following three categories:

Level 1: Quoted market prices in active markets for identical assets or liabilities.

Level 2: Inputs that reflect quoted prices for identical assets or liabilities in less active markets; quoted prices for similar assets or liabilities in active markets; benchmark yields, reported trades, broker/dealer quotes, 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.

Level 3: Unobservable inputs that reflect our own assumptions incorporated in valuation techniques used to measure fair value. These assumptions are required to be consistent with market participant assumptions that are reasonably available.

## Assets Measured at Fair Value on a Recurring Basis:

The following table summarizes our investments measured at fair value on a recurring basis using the above input categories. As of June 30, 2016 and December 31, 2015, we did not hold any Level 3 assets, and our Level 1 and Level 2 holdings were as follows (in thousands):

|                                     | June 30, 2016 |          |          | December 31, 2015 |          |          |
|-------------------------------------|---------------|----------|----------|-------------------|----------|----------|
|                                     | Level 1       | Level 2  | Total    | Level 1           | Level 2  | Total    |
| <b>Cash equivalents:</b>            |               |          |          |                   |          |          |
| Money market funds                  | \$20,748      | \$-      | \$20,748 | \$4,071           | \$-      | \$4,071  |
| Commercial paper                    | -             | -        | -        | -                 | 999      | 999      |
| Total cash equivalents              | 20,748        | -        | 20,748   | 4,071             | 999      | 5,070    |
| <b>Investments:</b>                 |               |          |          |                   |          |          |
| Commercial paper                    | -             | 17,808   | 17,808   | -                 | 27,846   | 27,846   |
| Corporate debt securities           | -             | 34,495   | 34,495   | -                 | 45,830   | 45,830   |
| Municipal bonds                     | -             | 2,509    | 2,509    | -                 | 1,433    | 1,433    |
| Total investments                   | -             | 54,812   | 54,812   | -                 | 75,109   | 75,109   |
| Total assets measured at fair value | \$20,748      | \$54,812 | \$75,560 | \$4,071           | \$76,108 | \$80,179 |

## Fair Value Measurements

Money Market Funds – We value our money market funds using quoted active market prices for such funds.

Commercial paper, Corporate debt securities, and Municipal bonds – The fair value of these securities are estimated using observable market prices for identical securities that may be traded in less-active markets, if available. When observable market prices for identical securities are not available, we value these securities using non-binding market price quotes from brokers which we review for reasonableness using observable market data; quoted prices for similar instruments; or pricing models, such as a discounted cash flows.

#### Other Financial Instruments

The carrying amounts of cash and cash equivalents (other than investments recorded on a fair value basis disclosed above), accounts and other receivables, and trade accounts payable approximate fair value because of the immediate or short-term maturities of these financial instruments.

The fair value of the Convertible Notes is considered to be a Level 2 measurement because it is based on a recent bid price quote for the Convertible Notes, reflecting activity in a less than active market. The carrying value and estimated fair value of our Convertible Notes are as follows (in thousands):

|                   | June 30, 2016  |                      | December 31, 2015 |                      |
|-------------------|----------------|----------------------|-------------------|----------------------|
|                   | Carrying Value | Estimated Fair Value | Carrying Value    | Estimated Fair Value |
| Convertible notes | \$84,122       | \$137,954            | \$81,985          | \$108,330            |

#### NOTE 4. INVESTMENTS – AVAILABLE FOR SALE

Our investments generally consist of money market funds, commercial paper, corporate debt securities and municipal bonds. All of our investments have original maturities (maturity at the purchase date) of less than 12 months. Investments with original maturities of three months or less are classified as cash equivalents.

We classify our investments as available for sale at the time of purchase and we reevaluate such classification as of each balance sheet date. These short-term investments are carried at fair value with unrealized gains or losses classified as a component of accumulated other comprehensive income (loss). Amortization of premiums and accretion of discounts to maturity are computed under the effective interest method and is included in interest income. Interest on securities is included in interest income when earned. Realized gains and losses on the sale of investments are determined using the specific identification method and recorded in "Other income (expense)" in the Condensed Consolidated Statements of Operations and Comprehensive Loss.

Our investments as of June 30, 2016 and December 31, 2015 were as follows (in thousands):

|                           | June 30, 2016  |                               | Fair Value/Net Carrying Value | Cash and Cash Equivalents | Investments |
|---------------------------|----------------|-------------------------------|-------------------------------|---------------------------|-------------|
|                           | Amortized Cost | Net Unrealized Gains (Losses) |                               |                           |             |
| Commercial paper          | \$17,808       | \$ -                          | \$ 17,808                     | \$ -                      | \$ 17,808   |
| Corporate debt securities | 34,484         | 11                            | 34,495                        | -                         | 34,495      |
| Money market funds        | 20,748         | -                             | 20,748                        | 20,748                    | -           |
| Municipal bonds           | 2,509          | -                             | 2,509                         | -                         | 2,509       |
| Total                     | \$75,549       | \$ 11                         | \$ 75,560                     | \$ 20,748                 | \$ 54,812   |

|  | December 31, 2015 |                      | Fair Value/Net Carrying Value | Cash and Cash Equivalents | Investments |
|--|-------------------|----------------------|-------------------------------|---------------------------|-------------|
|  | Amortized Cost    | Net Unrealized Gains |                               |                           |             |

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|                           |          | (Losses) | Value     |          |           |
|---------------------------|----------|----------|-----------|----------|-----------|
| Commercial paper          | \$28,845 | \$ -     | \$ 28,845 | \$ 999   | \$ 27,846 |
| Corporate debt securities | 45,911   | (81 )    | 45,830    | -        | 45,830    |
| Money market funds        | 4,071    | -        | 4,071     | 4,071    | -         |
| Municipal bonds           | 1,433    | -        | 1,433     | -        | 1,433     |
| Total                     | \$80,260 | \$ (81 ) | \$ 80,179 | \$ 5,070 | \$ 75,109 |

As of June 30, 2016 all our investments had contractual maturities of less than one year.

At June 30, 2016 and December 31, 2015, we had \$4,000 and \$81,000 of gross unrealized losses on certain investments, respectively. We regularly review our investment portfolio to identify and evaluate investments that have indications of possible impairment that is other-than-temporary. Factors considered in determining whether a loss is temporary include:

- the length of time and extent to which fair value has been lower than the cost basis;
- the financial condition, credit quality and near-term prospects of the investee; and
- whether it is more likely than not that the Company will be required to sell the security prior to recovery.



We believe that there were no investments held at June 30, 2016 that were other-than-temporarily impaired. For the six months ended June 30, 2016, proceeds from maturities of investments were \$49.1 million for an immaterial realized gain, \$1.0 million of these maturities were securities included in cash equivalents. We sold \$2.7 million of investments for the six months ended June 30, 2016.

## NOTE 5. ACQUISITIONS

### AC2 Acquisition

On January 13, 2016, we acquired 100% of the outstanding shares of AC2 Solutions, Inc. (“AC2”), a Delaware corporation. AC2 provides Workforce Optimization products and services to call centers. inContact acquired AC2 for an aggregate purchase price of approximately \$12.3 million, which was paid with cash in the amount of \$12.0 million and 40,456 restricted shares of the Company’s common stock valued at \$344,000. An additional 505,700 restricted shares of our common stock were issued, but not included in the purchase considerations as the shares will vest as services are provided over a two year period. The acquisition of AC2 was accounted for under the purchase method of accounting in accordance with ASC 805, Business Combinations. Under the purchase method of accounting, the total purchase price is allocated to the preliminary tangible and identifiable intangible assets acquired and liabilities assumed based on their estimated fair values, as determined by management. The total purchase price was allocated using information currently available. The purchase price allocation for the AC2 acquisition will be finalized during calendar year 2016. As a result, we may continue to adjust the preliminary estimated purchase price allocation after obtaining more information regarding asset valuations, liabilities assumed, and revision of preliminary estimates. The following is the total preliminary purchase price allocation on estimated purchase consideration based on information available as of June 30, 2016 (in thousands):

|                                     | Amount          |
|-------------------------------------|-----------------|
| <b>Assets acquired:</b>             |                 |
| Cash and cash equivalents           | \$78            |
| Accounts receivable                 | 100             |
| Other current assets                | 63              |
| Intangible assets                   | 6,710           |
| Goodwill                            | 8,243           |
| <b>Total assets acquired</b>        | <b>15,194</b>   |
| <b>Liabilities assumed:</b>         |                 |
| Accrued liabilities                 | 136             |
| Current portion of deferred revenue | 74              |
| Deferred tax liability              | 2,666           |
| <b>Total liabilities assumed</b>    | <b>2,876</b>    |
| <b>Net assets acquired</b>          | <b>\$12,318</b> |

In connection with the acquisition, we incurred professional fees of \$188,000, including transaction costs such as legal and valuation services, which were expensed as incurred. These costs are included within general and administrative

expenses in the Condensed Consolidated Statements of Operations and Comprehensive Loss. The premium paid over the fair value of the net assets acquired in the purchase, or goodwill, represents future economic benefits expected to arise from deploying cutting edge technology to enhance our competitive differentiation. All of the goodwill was assigned to the Software segment. The entire amount allocated to goodwill is not expected to be deductible for tax purposes.

Intangible assets acquired from the acquisition include customer relationships, which are amortized on a double-declining basis, technologies, patents and a non-competition agreement, which are amortized on a straight-line basis and in-process research and development which has an initial indefinite life and is expected to be amortized once technical feasibility is established. The fair values of the intangible assets were determined primarily using the income approach and the discount rates range from 20% to 25%. The following sets forth the intangible assets purchased as part of the AC2 acquisition and their respective preliminary estimated economic useful life at the date of the acquisition (in thousands, except useful life):

|                                     | Amount   | Economic<br>Useful Life<br>(in years) |
|-------------------------------------|----------|---------------------------------------|
| Customer relationships              | \$ 710   | 8                                     |
| Technology                          | 321      | 5                                     |
| In-process research and development | 3,014    | Indefinite                            |
| Patents                             | 2,641    | 12                                    |
| Non-competition agreement           | 24       | 2                                     |
| Total intangible assets             | \$ 6,710 |                                       |

The Company recorded a deferred tax benefit of \$2.7 million at the time of the acquisition. The tax benefit related to recording a deferred tax liability upon acquisition of AC2 related to acquisition of intangibles for which no tax benefit will be derived. The reduction of carrying value resulted in a partial reversal of the deferred tax asset valuation allowance upon consolidation.

