inContact, Inc.
Form 10-Q
November 02, 2012

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 September 30, 2012

Commission File No. 1-33762

inContact, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**87-0528557**
(State or other jurisdiction of incorporation or organization)	**(IRS Employer Identification No.)**

7730 S. Union Park Avenue, Suite 500, Salt Lake City, UT 84047

(Address of principal executive offices and Zip Code)

(801) 320-3200

(Registrant s telephone number, including area code)

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

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

Indicate by check mark 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	x
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 x

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 October 18, 2012**
Common Stock, $0.0001 par value	52,805,640 Shares

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INCONTACT, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS - (Unaudited)

(in thousands, except share and per share data)

	September 30, 2012	December 31, 2011
ASSETS		
Current assets:		
Cash and cash equivalents	$ 48,513	$ 17,724
Restricted cash	81	246
Accounts and other receivables, net of allowance for uncollectible accounts of $906 and $491, respectively	15,833	12,916
Other current assets	3,447	2,526
Total current assets	67,874	33,412
Property and equipment, net	20,273	18,685
Intangible assets, net	1,342	1,394
Goodwill	4,086	4,086
Other assets	951	837
Total assets	$ 94,526	$ 58,414
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Trade accounts payable	$ 7,405	$ 7,180
Accrued liabilities	2,588	2,769
Accrued commissions	1,563	1,291
Current portion of deferred revenue	1,665	1,056
Current portion of long-term debt and capital lease obligations	2,806	2,831
Total current liabilities	16,027	15,127
Long-term debt and capital lease obligations	2,509	5,964
Deferred rent	370	161
Deferred revenue	1,947	946
Total liabilities	20,853	22,198
Commitments and contingencies		
Stockholders equity:		
Common stock, $0.0001 par value; 100,000,000 shares authorized; 52,788,077 and 43,623,381 shares issued and outstanding as of September 30, 2012 and December 31, 2011, respectively	5	4
Additional paid-in capital	153,258	111,415
Accumulated deficit	(79,590)	(75,203)
Total stockholders equity	73,673	36,216
Total liabilities and stockholders equity	$ 94,526	$ 58,414

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 ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
Net revenue:				
Software	$ 13,976	$ 10,015	$ 39,106	$ 28,852
Telecom	13,886	12,137	40,646	36,378
Total net revenue	27,862	22,152	79,752	65,230
Costs of revenue:				
Software	5,623	4,488	15,972	12,071
Telecom	9,195	9,049	27,618	26,680
Total costs of revenue	14,818	13,537	43,590	38,751
Gross profit	13,044	8,615	36,162	26,479
Operating expenses:				
Selling and marketing	6,956	6,641	20,874	17,738
Research and development	2,495	1,575	6,611	4,347
General and administrative	4,341	3,451	12,484	10,103
Total operating expenses	13,792	11,667	39,969	32,188
Loss from operations	(748)	(3,052)	(3,807)	(5,709)
Other income (expense):				
Interest income			3	
Interest expense	(129)	(59)	(331)	(337)
Change in fair value of warrants				(158)
Other expense	(55)	(42)	(201)	(58)
Total other expense	(184)	(101)	(529)	(553)
Loss before income taxes	(932)	(3,153)	(4,336)	(6,262)
Income tax expense	(21)	(17)	(51)	(48)
Net loss and comprehensive loss	$ (953)	$ (3,170)	$ (4,387)	$ (6,310)
Net loss per common share:				
Basic and diluted	$ (0.02)	$ (0.07)	$ (0.10)	$ (0.16)
Weighted average common shares outstanding:				
Basic and diluted	46,214	43,836	44,992	39,238

See accompanying notes to condensed consolidated financial statements.

INCONTACT, INC.

CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY - (Unaudited)

(in thousands)

	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Accumulated Deficit	Total
Balance at December 31, 2011	43,624	$ 4	$ 111,415	$ (75,203)	$ 36,216
Issuance of common stock, net of issuance costs	8,000	1	37,260		37,261
Common stock issued for options exercised	1,117		3,006		3,006
Common stock issued under the employee stock purchase plan	47		197		197
Stock-based compensation			1,380		1,380
Net loss				(4,387)	(4,387)
Balance at September 30, 2012	52,788	$ 5	$ 153,258	$ (79,590)	$ 73,673

See accompanying notes to condensed consolidated financial statements.

INCONTACT, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

(in thousands)