#### Attensity Acquisition

On February 8, 2016, we acquired certain intangible assets from Attensity Group, Inc., a Delaware corporation, Biz360, Inc., a California corporation, and Attensity Americas, Inc., a Delaware corporation (collectively “Attensity”). The purchase consideration was approximately \$6.6 million in cash. The patents purchased from Attensity provide advanced analytics technology to corporate customers. The acquisition of Attensity technology was accounted for under the purchase method of accounting in accordance with ASC 805, Business Combinations. Under the purchase method of accounting, the total purchase price is allocated to the tangible and identifiable intangible assets acquired and liabilities assumed based on their estimated fair values, as determined by management. The following is the total purchase price allocation as of June 30, 2016 (in thousands):

|                                                | Amount |
|------------------------------------------------|--------|
| <b>Assets acquired:</b>                        |        |
| Property, plant and equipment and other assets | 290    |
| Intangible assets                              | 4,917  |
| Goodwill                                       | 1,525  |
| Total assets acquired                          | 6,732  |
| <b>Liabilities assumed:</b>                    |        |
| Current portion of deferred revenue            | 157    |
| Long-term portion of deferred revenue          | 25     |

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|                           |          |
|---------------------------|----------|
| Total liabilities assumed | 182      |
| Net assets acquired       | \$ 6,550 |

In connection with the acquisition, we incurred professional fees of \$27,000, including transaction costs such as legal and valuation services, which were expensed as incurred. These costs are included within general and administrative expenses in the Condensed Consolidated Statements of Operations and Comprehensive Loss.

The premium paid over the fair value of the net assets acquired in the purchase, or goodwill, represents future economic benefits expected to arise from synergies from enhancing our product offerings through the addition of text analysis technology. All of the goodwill was assigned to the Software segment. The entire amount allocated to goodwill is not expected to be deductible for tax purposes.

Intangible assets acquired from the acquisition include customer relationships, which are amortized on a double-declining basis, technologies and patents, which are amortized on a straight-line basis and in-process research and development which has an initial indefinite life and is expected to be amortized once technical feasibility is established. The fair values of the intangible assets were

determined primarily using the income approach and the discount rates range from 25% - 30%. The following sets forth the intangible assets purchased as part of the Attensity acquisition and their respective preliminary estimated economic useful life at the date of the acquisition (in thousands, except useful life):

|                                     | Amount   | Economic Useful Life (in years) |
|-------------------------------------|----------|---------------------------------|
| Customer relationships              | 140      | 5                               |
| Technology                          | 141      | 5                               |
| In-process research and development | 3,193    | Indefinite                      |
| Patents                             | 1,443    | 8                               |
| Total intangible assets             | \$ 4,917 |                                 |

#### NOTE 6. INTANGIBLE ASSETS

Intangible assets consisted of the following (in thousands):

|                            | June 30, 2016 |                          |                        | December 31, 2015 |                          |                        |
|----------------------------|---------------|--------------------------|------------------------|-------------------|--------------------------|------------------------|
|                            | Gross Assets  | Accumulated Amortization | Intangible Assets, Net | Gross Assets      | Accumulated Amortization | Intangible Assets, Net |
| Customer lists acquired    | \$28,973      | \$ (21,954 )             | \$ 7,019               | \$28,123          | \$ (20,859 )             | \$ 7,264               |
| Technology and patents     | 35,112        | (15,396 )                | 19,716                 | 24,358            | (14,222 )                | 10,136                 |
| Trade names and trademarks | 3,214         | (1,598 )                 | 1,616                  | 3,190             | (1,358 )                 | 1,832                  |
| Total intangible assets    | \$67,299      | \$ (38,948 )             | \$ 28,351              | \$55,671          | \$ (36,439 )             | \$ 19,232              |

Amortization expense was \$2.5 million and \$2.6 million during the six months ended June 30, 2016 and 2015, respectively.

Based on the recorded intangibles at June 30, 2016, estimated amortization expense is expected to be \$2.3 million during the remainder of 2016, \$4.3 million in 2017, \$3.8 million in 2018, \$3.4 million in 2019, \$3.3 million in 2020 and \$5.0 million thereafter.

#### NOTE 7. ACCRUED LIABILITIES

Accrued liabilities consisted of the following (in thousands):

|                                        | June 30, | December |
|----------------------------------------|----------|----------|
|                                        | 2016     | 31, 2015 |
| Accrued payroll and other compensation | \$7,221  | \$4,726  |
| Accrued state sales taxes              | 3,511    | 3,939    |
| Accrued vendor charges                 | 1,874    | 1,281    |
| Accrued interest                       | 725      | 717      |
| Other                                  | 2,426    | 2,165    |
| Total accrued liabilities              | \$15,757 | \$12,828 |

## NOTE 8. LONG-TERM DEBT AND CAPITAL LEASE OBLIGATIONS

### Convertible Notes

On March 30, 2015, we issued \$115.0 million in aggregate principal amount of 2.50% Convertible Senior Notes (the “Convertible Notes”) due April 1, 2022, unless earlier converted by the holder pursuant to their terms. Net proceeds from the Convertible Notes were approximately \$111.2 million, net of transaction fees. The Convertible Notes pay interest in cash semiannually in arrears at a rate of 2.50% per annum.

The Convertible Notes are unsecured and will be senior in right of payment to any future debt that is expressly subordinated to the Convertible Notes. The Convertible Notes will be structurally subordinated to all debt and other liabilities and commitments of our

subsidiaries, including trade payables and any guarantees that they may provide with respect to any of our existing or future debt, and will be effectively subordinated to any secured debt that we may incur to the extent of the assets securing such indebtedness.

The Convertible Notes are convertible by the holders under certain circumstances. The conversion price of the Convertible Notes at any time is equal to \$1,000 divided by the then-applicable conversion rate. The Convertible Notes have a conversion rate of 70.2790 shares of common stock per \$1,000 principal amount of Convertible Notes, which represents an effective conversion price of approximately \$14.23 per share of common stock and would result in the issuance of approximately 8.1 million shares if all of the Convertible Notes were converted. The conversion rate has not changed since issuance of the Convertible Notes, although throughout the term of the Convertible Notes, the conversion rate may be adjusted upon the occurrence of certain events, including a merger. Upon conversion, the Company has the option of satisfying the conversion obligation with cash, shares of Company common stock, or a combination of cash and common shares.

Holders may tender their Convertible Notes for conversion at any time prior to the close of business on the business day immediately preceding October 1, 2021, only under the following circumstances:

- during any calendar quarter commencing after the calendar quarter which ended on March 31, 2015, if the closing sale price of our common stock, for at least 20 trading days (whether or not consecutive) in the period of 30 consecutive trading days ending on the last trading day of the immediately preceding calendar quarter, is more than 130% of the conversion price of the Convertible Notes in effect on each applicable trading day;
- during the ten consecutive business day period immediately after any five consecutive trading-day period in which the trading price for the Convertible Notes for each such trading day was less than 98% of the closing sale price of our common stock on such date multiplied by the then-current conversion rate;
- upon the occurrence of specified corporate events, as described in the indenture governing the Convertible Notes, such as a consolidation, merger, or binding share exchange (a “Fundamental Change” as defined in the indenture); or
- we have called the Convertible Notes for redemption.

On or after October 1, 2021, until the close of business on the second scheduled trading day immediately preceding the maturity date, holders may tender their Convertible Notes for conversion regardless of whether any of the foregoing conditions have been satisfied. As of June 30, 2016, the Convertible Notes were not convertible.

Under the terms of the Convertible Notes, the consummation of the proposed acquisition by NICE described in Note 1 will constitute a Fundamental Change, as defined in the indenture. As a result, holders of the Convertible Notes will be permitted to choose (i) to convert their Convertible Notes at a temporarily increased conversion rate, (ii) to require the Company to repurchase their Convertible Notes for a price equal to their principal amount plus accrued but unpaid interest up to but excluding the repurchase date, or (iii) to continue holding their Convertible Notes. If the Merger closes, the holders of the Convertible Notes would be expected to exercise the right to convert their Convertible Notes in accordance with their terms at a temporarily increased conversion rate shortly following the closing of the merger (although the holders’ actual decisions will depend upon their judgments based on the then prevailing market conditions) in which case the Convertible Notes will be converted into cash for the principal amount and the merger consideration with respect to the excess thereof.

In accordance with accounting guidance for convertible debt with a cash conversion option, we separately accounted for the debt and equity components of the Convertible Notes in a manner that reflected our estimated nonconvertible debt borrowing rate. We estimated the carrying amount of the debt component of the Convertible Notes to be \$81.6 million at the issuance date by measuring the fair value of a similar liability that does not have a convertible feature. The carrying amount of the equity component was determined to be approximately \$33.4 million by deducting the carrying amount of the debt component from the principal amount of the Convertible Notes, and was recorded as an increase to additional paid-in capital. The excess of the principal amount of the debt component over

its carrying amount (the “debt discount”) is being amortized as interest expense over the term of the Convertible Notes using the effective interest method. The equity component is not remeasured as long as it continues to meet the conditions for equity classification.

We allocated transaction costs related to the issuance of the Convertible Notes, including underwriting discounts of \$2.7 million and other transaction related fees of \$1.1 million to the debt and equity components, respectively. Issuance costs attributable to the debt component were recorded as a direct deduction to the related debt liability and are being amortized as interest expense over the term of the Convertible Notes, and issuance costs attributable to the equity component were netted with the equity component in additional paid-in capital. The carrying amount of the equity component, net of issuance costs, was \$32.3 million. Including the impact of the debt discount and related deferred debt issuance costs, the effective interest rate on the Convertible Notes is approximately 8.29%.



Based on the closing market price of our common stock on June 30, 2016, the if-converted value of the Convertible Notes was less than the aggregate principal amount of the Convertible Notes.

The Convertible Notes at June 30, 2016 consisted of the following (in thousands):

|                                                                                                                                | June 30,<br>2016 |
|--------------------------------------------------------------------------------------------------------------------------------|------------------|
| 2.50% Convertible Notes, bearing interest at 2.50% payable semi-annually with final principal payment to be made April 1, 2022 | \$ 115,000       |
| Unamortized debt issuance costs                                                                                                | (2,221 )         |
| Unamortized debt discounts                                                                                                     | (28,657 )        |
| Net carrying value of Convertible Notes                                                                                        | \$84,122         |

#### Revolving Credit Agreement

On July 16, 2009, we entered into a revolving credit loan agreement (“Revolving Credit Agreement”) with Zions First National Bank (“Zions”), which was subsequently amended in June 2013 and August 2014. As of July 1, 2016 the Revolving Credit Agreement expired by its terms and was not renewed.

Under the terms of the Revolving Credit Agreement, Zions agreed to loan up to \$15.0 million. The Revolving Credit Agreement was collateralized by substantially all the assets of inContact. The balance outstanding under the Revolving Credit Agreement could not exceed the lesser of (a) \$15.0 million or (b) the sum of 85% of eligible billed receivables, and 65% of eligible earned, but unbilled receivables as calculated on the 5th and 20th of each month. The interest rate on the Revolving Credit Agreement with Zions was 4.0% per annum above the ninety day LIBOR. We drew \$11.0 million on the Revolving Credit Agreement in December 2014, which was repaid in March 2015. Interest under the Revolving Credit Agreement was paid monthly in arrears. In August 2014, we amended certain terms of the Revolving Credit Agreement (“Amendment”). The Amendment extended the term from July 2015 to July 2016, added the Uptivity subsidiary as a guarantor of obligations arising under the loan agreement, pledged Uptivity’s assets to Zions as additional security, increased the financial covenant of minimum quarterly EBITDA from \$2.5 million to \$2.9 million, which was only applicable if net cash is less than \$2.5 million, increased the amount of additional debt from \$200,000 to \$600,000 for each of the calendar years ending December 31, 2014, 2015 and 2016 and \$200,000 for each calendar year thereafter, and increased the outstanding principal amount of our additional debt due at any time from \$500,000 to \$1.2 million for each of the calendar years ending December 31, 2014, 2015 and 2016 and \$500,000 for each calendar year thereafter. The Revolving Credit Agreement had certain financial covenants, with which we were in compliance as of June 30, 2016. There was no balance on the Revolving Credit Agreement at June 30, 2016 and December 31, 2015.

#### Term Loans

We entered into three term loan agreements (“Term Loans”) with Zions. We drew \$4.0 million, \$3.0 million, \$1.0 million and \$5.0 million from the Term Loans in April 2013, December 2013, June 2014 and December 2014, respectively. Interest on the Term Loans was due monthly in arrears and the principal was payable in 36 equal monthly installments. The interest rate on the Term Loans was between 4.0% and 4.5% per annum above the ninety day LIBOR rate, adjusted as of the date of any change in the ninety day LIBOR.

The financial covenants of the Term Loans were the same as the Revolving Credit Agreement, were collateralized by the same assets as the Revolving Credit Agreement and could be prepaid without penalty or premium. During the six months ended June 30, 2015, we paid \$10.4 million of total term loan principal to Zions. There was no balance on the term loans at June 30, 2016 and December 31, 2015.

#### Capital Leases

During the six months ended June 30, 2015, we paid \$1.4 million of capital lease obligations. There was no capital lease obligation as of June 30, 2016 and December 31, 2015.

## Interest Expense:

The following table presents the components of interest expense incurred on the Convertible Notes and on other borrowings (in thousands):

|                                              | Three Months<br>Ended June 30,<br>2016 |         | Six Months<br>Ended June 30,<br>2016 |         |
|----------------------------------------------|----------------------------------------|---------|--------------------------------------|---------|
|                                              | 2015                                   |         | 2015                                 |         |
| 2.50% Convertible Notes:                     |                                        |         |                                      |         |
| Interest expense at 2.50% coupon rate        | \$725                                  | \$725   | \$1,441                              | \$725   |
| Amortization of debt discount                | 996                                    | 921     | 1,944                                | 921     |
| Amortization of deferred debt issuance costs | 98                                     | 97      | 193                                  | 97      |
| Total interest from 2.50% convertible notes  | 1,819                                  | 1,743   | 3,578                                | 1,743   |
| Other Borrowings:                            |                                        |         |                                      |         |
| Interest from other borrowings               | -                                      | 25      | 4                                    | 459     |
| Total interest expense                       | \$1,819                                | \$1,768 | \$3,582                              | \$2,202 |

## NOTE 9. CAPITAL TRANSACTIONS

During the six months ended June 30, 2016, we received 119,000 shares of our common stock from cancelled restricted stock awards from separated employees and for the settlement of \$1.0 million in payroll taxes, associated with the lapsing of the selling restriction of restricted stock awards.

From the exercise of stock options, we issued 346,000 shares of common stock and 86,000 shares of treasury stock for proceeds of \$2.6 million during the six months ended June 30, 2016. We issued 181,000 shares of common stock and 23,000 shares of treasury stock as a result of the vesting of restricted stock awards. We issued 97,000 shares of common stock and 10,000 shares of treasury stock for proceeds of \$0.8 million under the employee stock purchase plan during the six months ended June 30, 2016.

## NOTE 10. COMMITMENTS AND CONTINGENCIES

## Litigation

In May 2009, inContact was served in a lawsuit titled California College, Inc., et al., v. UCN, Inc., et al. In the lawsuit, California College alleges that (1) inContact made fraudulent and/or negligent misrepresentations in connection with the sale of its services with those of Insidesales.com, Inc., another defendant in the lawsuit, (2) that inContact breached its service contract with California College and an alleged oral contract between the parties by failing to deliver contracted services and product and failing to abide by implied covenants of good faith and fair dealing, and (3) the conduct of inContact interfered with prospective economic business relations of California

College with respect to enrolling students. California College filed an amended complaint that has been answered by Insidesales.com and inContact. California College originally sought damages in excess of \$20.0 million. Furthermore, Insidesales.com and inContact filed cross-claims against one another, which they subsequently agreed to dismiss with prejudice. In October 2011, California College reached a settlement with Insidesales.com, the terms of which have not been disclosed and remain confidential. In June of 2013, California College amended its damages claim to \$14.4 million, of which approximately \$5.0 million was alleged pre-judgment interest. On September 10, 2013, the court issued an order on inContact's Motion for Partial Summary Judgment. The court determined that factual disputes exist as to several of the claims, but dismissed California College's cause of action for intentional interference with prospective economic relations and the claim for prejudgment interest. Dismissing the claim for prejudgment interest effectively reduced the claim for damages to approximately \$9.2 million. In February 2016 the trial court granted the inContact motion to stay the trial without date pending an interlocutory appeal to the Utah Supreme Court of the trial court's December 2015 ruling with respect to allowing California College's experts to testify at trial. The interlocutory appeal was referred to the Utah Court of Appeals and the parties are waiting for the court to set a briefing and hearing schedule. inContact has denied all of the substantive allegations of the complaint and continues to defend the claims. Management believes the claims against inContact are without merit. We cannot determine at this time whether the chance of success on one or more of inContact's defenses or claims is either probable or remote, and are unable to estimate the potential loss or range of loss should it not be successful. The Company believes that this matter will not have a material impact on our financial position, liquidity or results of operations.

On January 15, 2014, Microlog Corporation ("Microlog") filed a patent infringement suit against inContact in the United States District Court for the District of Delaware, Case No. 1:99-mc-09999, alleging that we are infringing one or more claims made in U.S. Patent No. 7,092,509 (the "'509 Patent"), entitled "Contact Center System Capable of Handling Multiple Media Types of Contacts and Method for Using the Same." Microlog is seeking a declaratory judgment, injunctive relief, damages and an ongoing royalty, and

costs, including attorney's fees and expenses. In December 2014 inContact filed a Motion for Judgment on the Pleadings which is pending before the Court. inContact also filed a petition for Inter Partes Review ("IPR") of the '509 Patent in January 2015 before the United States Patent and Trademark Office Patent Trial and Appeal board, and the PTAB instituted the IPR for the '509 Patent on all claims included in our petition. In a Final Written Decision entered on July 28, 2016 pursuant to the IPR rules, the PTAB held that all claims included in our IPR petition are invalid, meaning that the claims in the '509 Patent that Microlog alleged that we infringed cannot be enforced. Microlog has 30 days in which to file a request for rehearing of the PTAB Final Written Decision or 63 days in which to file an appeal of the Final Written Decision to the Court of Appeals for the Federal Circuit. We intend to continue to defend the claims vigorously. However, no estimate of the loss or range of loss can be made at this time.

On May 2, 2014, Info Directions, Inc. ("IDI") notified inContact of a Demand for Arbitration regarding a dispute related to the Software as a Service Agreement between IDI and inContact dated December 19, 2012 pursuant to which IDI was to provide inContact with billing systems software. IDI has asserted damages totaling at least \$3.6 million. inContact has asserted counterclaims and is defending this arbitration vigorously. The Arbitration Hearing in this matter was held in Rochester, New York in mid-April, 2016. No decision has been reached at this time; however, management believes the allegations and alleged damages set forth in IDI's Arbitration Demand to be without merit. The Company believes that this matter will not have a material impact on our financial position, liquidity or results of operations.

On June 10, 2016, a complaint captioned Natalie Gordon v. inContact, Inc., et al., Case No. 160903695 was filed in the Third Judicial District Court of Salt Lake County, State of Utah (the "Court") naming as defendants inContact and its Board of Directors (the "Gordon Action"). The plaintiff filed an amended complaint in the Gordon Action on July 1, 2016. On July 5, 2016, a complaint captioned David Stern v. inContact, Inc., et al., Case No. 160904200 was filed in the same Court naming as defendants inContact and its Board of Directors (the "Stern Action"). On July 8, 2016, a complaint captioned Andre Davis v. inContact, Inc., et al., Case No. 160904272 was filed in the same Court naming as defendants inContact, its Board of Directors, Parent and Merger Subsidiary (the "Davis Action"). On July 14, 2016 the Court ordered the three actions consolidated and designated the amended complaint in the Gordon action as the operative complaint. The consolidated action purports to be a class action brought by shareholders alleging that inContact's Board of Directors breached their fiduciary duties by approving the Merger Agreement with NICE pursuant to which the Company would be acquired as a wholly owned indirect subsidiary of NICE. The complaint seeks, among other things, either to enjoin the proposed transaction or to rescind the transaction in the event it is consummated. In management's view such litigation is a common occurrence in connection with acquisitions of public companies, regardless of any merits related to the underlying acquisition. The Company intends to defend against the actions vigorously. Defendants have not yet filed an answer to the consolidated complaint and the Company cannot predict at this time any possible outcome of the litigation.

We have established liabilities of \$877,000 relative to all contingent matters above. We believe the amounts provided in our consolidated financial statements are adequate in light of the probable and estimable liabilities. We have certain contingencies which are reasonably possible, with exposures to loss which are in excess of the amount accrued. However, the remaining reasonably possible exposure to loss cannot currently be estimated.

We are the subject of certain additional legal matters, which we consider incidental to our business activities. It is the opinion of management that the ultimate disposition of these other matters will not have a material impact on our financial position, liquidity or results of operations.

## NOTE 11. STOCK-BASED COMPENSATION

Stock-based compensation cost is measured at the grant date based on the fair value of the award granted and recognized as expense using the graded-vesting method over the period in which the award is expected to vest. Stock-based compensation expense recognized during a period is based on the value of the portion of stock-based awards that is ultimately expected to vest during the period.

We record stock-based compensation expense (including stock options, restricted stock and employee stock purchase plan) to the same departments where cash compensation is recorded as follows (in thousands):

|                                        | Six Months<br>Ended June 30, |         |
|----------------------------------------|------------------------------|---------|
|                                        | 2016                         | 2015    |
| Costs of revenue                       | \$553                        | \$538   |
| Selling and marketing                  | 776                          | 605     |
| Research and development               | 1,989                        | 1,182   |
| General and administrative             | 1,220                        | 1,885   |
| Total stock-based compensation expense | \$4,538                      | \$4,210 |

We utilize the Black-Scholes model to determine the estimated fair value for grants of stock options. The Black-Scholes model requires the use of subjective and complex assumptions to determine the fair value of stock-based awards, including the option's expected term, expected dividend yield, the risk-free interest rate and the price volatility of the underlying stock. The expected dividend yield is zero, based on our historical dividend rates and our intent to not declare dividends for the foreseeable future. Risk-free interest rates are based on U.S. Treasury rates. Volatility is based on historical stock prices over a period equal to the estimated life of the option. Stock options are issued with exercise prices representing the current market price of our common stock on the date of grant. Stock options issued are generally subject to a four-year vesting period with a contractual term of ten years.

The grant date fair value of the restricted stock award is determined using the closing market price of the Company's common stock on the grant date, with the associated compensation expense amortized over the vesting period of the restricted stock awards, net of estimated forfeitures.

We estimated the fair value of options granted under our employee stock-based compensation arrangements at the date of grant using the following weighted-average expected assumptions:

|                         | Six Months<br>Ended June 30, |       |
|-------------------------|------------------------------|-------|
|                         | 2016                         | 2015  |
| Dividend yield          | None                         | None  |
| Volatility              | 49%                          | 50%   |
| Risk-free interest rate | 1.90%                        | 1.69% |
| Expected life (years)   | 5.8                          | 5.7   |

During the six months ended June 30, 2016, we granted 536,000 stock options with exercise prices ranging from \$8.36 to \$8.43 and a weighted-average fair value of \$3.95 and 1,033,000 restricted stock awards and units with a weighted-average fair value of \$8.70.

As of June 30, 2016, there was \$7.6 million of unrecognized compensation cost related to non-vested stock-based compensation awards granted under our stock-based compensation plans. The compensation cost is expected to be recognized over a weighted average period of two years.

## NOTE 12. RELATED PARTY TRANSACTIONS

We paid our Chairman of the Board of Directors (the "Chairman") \$7,000 per month during the six months ended June 30, 2016 and 2015 for consulting and other activities, and such amounts have been recognized in our financial statements as general and administrative expenses. Amounts payable to the Chairman for such services were \$7,000 and \$7,000 at June 30, 2016 and December 31, 2015, respectively.

As a result of the May 2014 acquisition of Uptivity, we are a party to an agreement to sell software and services with a company that is owned by two employees and other minority shareholders of inContact. Revenue related to this agreement included in our Condensed Consolidated Statement of Operations and Comprehensive Loss was approximately \$9,000 and \$16,000 for the three and six months ended June 30, 2016, respectively. Related accounts receivable at June 30, 2016 and 2015 was \$0 and \$75,000, respectively.

The principal location of the employees from the May 2014 acquisition of Uptivity is in Columbus, Ohio. Their facility is a 36,000 square foot office that is leased from Cabo Leasing LLC, which is owned by two employees and other minority shareholders of inContact. The amount of rent for this facility included in our Condensed Consolidated Statement of Operations and Comprehensive Loss was approximately \$200,000 and \$400,000 for the three and six months ended June 30, 2016, respectively.

In October 2015, inContact entered into a referral agreement with a sales lead generation company in which two employees and other minority shareholders hold individual minority ownership interests. We pay commissions under this agreement based on sales generated. The amount of commission expense included in our Consolidated Statement of Operations and Comprehensive Loss was approximately \$67,000 for both the three and six months ended June 30, 2016. There was a recorded payable of \$11,000 on the balance sheet as of June 30, 2016, specific to this agreement.

In connection with the proposed merger with NICE-Systems Ltd. we have entered into a referral and reseller agreement. No transactions have occurred under this agreement as of June 30, 2016.



## NOTE 13. SEGMENTS

We operate under two business segments: Software and Network connectivity. The Software segment includes all monthly recurring revenue related to the delivery of our software applications, plus the associated professional services and setup fees. The Network connectivity segment includes all voice and data long distance services provided to customers.

Management evaluates segment performance based on financial information such as revenue, costs of revenue, and other operating expenses. Management does not evaluate and manage segment performance based on assets.

For segment reporting, we classify operating expenses as either “direct” or “indirect.” Direct expense refers to costs attributable solely to either selling and marketing efforts or research and development efforts, for a given segment. Indirect expense refers to costs that management considers to be overhead in running the business.

Operating segment revenues and profitability for three and six months ended June 30, 2016 and 2015 were as follows (in thousands, except percentages):

|                                 | Three Months Ended June 30, 2016 |                      |        |              |         |   | Three Months Ended June 30, 2015 |                      |        |              |         |   |
|---------------------------------|----------------------------------|----------------------|--------|--------------|---------|---|----------------------------------|----------------------|--------|--------------|---------|---|
|                                 | Software                         | Network Connectivity |        | Consolidated |         |   | Software                         | Network Connectivity |        | Consolidated |         |   |
| Net revenue                     | \$42,360                         | \$                   | 21,438 | \$           | 63,798  |   | \$34,052                         | \$                   | 19,019 | \$           | 53,071  |   |
| Costs of revenue                | 17,274                           |                      | 13,486 |              | 30,760  |   | 14,360                           |                      | 11,983 |              | 26,343  |   |
| Gross profit                    | 25,086                           |                      | 7,952  |              | 33,038  |   | 19,692                           |                      | 7,036  |              | 26,728  |   |
| Gross margin                    | 59                               | %                    | 37     | %            | 52      | % | 58                               | %                    | 37     | %            | 50      | % |
| Operating expenses:             |                                  |                      |        |              |         |   |                                  |                      |        |              |         |   |
| Direct selling and marketing    | 16,244                           |                      | 837    |              | 17,081  |   | 14,668                           |                      | 936    |              | 15,604  |   |
| Direct research and development | 8,482                            |                      | -      |              | 8,482   |   | 6,659                            |                      | -      |              | 6,659   |   |
| Indirect                        | 12,378                           |                      | 670    |              | 13,048  |   | 8,695                            |                      | 1,217  |              | 9,912   |   |
| Total operating expenses        | 37,104                           |                      | 1,507  |              | 38,611  |   | 30,022                           |                      | 2,153  |              | 32,175  |   |
| Income (Loss) from operations   | \$(12,018)                       | \$                   | 6,445  | \$           | (5,573) | ) | \$(10,330)                       | \$                   | 4,883  | \$           | (5,447) | ) |

|                                 | Six Months Ended June 30, 2016 |                      |        |              |         |   | Six Months Ended June 30, 2015 |                      |        |              |         |   |
|---------------------------------|--------------------------------|----------------------|--------|--------------|---------|---|--------------------------------|----------------------|--------|--------------|---------|---|
|                                 | Software                       | Network Connectivity |        | Consolidated |         |   | Software                       | Network Connectivity |        | Consolidated |         |   |
| Net revenue                     | \$83,908                       | \$                   | 42,277 | \$           | 126,185 |   | \$66,518                       | \$                   | 37,891 | \$           | 104,409 |   |
| Costs of revenue                | 33,939                         |                      | 26,922 |              | 60,861  |   | 28,057                         |                      | 23,794 |              | 51,851  |   |
| Gross profit                    | 49,969                         |                      | 15,355 |              | 65,324  |   | 38,461                         |                      | 14,097 |              | 52,558  |   |
| Gross margin                    | 60                             | %                    | 36     | %            | 52      | % | 58                             | %                    | 37     | %            | 50      | % |
| Operating expenses:             |                                |                      |        |              |         |   |                                |                      |        |              |         |   |
| Direct selling and marketing    | 32,669                         |                      | 1,694  |              | 34,363  |   | 28,654                         |                      | 1,759  |              | 30,413  |   |
| Direct research and development | 16,448                         |                      | -      |              | 16,448  |   | 12,952                         |                      | -      |              | 12,952  |   |

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|                               |            |           |             |            |           |              |
|-------------------------------|------------|-----------|-------------|------------|-----------|--------------|
| Indirect                      | 21,727     | 1,567     | 23,294      | 17,730     | 2,286     | 20,016       |
| Total operating expenses      | 70,844     | 3,261     | 74,105      | 59,336     | 4,045     | 63,381       |
| Income (Loss) from operations | \$(20,875) | \$ 12,094 | \$ (8,781 ) | \$(20,875) | \$ 10,052 | \$ (10,823 ) |

## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis of financial condition and results of operations should be read in conjunction with the audited December 31, 2015 Consolidated Financial Statements and notes thereto, along with Management's Discussion and Analysis of Financial Condition and Results of Operations included in our 2015 Annual Report on Form 10-K, filed separately with the Securities and Exchange Commission. This document contains statements that are, or may be deemed to be, forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, including forward-looking statements that relate to our proposed merger with NICE-Systems Ltd. All statements, other than statements of historical fact, which address activities, actions, goals, prospects, or new developments that we expect or anticipate will or may occur in the future, including such things as expansion and growth of our operations and other such matters are forward-looking statements. Any one or a combination of factors could materially affect our operations and financial condition. These factors include competitive pressures, success or failure of marketing programs, changes in pricing and availability of services and products offered to customers, legal and regulatory initiatives affecting software or long distance service, and conditions in the capital markets. Forward-looking statements made by us are based on knowledge of our business and the environment in which we operate as of the date of this report. Because of the factors discussed herein and in our 2015 Annual Report on Form 10-K under Item 1A "Risk Factors," and factors disclosed in subsequent reports filed with the Securities and Exchange Commission, actual results may differ from those in the forward-looking statements.

### OVERVIEW

inContact began in 1997 as a reseller of network connectivity services and has evolved to become a leading provider of cloud contact center software solutions. We help contact centers around the world create effective customer experiences through our powerful cloud contact center call routing, self-service and agent optimization software solutions. Our cloud software solutions and services enable contact centers to operate more efficiently, optimize the cost and quality of every customer interaction and ensure ongoing customer-centric business improvement and growth.

We began offering cloud software solutions to the contact center market in 2005. Our dynamic technology platform provides our customers a pay-as-you-go solution without the costs and complexities of premise-based systems. Our proven cloud delivery model provides compelling total cost of ownership savings over premise-based technology by reducing upfront capital expenditures, eliminating the expense of system management and maintenance fees, while providing agility that enables businesses to scale their technology as they grow.

### PROPOSED MERGER WITH NICE-SYSTEMS LTD.

On May 17, 2016, we entered into an Agreement and Plan of Merger (the "Merger Agreement") with NICE-Systems Ltd., a company organized under the laws of the State of Israel ("Parent" or "NICE"), and Victory Merger Sub Inc. ("Merger Sub"), a wholly owned indirect subsidiary of NICE, providing for the merger of Merger Sub with and into the Company (the "Merger"), with our company surviving the Merger as a wholly owned indirect subsidiary of NICE.

In the Merger, each issued and outstanding share of our common stock will be cancelled and extinguished and automatically converted into the right to receive cash in an amount equal to \$14.00, without interest thereon. Each outstanding and vested restricted stock unit or option to purchase our common stock will be cancelled and extinguished and automatically converted into the right to receive an amount in cash of \$14.00 per share less, in the case of options, the exercise price per share underlying such option. Each outstanding and unvested restricted stock unit, share or restricted stock and option to purchase our common stock or other right to purchase or receive our common stock will be converted into an option to purchase or other right to purchase or receive American Depositary Shares of Parent, with the same vesting schedule and existing vesting conditions of such equity award continuing after

the Merger, subject to existing vesting conditions and the exercise price of options adjusted in accordance with applicable tax law.

The consummation of the Merger is subject to certain conditions, including, without limitation, (i) the receipt of the necessary approval of the Merger from our stockholders; (ii) the expiration or termination of any waiting periods under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 in the United States and any other applicable foreign antitrust and competition laws; (iii) approval of the Merger by the Committee on Foreign Investment in the United States; (iv) all applicable approvals from the Federal Communications Commission as well as all applicable state utility commissions or other state or local governmental authorities and (v) the absence of any law or order restraining, enjoining or otherwise prohibiting the Merger. In addition, the obligations of the Parent and Merger Subsidiary, on the one hand, and us, on the other hand, to consummate the Merger are subject to certain other conditions, including, without limitation, (x) the accuracy of the other party's representations and warranties (subject to certain materiality qualifiers) and (y) the other party's performance of its obligations and covenants contained in the Merger Agreement in all material respects. In addition, the obligations of the Parent and Merger Subsidiary to consummate the Merger are subject to there not having occurred any event, occurrence, revelation or development of a state of circumstances or facts which individually or in the aggregate,

has had or would reasonably be expected to have a material adverse effect on the condition (financial or otherwise), business, assets or results of operations of inContact and its subsidiaries, taken as a whole, from December 31, 2015 through the closing of the Merger, subject in each case, to certain exclusions as set forth in the Merger Agreement.

The Merger Agreement contains customary representations and warranties by Parent, Merger Sub and inContact. The Merger Agreement also contains customary covenants and agreements, including with respect to the operation of our business and our subsidiaries between signing and closing, governmental filings and approvals and other matters.

The Merger Agreement contains certain termination rights for each of the Parent, Merger Sub and inContact and provides certain circumstances as described in the Merger Agreement under which we may be required to pay NICE a termination fee of \$34.1 million. The Board of Directors of inContact has unanimously approved the transaction.

See Note 8 to the Condensed Consolidated Financial Statements, “Long-Term Debt and Capital Lease Obligations” for discussion of the treatment of our 2.5% Convertible Senior Notes due 2022 in connection with the pending acquisition of inContact by NICE.

The transaction is expected to close in the second half of 2016. Following completion of the Merger, we will become a wholly-owned subsidiary of NICE, our common stock will be delisted from The NASDAQ Stock Market and deregistered under the Securities Exchange Act of 1934, as amended, and as such, we will no longer file periodic reports with the SEC.

In connection with the proposed Merger, we have incurred certain costs related to professional services, regulatory fees and employee-related expenses.

The description of the Merger Agreement in this Quarterly Report on Form 10-Q does not purport to be complete and is qualified in its entirety by reference to the full text of the Merger Agreement, which is filed as Exhibit 2.1 to our Current Report on Form 8-K filed with the SEC on May 18, 2016.

If the Merger is consummated, we will become a wholly-owned subsidiary of NICE. Accordingly, this Quarterly Report on Form 10-Q, which assumes we remain a standalone business, should be read with the understanding that should the Merger be completed, NICE will have the power to control the conduct of our business.

## DEVELOPMENTS

In January 2016, we acquired AC2 Solutions, Inc. (“AC2”), a Delaware corporation. AC2 provides call center Workforce Optimization products and services to call centers. The purchase consideration was approximately \$12.3 million, which was paid with cash in the amount of \$12.0 million and 40,456 restricted shares of the Company’s common stock valued at \$344,000. An additional 505,700 restricted shares of our common stock were issued, but not included in the purchase considerations as the shares will vest as services are provided over a two-year period.

In February 2016, we acquired certain technology, customers and equipment from Attensity, Inc., a Delaware corporation, which provides call center analytics products and services. The purchase consideration was approximately \$6.6 million in cash.

## SOURCES OF REVENUE

Our revenue is reported and recognized based on the type of services provided to the customer as follows:

Software Revenue. Software revenue includes two main sources of revenue:

(1) Software delivery and support of our inContact cloud software solutions that are provided on a monthly subscription basis and associated professional services. Because our customers purchasing software and support services on a monthly recurring basis do not have the right to take possession of the software, we consider these arrangements to be service contracts and are not within the scope of Industry Topic 985, Software. We generally bill monthly recurring subscription charges in arrears and recognize these charges in the period in which they are earned. In addition to the monthly recurring revenue, revenue is also received on a non-recurring basis for professional services or on a recurring basis related to improving a customer's contact center efficiency and effectiveness as it relates to utilization of the inContact cloud software solutions.

For subscription service contracts with multiple elements (hosted software, training, installation and long distance services), we follow the guidance provided in Accounting Standards Codification (“ASC”) 605-25, Revenue Recognition for Multiple Element Arrangements. In addition to the monthly recurring subscription revenue, we also derive revenue on a non-recurring basis for professional services included in implementing or improving a customer’s inContact cloud software solutions experience. Because our professional services, such as training and implementation, are not considered to have standalone value, we defer revenue for upfront fees received for professional services in multiple element arrangements and recognize such fees as revenue over the estimated life of the customer. Fees for network connectivity services in multiple element arrangements within the inContact cloud software solutions are based on usage and we recognize revenue in the same manner as fees for telecommunication services discussed in the “Network Connectivity Services Revenue” below.

(2) Perpetual product and services revenues are primarily derived from the sale of licenses to our Workforce Optimization (“WFO”) on-premise software products and services. For software license arrangements that do not require significant modification or customization of the underlying software, revenue is recognized when all revenue recognition criteria are met.

Many of our customers purchase a combination of software, service, hardware, post contract customer support (“PCS”) and hosting. PCS provided to our customers includes technical software support services and unspecified software upgrades to customers on a when-and-if available basis.

Product revenue from customers who purchase our products for resale is generally recognized when such products are released (on a “sell-through” basis). Periodically we review our reseller arrangements as our business and products change.

**Network Connectivity Service Revenue.** Network Connectivity Services revenue is derived from network connectivity, such as dedicated transport, switched long distance and data services. These services are provided over our network or through third party network connectivity providers. Our network is the backbone of our subscription software and allows us to provide the all-in-one inContact cloud contact center software solutions. Revenue for the network connectivity usage is derived based on customer specific rate plans and the customer’s call usage and is recognized in the period the call is initiated. Customers are also billed monthly charges in arrears and revenue is recognized for such charges over the billing period. If the billing period spans more than one month, earned but unbilled revenues are recognized as revenue for incurred usage to date.

Further information about our revenue recognition policies are disclosed at Part I, Item 1 “Financial Statements” - Note 1 – “Organization and Basis of Presentation.”

## **COSTS OF REVENUE AND OPERATING EXPENSES**

### **Costs of Revenue**

Costs of revenue consist primarily of payments to third party network connectivity service providers for resold network connectivity services to our customers. Costs of revenue also include labor costs (including stock-based compensation) and related expenses for our software services delivery, professional services, customer support and network operations organizations and equipment depreciation and expenses relating to our network infrastructure, amortization of acquired intangible assets, amortization of capitalized internal use software development costs, and allocated overhead, such as rent, utilities and depreciation on property and equipment. As a result, overhead expenses are included in costs of revenue and each operating expense category. Cost of revenue can fluctuate based on a number of factors, including the fees we pay to telecommunications providers and for third party technology licenses, which vary depending on our customers’ usage of our inContact cloud software solutions, the timing of capital

expenditures and related depreciation charges and changes in headcount. We expect costs of revenue in absolute dollars to continue to increase as we incur additional costs for network connectivity service providers and for third party technology licenses, continue investing in our network infrastructure and operation and support activities to maintain high availability and quality of service. As our business grows, we expect to realize economies of scale in network infrastructure and personnel costs related to professional services, customer support and network operations organizations.

#### Selling and Marketing

Selling and marketing expenses consist primarily of labor costs (including stock-based compensation) and related expenses for employees in sales and marketing, including commissions and bonuses, advertising, marketing events, corporate communications, expenses, travel costs and allocated overhead. Since our Software segment revenue is delivered and, therefore, recognized over time, we have experienced a delay between increasing sales and marketing expenses and the recognition of the corresponding revenue. We believe it is important to continue investing in selling and marketing to create brand awareness and lead generation opportunities, to increase market share and to support our reseller channels. Accordingly, we expect selling and marketing expenses to increase in



absolute dollars as we continue to support growth initiatives, although these expenses as a percentage of our revenue are expected to decrease over time.

## Research and Development

Research and development expenses consist primarily of the non-capitalized portion of labor costs (including stock-based compensation) and related expenses for development personnel and costs related to the development of new products, enhancement of existing products, quality assurance, market research, testing, product management and allocated overhead. We expect research and development expenses to increase in absolute dollars in the future as we intend to release new features and functionality on a frequent basis, expand our content offerings, upgrade and extend our service offerings and develop new technologies, although these expenses as a percentage of our revenue are expected to decrease over time.

## General and Administrative

General and administrative expenses consist primarily of personnel costs (including stock-based compensation) and related expenses for management, finance and accounting, legal, information systems and human resources personnel, professional fees, other corporate expenses and allocated overhead. We anticipate that we will incur additional employee salaries and related expenses, professional service fees and other corporate expenses related to the growth of our business, the proposed merger with NICE, and future operations. As such, we expect general and administrative expenses to fluctuate in absolute dollars from period to period, although these expenses as a percentage of our revenue are expected to decrease over time.

## RESULTS OF OPERATIONS

### Three Months Ended June 30, 2016 and 2015

The following is a tabular presentation of our condensed consolidated operating results for the three months ended June 30, 2016 compared to our condensed consolidated operating results for the three months ended June 30, 2015 (in thousands, except percentages):

|                              | 2016       | 2015       | \$<br>Change | %<br>Change |
|------------------------------|------------|------------|--------------|-------------|
| Net revenue                  | \$63,798   | \$53,071   | \$10,727     | 20%         |
| Costs of revenue             | 30,760     | 26,343     | 4,417        | 17%         |
| Gross profit                 | 33,038     | 26,728     | 6,310        |             |
| Gross margin                 | 52 %       | 50 %       |              |             |
| Operating expenses:          |            |            |              |             |
| Selling and marketing        | 18,117     | 16,264     | 1,853        | 11%         |
| Research and development     | 9,220      | 7,040      | 2,180        | 31%         |
| General and administrative   | 11,274     | 8,871      | 2,403        | 27%         |
| Total operating expenses     | 38,611     | 32,175     | 6,436        |             |
| Loss from operations         | (5,573 )   | (5,447 )   | (126 )       |             |
| Other expense                | (1,652 )   | (1,711 )   | 59           |             |
| Loss before income taxes     | (7,225 )   | (7,158 )   | (67 )        |             |
| Income tax benefit (expense) | (194 )     | (132 )     | (62 )        |             |
| Net loss                     | \$(7,419 ) | \$(7,290 ) | \$(129 )     |             |

#### Net revenue

Net revenues increased \$10.7 million or 20% to \$63.8 million during the three months ended June 30, 2016 compared to net revenues of \$53.1 million during the same period in 2015. The increase to net revenue relates to an increase of \$8.3 million in Software segment revenue due to continued focus and investment in selling and marketing efforts of our inContact cloud contact center solutions through our direct sales and referral and reseller partner arrangements. Network connectivity segment revenue increased \$2.4 million as the increase of Network connectivity revenue associated with our inContact cloud software solution customers exceeded the attrition of our Network connectivity-only customers.

### Costs of revenue and gross margin

Costs of revenue increased \$4.4 million or 17% to \$30.8 million during the three months ended June 30, 2016 compared to \$26.3 million for the same period in 2015. Gross margin increased two percentage points to 52% for the three months ended June 30, 2016 from 50% for the same period in 2015. Gross margin primarily increased as a result of higher gross margin Software revenue growing more than Network connectivity revenue, which has a comparatively lower gross margin. The growth in Software revenue more than offset greater professional service and customer service personnel related costs from headcount additions to service larger mid-market and enterprise customers and to support resellers, increased software and depreciation expenses related to our additional investments in software, equipment and in the development of our cloud contact center solutions to support current and anticipated customer growth.

### Selling and marketing

Selling and marketing expenses increased \$1.9 million or 11% to \$18.1 million during the three months ended June 30, 2016 from \$16.3 million for the same period in 2015. This increase is primarily a result of increased personnel related costs from headcount additions for direct sales employees and channel sales employees focused on managing and enhancing our partner relationships to support our growth strategy, increased commissions as a result of increased revenue and to a lesser extent higher levels of investment in marketing efforts to create increased awareness of our inContact cloud contact center solutions.

### Research and development

Research and development expense increased \$2.2 million or 31% to \$9.2 million during the three months ended June 30, 2016 from \$7.0 million during the same period in 2015. The increase relates to our efforts to expand our content offerings, upgrade and extend our service offerings and develop new technologies primarily through headcount additions, including the addition of employees from the AC2 and Attensity acquisitions.

### General and administrative

General and administrative expense increased \$2.4 million or 27% to \$11.3 million during the three months ended June 30, 2016 compared to \$8.9 million during the same period in 2015. The increase is primarily due to \$1.9 million of costs related to professional services, regulatory fees and employee-related expenses incurred in connection with the proposed merger with NICE-Systems Ltd. The remaining increase is due to increased personnel and software costs incurred to support our domestic and international business expansion.

### Other expense

Other expense decreased \$59,000 to \$1.7 million during the three months ended June 30, 2016 from \$1.7 million for the same period in 2015. The decrease is primarily due to an increase in interest income related to investments.

### Income taxes

Benefit (provision) for income taxes, which consists of various state income taxes and foreign taxes, was (\$194,000) for the three months ended June 30, 2016 compared to (\$132,000) for the same period in 2015.



## Six Months Ended June 30, 2016 and 2015

The following is a tabular presentation of our condensed consolidated operating results for the six months ended June 30, 2016 compared to our condensed consolidated operating results for the six months ended June 30, 2015 (in thousands, except percentages):

|                              | 2016       | 2015        | \$<br>Change | %<br>Change |
|------------------------------|------------|-------------|--------------|-------------|
| Net revenue                  | \$126,185  | \$104,409   | \$21,776     | 21%         |
| Costs of revenue             | 60,861     | 51,851      | 9,010        | 17%         |
| Gross profit                 | 65,324     | 52,558      | 12,766       |             |
| Gross margin                 | 52 %       | 50 %        |              |             |
| Operating expenses:          |            |             |              |             |
| Selling and marketing        | 36,327     | 31,739      | 4,588        | 14%         |
| Research and development     | 17,829     | 13,693      | 4,136        | 30%         |
| General and administrative   | 19,949     | 17,949      | 2,000        | 11%         |
| Total operating expenses     | 74,105     | 63,381      | 10,724       |             |
| Loss from operations         | (8,781 )   | (10,823 )   | 2,042        |             |
| Other expense                | (3,262 )   | (2,144 )    | (1,118 )     |             |
| Loss before income taxes     | (12,043 )  | (12,967 )   | 924          |             |
| Income tax benefit (expense) | 2,396      | (311 )      | 2,707        |             |
| Net loss                     | \$(9,647 ) | \$(13,278 ) | \$3,631      |             |

## Net revenue

Net revenues increased \$21.8 million or 21% to \$126.2 million during the six months ended June 30, 2016 compared to net revenues of \$104.4 million during the same period in 2015. The increase to net revenue relates to an increase of \$17.4 million in Software segment revenue due to continued focus and investment in selling and marketing efforts of our inContact cloud contact center solutions through our direct sales and referral and reseller partner arrangements. Network connectivity segment revenue increased \$4.4 million as the increase of Network connectivity revenue associated with our inContact cloud software solution customers exceeded the attrition of our Network connectivity-only customers.

## Costs of revenue and gross margin

Costs of revenue increased \$9.0 million or 17% to \$60.9 million during the six months ended June 30, 2016 compared to \$51.9 million for the same period in 2015. Gross margin increased two percentage points to 52% for the six months ended June 30, 2016 from 50% for the same period in 2015. Gross margin primarily increased as a result of higher gross margin Software revenue growing more than Network connectivity revenue, which has a comparatively lower gross margin. The growth in Software revenue more than offset greater professional service and customer service personnel related costs from headcount additions to service larger mid-market and enterprise customers and to support resellers, increased software and depreciation expenses related to our additional investments in software, equipment and in the development of our cloud contact center solutions to support current and anticipated customer growth. The increase in gross margin was also partially offset by increased network connectivity costs related to temporarily duplicated facilities and network connection expenses incurred during the migration of one of our data centers.

## Selling and marketing

Selling and marketing expenses increased \$4.6 million or 14% to \$36.3 million during the six months ended June 30, 2016 from \$31.7 million for the same period in 2015. This increase is primarily a result of increased personnel related costs from headcount additions for direct sales employees and channel sales employees focused on managing and enhancing our partner relationships to support our growth strategy, increased commissions as a result of increased revenue and to a lesser extent higher levels of investment in marketing efforts to create increased awareness of our inContact cloud contact center solutions.

#### Research and development

Research and development expense increased \$4.1 million or 30% to \$17.8 million during the six months ended June 30, 2016 from \$13.7 million during the same period in 2015. The increase relates to our efforts to expand our content offerings, upgrade and extend our service offerings and develop new technologies primarily through headcount additions, including the addition of employees from the AC2 and Attensity acquisitions.

## General and administrative

General and administrative expense increased \$2.0 million or 11% to \$19.9 million during the six months ended June 30, 2016 compared to \$17.9 million during the same period in 2015. The increase is primarily due to \$1.9 million of costs related to professional services, regulatory fees and employee-related expenses incurred in connection with the proposed merger with NICE-Systems Ltd.

## Other expense

Other expense increased \$1.1 million to \$3.3 million during the six months ended June 30, 2016 from \$2.1 million for the same period in 2015. The increase is primarily due to interest related to the Convertible Notes issued on March 30, 2015.

## Income taxes

Benefit (provision) for income taxes, which consists of various state income taxes and foreign taxes, was \$2.4 million for the six months ended June 30, 2016 compared to (\$0.3) million for the same period in 2015. The tax benefit was due to recording a \$2.7 million deferred tax liability upon acquisition of AC2 related primarily to the acquisition of intangibles for which no tax benefit will be derived.

## SEGMENT REPORTING

We operate under two business segments: Software and Network connectivity. The Software segment includes all monthly recurring revenue related to the delivery of our software solutions plus the associated professional services and setup fees. The Network connectivity segment includes all voice and data long distance services provided to customers.

Management evaluates segment performance based on operating data (revenue, costs of revenue, and other operating expenses). Management does not evaluate and manage segment performance based on assets.

For segment reporting, we classify operating expenses as either “direct” or “indirect.” Direct expense refers to costs attributable solely to either selling and marketing efforts or research and development efforts. Indirect expense refers to costs that management considers to be overhead in running the business. Management evaluates expenditures for both selling and marketing and research and development efforts at the segment level without the allocation of overhead expenses, such as rent, utilities and depreciation on property and equipment.

## Software Segment Results

The following is a tabular presentation and comparison of our Software segment unaudited condensed consolidated operating results for the six months ended June 30, 2016 and 2015 (in thousands, except percentages):

|                  | Three Months Ended June 30, |          |           |          | Six Months Ended June 30, |          |           |          |
|------------------|-----------------------------|----------|-----------|----------|---------------------------|----------|-----------|----------|
|                  | 2016                        | 2015     | \$ Change | % Change | 2016                      | 2015     | \$ Change | % Change |
| Net revenue      | \$42,360                    | \$34,052 | \$ 8,308  | 24%      | \$83,908                  | \$66,518 | \$ 17,390 | 26%      |
| Costs of revenue | 17,274                      | 14,360   | 2,914     | 20%      | 33,939                    | 28,057   | 5,882     | 21%      |
| Gross profit     | 25,086                      | 19,692   | 5,394     |          | 49,969                    | 38,461   | 11,508    |          |
| Gross margin     | 59                          | % 58     | %         |          | 60                        | % 58     | %         |          |

Operating expenses:

|                                 |            |            |            |     |            |            |       |     |
|---------------------------------|------------|------------|------------|-----|------------|------------|-------|-----|
| Direct selling and marketing    | 16,244     | 14,668     | 1,576      | 11% | 32,669     | 28,654     | 4,015 | 14% |
| Direct research and development | 8,482      | 6,659      | 1,823      | 27% | 16,448     | 12,952     | 3,496 | 27% |
| Indirect                        | 12,378     | 8,695      | 3,683      | 42% | 21,727     | 17,730     | 3,997 | 23% |
| Loss from operations            | \$(12,018) | \$(10,330) | \$(1,688 ) |     | \$(20,875) | \$(20,875) | \$ -  |     |



### Three Months Ended June 30, 2016 and 2015

The Software segment revenue increased by \$8.3 million or 24% to \$42.4 million during the three months ended June 30, 2016 from \$34.1 million for the same period in 2015. The increase relates primarily to revenue generated from our inContact cloud contact center solutions and is due to our continued focus and investment in sales and marketing through our direct sales and referral and reseller partner arrangements.

Gross margin increased one percentage point to 59% for the three months ended June 30, 2016 from 58% for the same period in 2015. Gross margin increased primarily as a result of Software revenue growth that was partially offset by greater professional service and customer service personnel related costs from headcount additions to service larger mid-market and enterprise customers and to support resellers, increased software and depreciation expenses related to our additional investments in software, equipment and in the development of our cloud contact center solutions to support current and anticipated customer growth.

Direct selling and marketing expenses in the Software segment increased \$1.6 million or 11% to \$16.2 million during the three months ended June 30, 2016 compared to \$14.7 million for the same period in 2015. The increase in direct selling and marketing expenses in the Software segment is a result of headcount additions for direct sales employees and channel sales employees focused on managing and enhancing our partner relationships to support our growth strategy, increased commissions as a result of increased revenue and to a lesser extent higher levels of investment in marketing efforts to create increased awareness of our inContact cloud contact center solutions.

We also continue to develop the software applications and services provided in the Software segment by investing in research and development. During the three months ended June 30, 2016, we incurred \$8.5 million in direct research and development costs compared to \$6.7 million for the same period in 2015 and have capitalized an additional \$3.3 million of costs incurred during the three months ended June 30, 2016 related to our internally developed software compared to \$2.2 million for the same period in 2015.

Indirect expenses, which consist of overhead, such as allocated general and administrative expenses, rent, utilities and depreciation on property and equipment, increased \$3.7 or 42% to \$12.4 million during the three months ended June 30, 2016 from \$8.7 million for the same period in 2015 due to \$1.9 million of costs related to professional services, regulatory fees and employee-related expenses incurred in connection with the proposed merger with NICE-Systems Ltd., the general increase in direct expenses, and more indirect costs being allocated to the Software segment with the increasing investment in the Software segment.

### Six Months Ended June 30, 2016 and 2015

The Software segment revenue increased by \$17.4 million or 26% to \$83.9 million during the six months ended June 30, 2016 from \$66.5 million for the same period in 2015. The increase relates primarily to revenue generated from our inContact cloud contact center solutions and is due to our continued focus and investment in sales and marketing through our direct sales and referral and reseller partner arrangements.

Gross margin increased two percentage points to 60% for the six months ended June 30, 2016 from 58% for the same period in 2015. Gross margin increased primarily as a result of Software revenue growth that was partially offset by greater professional service and customer service personnel related costs from headcount additions to service larger mid-market and enterprise customers and to support resellers, increased software and depreciation expenses related to our additional investments in software, equipment and in the development of our cloud contact center solutions to support current and anticipated customer growth.

Direct selling and marketing expenses in the Software segment increased \$4.0 million or 14% to \$32.7 million during the six months ended June 30, 2016 compared to \$28.7 million for the same period in 2015. The increase in direct selling and marketing expenses in the Software segment is a result of headcount additions for direct sales employees and channel sales employees focused on managing and enhancing our partner relationships to support our growth strategy, increased commissions as a result of increased revenue and to a lesser extent higher levels of investment in marketing efforts to create increased awareness of our inContact cloud contact center solutions.

We also continue to develop the software applications and services provided in the Software segment by investing in research and development. During the six months ended June 30, 2016, we incurred \$16.4 million in direct research and development costs compared to \$13.0 million for the same period in 2015 and have capitalized an additional \$7.2 million of costs incurred during the six months ended June 30, 2016 related to our internally developed software compared to \$4.4 million for the same period in 2015.

Indirect expenses, which consist of overhead, such as allocated general and administrative expenses, rent, utilities and depreciation on property and equipment, increased \$4.0 million or 23% to \$21.7 million during the six months ended June 30, 2016 from \$17.7 million for the same period in 2015 due to \$1.9 million of costs related to professional services, regulatory fees and employee-related

expenses incurred in connection with the proposed merger with NICE-Systems Ltd., the general increase in direct expenses, and more indirect costs being allocated to the Software segment with the increasing investment in the Software segment.

## Network Connectivity Segment Results

The following is a tabular presentation and comparison of our Network connectivity segment condensed consolidated operating results for the three and six months ended June 30, 2016 and 2015 (in thousands, except percentages):

|                              | Three Months Ended June 30, |          |           |          | Six Months Ended June 30, |          |           |          |
|------------------------------|-----------------------------|----------|-----------|----------|---------------------------|----------|-----------|----------|
|                              | 2016                        | 2015     | \$ Change | % Change | 2016                      | 2015     | \$ Change | % Change |
| Net revenue                  | \$21,438                    | \$19,019 | \$ 2,419  | 13%      | \$42,277                  | \$37,891 | \$ 4,386  | 12%      |
| Costs of revenue             | 13,486                      | 11,983   | 1,503     | 13%      | 26,922                    | 23,794   | 3,128     | 13%      |
| Gross profit                 | 7,952                       | 7,036    | 916       |          | 15,355                    | 14,097   | 1,258     |          |
| Gross margin                 | 37 %                        | 37 %     |           |          | 36 %                      | 37 %     |           |          |
| Operating expenses:          |                             |          |           |          |                           |          |           |          |
| Direct selling and marketing | 837                         | 936      | (99 )     | (11%)    | 1,694                     | 1,759    | (65 )     | (4%)     |
| Indirect                     | 670                         | 1,217    | (547 )    | (45%)    | 1,567                     | 2,286    | (719 )    | (31%)    |
| Income from operations       | \$6,445                     | \$4,883  | \$ 1,562  |          | \$12,094                  | \$10,052 | \$ 2,042  |          |

## Three Months Ended June 30, 2016 and 2015

Network connectivity segment revenue increased \$2.4 million or 13% to \$21.4 million during the three months ended June 30, 2016 compared to \$19.0 million for the same period in 2015 due to the increase of Network connectivity revenue associated with our inContact suite customers exceeding the attrition of our Network connectivity-only customers. Our costs of revenue increased 13% due to the increase in revenue. Network connectivity gross margin remained consistent versus the prior period.

Selling and marketing expenses decreased \$0.1 million or 11% during the three months ended June 30, 2016 compared to \$0.9 million for the same period in 2015 driven by sourcing of internal leads as opposed to referral partners. Indirect expenses, which consist of overhead, such as allocated general and administrative expense, rent, utilities and depreciation on property and equipment decreased \$0.5 million or 45% during the three months ended June 30, 2016 compared to \$1.2 million for the same period in 2015 primarily related to the decreasing allocation of expenses to the network connectivity segment and the pass thru of regulatory fees previously not collected.

## Six Months Ended June 30, 2016 and 2015

Network connectivity segment revenue increased \$4.4 million or 12% to \$42.3 million during the six months ended June 30, 2016 compared to \$37.9 million for the same period in 2015 due to the increase of Network connectivity revenue associated with our inContact suite customers exceeding the attrition of our Network connectivity-only customers. Our costs of revenue increased 13% due to the increase in revenue. Network connectivity gross margin

decreased one percent in part due to increased costs related to duplicated facilities and network connection expenses incurred during the migration of one of our data centers. These costs were partially offset by lower network connectivity call usage costs due to increased usage efficiencies related to a continued investment in technology, call routing and lower negotiated direct usage costs.

Selling and marketing expenses were flat over the prior period. Indirect expenses, which consist of overhead, such as allocated general and administrative expense, rent, utilities and depreciation on property and equipment decreased \$0.7 million or 31% during the six months ended June 30, 2016 compared to \$2.3 million for the same period in 2015 primarily related to the decreasing allocation of expenses to the network connectivity segment and the pass thru of regulatory fees previously not collected.

## LIQUIDITY AND CAPITAL RESOURCES

### Current Financial Condition

Our principal sources of liquidity are cash and cash equivalents and short-term investments. At June 30, 2016, we had \$37.9 million of cash and cash equivalents and \$54.8 million of short-term investments. As of July 1, 2016, we allowed our \$15.0 million Revolving Credit Agreement with Zions First National Bank to expire, so that it ceased to be a source of liquidity. No amounts were outstanding on the Revolving Credit Agreement at expiration, and the termination of the relationship was made voluntarily by us.

On March 30, 2015, we issued \$115.0 million in aggregate principal amount of 2.50% Convertible Senior Notes (the “Convertible Notes”) due April 1, 2022, unless earlier converted by the holder pursuant to their terms. Net proceeds from the Convertible Notes were approximately \$111.2 million, net of transaction fees. The Convertible Notes pay interest in cash semiannually in arrears at a rate of 2.50% per annum. Upon consummation of the proposed merger, the Convertible Notes will become convertible by the holder. For further information, see Note 8 to the Condensed Consolidated Financial Statements contained in Part 1, Item 1.

We continue to take a proactive approach in managing our operating expenditures and cash flow from operations. Absent the proposed merger, we expect to rely on internally generated cash and the proceeds from the Convertible Notes to finance operations and capital requirements.

Our future capital requirements will depend on many factors including our growth rate, continuing market acceptance of our solution, customer retention, ability to gain new customers, the timing and extent of spending to support development efforts, the expansion of sales and marketing activities, and the introduction of new and enhanced offerings. We may also acquire or invest in complementary businesses, technologies and intellectual property rights.

We believe our existing cash and short-term investments will be sufficient to meet our needs during the next twelve months.

### Cash Flows

In summary, our cash flows for the six months ended June 30, 2016 were as follows (in thousands):

|                                           | 2016     |
|-------------------------------------------|----------|
| Net cash provided by operating activities | \$25,832 |
| Net cash used in investing activities     | (19,457) |
| Net cash provided by financing activities | 2,439    |

We experienced a net loss of \$9.6 million during the six months ended June 30, 2016. Significant non-cash items affecting operations during the six months ended June 30, 2016 included a \$2.7 million partial reversal of the deferred tax asset valuation allowance as a result of the acquisition of AC2, \$13.2 million of depreciation and amortization and \$4.5 million of stock-based compensation.

Sources of working capital primarily related to an increase in accounts payable of \$4.0 million due to the timing of the payment of vendor invoices, an increase of \$6.4 million in deferred rent and lease incentive obligation related to lease incentives received as part of a new operating lease of Company’s corporate headquarters and an increase of \$3.2

million in PCS-related deferred revenue associated to the delivery of perpetual licenses as of June 30, 2016.

Investing activities provided \$19.5 million primarily from the net purchases and maturities of available for sale short-term investments. Additionally, we used \$7.0 million, net of \$6.9 million in tenant incentive leasehold improvements, for purchases of equipment primarily for use within our network infrastructure, \$7.2 million of capitalization of internally developed software costs and \$18.4 million for the acquisition of AC2 and Attensity.

Financing activities provided \$2.4 related to employee exercises of stock options of \$2.6 million, \$0.8 million from the sale of stock under the employee stock purchase plan, offset by purchases of treasury stock of \$1.0 million.

#### CRITICAL ACCOUNTING POLICIES AND ESTIMATES

A summary of our significant accounting policies and estimates is discussed in Management's Discussion and Analysis of Financial Condition and Results of Operations and in Note 1 of our Annual Report on Form 10-K for the year ended December 31, 2015. The preparation of the financial statements in accordance with GAAP requires us to make judgments, estimates and assumptions regarding uncertainties that affect the reported amounts of assets and liabilities. Significant areas of uncertainty that require judgments, estimates and assumptions include the accounting for income taxes and other contingencies as well as asset impairment and collectability of

accounts receivable. We use historical and other information that we consider to be relevant to make these judgments and estimates. However, actual results may differ from those estimates and assumptions that are used to prepare our financial statements.

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market risk represents the risk of loss that may impact our financial condition due to adverse changes in financial market prices and rates. We are exposed to market risk related to changes in interest rates and foreign currency exchange rate fluctuations. Market risks at June 30, 2016 have not materially changed from those discussed under Item 7A in our annual report on Form 10-K dated and filed with the Securities and Exchange Commission on March 4, 2016.

### ITEM 4. CONTROLS AND PROCEDURES

#### Evaluation of Disclosure Controls and Procedures

This Report includes the certifications of our Chief Executive Officer and Chief Financial Officer required by Rule 13a-14 of the Securities Exchange Act of 1934 (the “Exchange Act”). See Exhibits 31.1 and 31.2. This Item 4 includes information concerning the controls and control evaluations referred to in those certifications.

Disclosure controls and procedures (as defined in Rule 13a15(e) under the Exchange Act) are designed to ensure that information required to be disclosed in reports filed or submitted under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in rules and forms adopted by the Securities and Exchange Commission, and that such information is accumulated and communicated to management, including the Chief Executive Officer and the Chief Financial Officer, to allow timely decisions regarding required disclosures.

In connection with the preparation of this report, our management, under the supervision and with the participation of the Chief Executive Officer and Chief Financial Officer, reassessed the effectiveness of the design and operation of our disclosure controls and procedures. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures were effective as of June 30, 2016.

#### Changes in Internal Control Over Financial Reporting

There have been no changes in our internal control over financial reporting during the fiscal quarter ended June 30, 2016 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## PART II

### ITEM 1. LEGAL PROCEEDINGS

For a discussion of developments in the legal proceedings see Note 10 to the Condensed Consolidated Financial Statements contained in Part I, Item 1.

### ITEM 1A. RISK FACTORS

Our most recent Annual Report on Form 10-K, as well as other filings with the Securities and Exchange Commission, contain discussions of risks we believe to be significant with respect to our business, operations, financial condition, and other matters pertaining to our business and an investment in our common stock. Other than as noted below, there were no material changes to the risk factors disclosed in “Part I, Item 1A. Risk Factors” of our Form 10-K for the year ended December 31, 2015. Before deciding to purchase, hold or sell our common stock, you should carefully consider the risks presented in those filings. The risks and uncertainties presented in those filings are not the only ones we face. If any of these known or unknown risks or uncertainties actually occurs with material adverse effects, our business, financial condition and results of operations could be seriously harmed. In that event, the market price for our common stock could decline.

#### Risks Related to our Pending Merger with NICE-Systems Ltd.

Our proposed merger with NICE-Systems Ltd. is subject to a number of conditions beyond our control. Failure to complete the merger within the expected timeframe or at all could materially and adversely affect our future business, results of operations, financial condition and stock price.

On May 17, 2016, we entered into an Agreement and Plan of Merger (the “Merger Agreement”) with NICE-Systems Ltd., a company organized under the laws of the State of Israel (“Parent”) and Victory Merger Sub, Inc., a Delaware corporation and a wholly-owned subsidiary of Parent (“Merger Sub”). The Merger Agreement provides, subject to the terms of the Merger Agreement, for the merger of Merger Sub with and into the Company (the “Merger”), with the Company surviving the Merger as a wholly owned indirect subsidiary of Parent. At the time the Merger is consummated (the “Effective Time”), each share of common stock of the Company (the “Company Common Stock”) issued and outstanding as of immediately prior to the Effective Time (other than shares of Company Common Stock held by the Company or shares subject to equity awards or owned by Parent or any of its subsidiaries, or held by any subsidiary of the Company, and shares owned by stockholders who have properly exercised and perfected appraisal rights under Delaware law) will be cancelled and extinguished and automatically converted into the right to receive cash in an amount equal to \$14.00, without interest thereon.

The consummation of the Merger is subject to certain conditions, including, without limitation, (i) the receipt of the necessary approval of the Merger from the Company’s stockholders; (ii) the expiration or termination of any waiting periods under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 in the United States and any other applicable foreign antitrust and competition laws; (iii) approval of the Merger by the Committee on Foreign Investment in the United States; (iv) all applicable approvals from the Federal Communications Commission as well as all applicable state utility commissions or similar state or local governmental authorities, (v) the absence of any law or order restraining, enjoining or otherwise prohibiting the Merger and (vi) other conditions set forth in the Merger Agreement.

We cannot predict whether and when these conditions will be satisfied. If one or more of these conditions is not satisfied, and as a result, we do not complete the Merger, or in the event the proposed Merger is not completed or is delayed for any other reason, our business, results of operations, financial condition and stock price may be harmed



because:

- management's and our employees' attention may be diverted from our day-to-day operations as they focus on matters related to preparing for integration of our operations with those of NICE-Systems;
- we could potentially lose customers, new customer contracts could be delayed or decreased and we may have difficulty hiring and retaining employees;
- we could potentially lose key employees if such employees experience uncertainty about their future roles with us and decide to pursue other opportunities in light of the proposed Merger;

33

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- we have agreed to restrictions in the Merger Agreement that limit how we conduct our business prior to the consummation of the Merger, including, among other things, restrictions on our ability to make certain capital expenditures, investments and acquisitions, sell, transfer or dispose of our assets, amend our organizational documents and incur indebtedness. These restrictions may not be in our best interests as an independent company, and may disrupt or otherwise adversely affect our business and our relationships with our customers, prevent us from pursuing otherwise attractive business opportunities,

limit our ability to respond effectively to competitive pressures, industry developments and future opportunities, and otherwise harm our business, financial results and operations;

- we have incurred and expect to continue to incur expenses related to the Merger, such as legal, financial advisory and accounting fees, and other expenses that are payable by us whether or not the proposed Merger is completed;

- we may be required to pay a termination fee to Parent if the Merger Agreement is terminated under certain circumstances, which would negatively affect our financial results and liquidity;

- activities related to the Merger and related uncertainties may lead to a loss of revenue and market position that we may not be able to regain if the proposed Merger does not occur; and

- the failure to, or delays in, consummating the Merger may result in a negative impression of us with customers, potential customers or the investment community.

The occurrence of these or other events individually or in combination could have a material adverse effect on our business, results of operations, financial condition and stock price.

In addition, our stock price may fluctuate significantly based on announcements by us, NICE-Systems or other third parties regarding the proposed Merger.

The Merger Agreement contains provisions that could discourage a potential competing acquiror.

The Merger Agreement contains “no solicitation” provisions that, subject to exceptions, restrict our ability to solicit, initiate, or knowingly encourage, facilitate or induce third party proposals for the acquisition of our common stock. In addition, Parent has an opportunity to modify the terms of the Merger in response to any competing acquisition proposals before our Board of Directors may withdraw or change its recommendation with respect to the Merger. Upon the termination of the Merger Agreement, including in connection with a “superior proposal”, we may be required to pay \$34.1 million as a termination fee.

These provisions could discourage a potential third party acquiror from considering or proposing an acquisition transaction, even if it were prepared to pay a higher per share price than what would be received in the Merger. These provisions might also result in a potential third party acquiror proposing to pay a lower price per share to our stockholders than it might otherwise have proposed to pay because of the added expense of the \$34.1 million termination fee that may become payable.

If the Merger Agreement is terminated and we determine to seek another business combination, we may not be able to negotiate a transaction with another party on terms comparable to, or better than, the terms of the Merger.

Our executive officers and directors have interests in the Merger that may be different from, or in addition to, the interests of our stockholders generally.

Our executive officers and members of our Board of Directors may be deemed to have interests in the Merger that may be different from or in addition to those of our stockholders, generally. These interests may create potential conflicts of interest. Our Board of Directors was aware of these potentially differing interests and considered them, among other matters, in evaluating and negotiating the Merger Agreement and in reaching its decision to approve the Merger Agreement and the transactions thereunder. These interests relate to or arise from, among other things:

- the consideration to be received in respect of options to purchase Shares and restricted stock unit awards held by our executive officers and members of our Board of Directors;
- the receipt of certain payments and benefits to which certain executive officers may become entitled pursuant to such executive officers' respective employment agreements and in connection with the completion of the Merger; and
- the right to continued indemnification and insurance coverage for our directors and executive officers following the completion of the Merger.

We are subject to lawsuits, which purport to be class actions, relating to the Merger, which could materially adversely affect our business, financial condition and operating results.

We, our directors and officers, Parent and Merger Sub are subject to lawsuits, which purport to be class actions brought by shareholders relating to the Merger and may become subject to other additional lawsuits that may be filed. Such litigation is very common in connection with acquisitions of public companies, regardless of any merits related to the underlying acquisition. While we

intend to defend against any actions vigorously, the costs of the defense of such lawsuits and other effects of such litigation could have an adverse effect on our business, financial condition and operating results.

One of the conditions to consummating the Merger is that no injunction or other order prohibiting or otherwise preventing the consummation of the Merger shall have been issued by any governmental entity of competent jurisdiction in the United States. Consequently, if any of the plaintiffs in these lawsuits or in any other subsequently filed similar lawsuit is successful in obtaining an injunction preventing the parties from consummating the Merger, such injunction may prevent the Merger from being completed in the expected timeframe, or at all.

We have obligations under certain circumstances to hold harmless and indemnify our directors and officers against judgments, fines, settlements and expenses related to claims against such directors and officers and otherwise to the fullest extent permitted under Delaware law and our bylaws and certificate of incorporation. Such obligations may apply to the current lawsuits and any other potential litigation. However, an unfavorable outcome in any lawsuit related to the Merger could prevent or delay the consummation of the Merger and result in substantial costs to us.

We will incur significant costs in connection with the Merger, whether or not it is consummated.

We will incur substantial expenses related to the Merger, whether or not it is completed. Payment of these expenses by us as a standalone entity would adversely affect our operating results and financial condition and would likely adversely affect our stock price.

## ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

### Repurchases of Securities

Stock repurchases for the three months ended June 30, 2016, were as follows (in thousands, except per share data):

| Period                            | Total number of<br>shares purchased | Average<br>price<br>per<br>share | Total<br>number of<br>shares<br>purchased<br>as part of<br>publicly<br>announced<br>plans<br>or<br>programs | Maximum<br>number<br>of shares<br>that may<br>yet be<br>purchased<br>under the<br>plans or<br>programs |
|-----------------------------------|-------------------------------------|----------------------------------|-------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------|
| April 1 - 30, 2016 <sup>(1)</sup> | 24                                  | \$ 4.25                          | -                                                                                                           | -                                                                                                      |
| May 1 - 31, 2016 <sup>(2)</sup>   | 20                                  | \$ 10.62                         | -                                                                                                           | -                                                                                                      |
| June 1 - 30, 2016 <sup>(3)</sup>  | 10                                  | \$ 13.85                         | -                                                                                                           | -                                                                                                      |
| Total shares repurchased          | 54                                  |                                  | -                                                                                                           | -                                                                                                      |

(1) In April 2016, we received 11,000 shares of our common stock from employees for the settlement of the employees' payroll tax obligation of \$104,000 associated with the lapsing of the selling restriction of a restricted stock award. We received 13,000 shares of our common stock from employees as a result of the cancellation of a

restricted stock award upon termination of employment.

- (2) In May 2016, we received 20,000 shares of our common stock from employees for the settlement of the employees' payroll tax obligation of \$213,000 associated with the lapsing of the selling restriction of a restricted stock award.
- (3) In June 2016, we received 10,000 shares of our common stock from employees for the settlement of the employees' payroll tax obligation of \$140,000 associated with the lapsing of the selling restriction of a restricted stock award.

ITEM 6. EXHIBITS

Exhibit No. Title of Document

|         |                                                                                                                                     |
|---------|-------------------------------------------------------------------------------------------------------------------------------------|
| 2.1     | Agreement and Plan of Merger, dated as of May 17, 2016, among inContact, Inc., NICE-Systems LTD., and Victory Merger Sub Inc. *     |
| 31.1    | Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002                              |
| 31.2    | Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002                              |
| 32.1    | Certifications of the Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| 101.INS | XBRL Instance Document                                                                                                              |
| 101.SCH | XBRL Taxonomy Extension Schema Document                                                                                             |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document                                                                               |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document                                                                                |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase Document                                                                                     |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document                                                                              |

\* The Agreement and Plan of Merger was filed as Exhibit 2.1 to the current report on Form 8-K filed by the Company with the SEC on May 18, 2016, and is incorporated herein by this reference. Schedules to the Agreement and Plan of Merger are omitted pursuant to Item 601(b)(2) of Regulation S-K. The Company agrees to furnish supplementally to the Securities and Exchange Commission a copy of any omitted schedule upon request.

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.

inContact, INC.

Date: August 5, 2016 By: /s/ Paul Jarman  
Paul Jarman  
Chief Executive Officer

Date: August 5, 2016 By: /s/ Gregory S. Ayers  
Gregory S. Ayers  
Chief Financial Officer