	Nine months ended September 30, 2012	Nine months ended September 30, 2011
Cash flows from operating activities:		
Net loss	$ (4,387)	$ (6,310)
Adjustments to reconcile net loss to net cash from operating activities:		
Depreciation of property and equipment	3,691	2,667
Amortization of software development costs	3,035	2,135
Amortization of intangible assets	185	409
Amortization of note financing costs	24	48
Interest accretion	9	13
Stock-based compensation	1,380	1,167
Change in fair value of warrants		158
Loss on disposal of property and equipment	200	69
Changes in operating assets and liabilities:		
Accounts and other receivables, net	(2,968)	(2,018)
Other current assets	(927)	(552)
Other non-current assets	(90)	(55)
Trade accounts payable	161	(1,189)
Accrued liabilities	(2)	(614)
Accrued commissions	272	175
Deferred rent	60	(66)
Deferred revenue	1,610	525
Net cash provided by (used in) operating activities	2,253	(3,438)
Cash flows from investing activities:		
Decrease in restricted cash	165	
Contingent purchase price payments		(135)
Purchase of intangible assets	(133)	
Payments made for deposits	(23)	(22)
Proceeds from deposits		105
Capitalized software development costs	(4,154)	(3,497)
Purchases of property and equipment	(2,949)	(3,672)
Net cash used in investing activities	(7,094)	(7,221)
Cash flows from financing activities:		
Proceeds from exercise of options and warrants	3,006	880
Proceeds from sale of stock under employee stock purchase plan	197	164
Proceeds from issuance of common stock	37,474	23,865
Offering costs payments	(125)	(32)
Payment of debt financing fees	(29)	
Principal payments on long-term debt and capital leases	(2,393)	(1,709)
Borrowings under the revolving credit notes	6,000	10,230
Payments under the revolving credit notes	(8,500)	(15,000)
Net cash provided by financing activities	35,630	18,398
Net increase in cash and cash equivalents	30,789	7,739
Cash and cash equivalents at beginning of period	17,724	10,321

Cash and cash equivalents at end of period	$ 48,513	$ 18,060
Supplemental schedule of non-cash investing and financing activities:		
Payments due for property and equipment included in trade accounts payable	$ 93	$ 765
Property and equipment and other assets financed through capital leases	1,414	3,257
Cashless exercise of warrants		404
Equity issuance costs included in accrued liabilities	88	200

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 applicatio through our inContact® portfolio, an advanced contact handling and performance management software application. Cloud is a term to refer to computing, data storage and delivery of technology services through the Internet, which includes software-as-a-service (SaaS). Our services provide a variety of connectivity options for carrying inbound contacts to our inContact portfolio or 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 telecommunications 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 telecommunications 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.

Basis of Presentation

These unaudited condensed consolidated financial statements of inContact and its subsidiaries have been prepared in accordance with 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 accounting principles generally accepted in the United States, 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, 2011, filed with the SEC on March 9, 2012. The results of operations for the three and nine month periods ended September 30, 2012 are not necessarily indicative of the results to be expected for the year ending December 31, 2012. Our significant accounting policies are set forth in Note 1 to the consolidated financial statements in the 2011 Annual Report on Form 10-K.

Recent Accounting Pronouncements

Effective January 1, 2012, the Company adopted Financial Accounting Standards Board (FASB) accounting guidance which requires an entity to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income, or in two separate but consecutive statements. The guidance eliminates the option to present components of other comprehensive income as part of the statement of equity. In addition, in December 2011, the FASB issued an amendment to the accounting standard which defers the requirement to present components of reclassifications of other comprehensive income on the face of the income statement. In accordance with the guidance, we have presented condensed statements of operations and comprehensive income as a single continuous statement.

NOTE 2. 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.

Revenue is determined and recognized based on the type of service provided for the customer as follows:

inContact portfolio of services. Revenue is derived from the delivery of any of our software services within the inContact portfolio which are provided on a monthly recurring subscription basis. Because customers do not have the right to take possession of the software, these arrangements are considered service contracts and are not within the scope of Industry Topic 985*, Software.* Monthly recurring subscription charges are generally billed in arrears and recognized for the period in which they are earned. For subscription 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 Arrangement*. In addition to the monthly recurring subscription revenue, revenue is also derived on a non-recurring basis for professional services included in implementing or improving a customer s inContact portfolio experience. Because our professional services, such as training and installation, 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. Professional services sold separately (i.e. not sold contemporaneously with the negotiation of a subscription contract) are recognized as revenue over the period that services are provided. Fees for telecommunications services in multiple element arrangements within the inContact portfolio are based on usage and are recognized as revenue in the same manner as fees for telecommunications services discussed in the following paragraph. Also included is revenue related to the quarterly minimum purchase commitments from a related party reseller (Note 11).

Telecommunications services. Revenue is derived from telecommunications services, such as dedicated transport, switched long distance and data services. These services are provided over our network or through third party telecommunications providers. Our network is the backbone of our inContact portfolio and allows us to provide the all-in-one inContact solution. Revenue for the telecommunications 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.

NOTE 3. BASIC AND DILUTED NET (LOSS) INCOME PER COMMON SHARE

Basic earnings per common share is computed by dividing the net income or 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 income or 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, warrants and restricted stock units. 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 nine months ended September 30, 2012 and 2011, no potentially dilutive securities are included in the calculation of diluted earnings per share because such effect would be anti-dilutive. We had potentially dilutive securities representing approximately 4.5 million and 5.6 million shares of common stock at September 30, 2012 and 2011, respectively.

NOTE 4. 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 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: Observable market based inputs or unobservable inputs that are corroborated by market data.

Level 3: Unobservable inputs that are not corroborated by market data.

Recurring Level 3 Activity

The table below provides a reconciliation of the beginning and ending balances for the major classes of assets and liabilities measured at fair value using significant unobservable inputs (Level 3). There was no activity for the three and nine months ended September 30, 2012 and the three months ended September 30, 2011. The table reflects activity for all financial assets and liabilities categorized as Level 3 during the nine months ended September 30, 2011 (*in thousands*):

	Warrants
Balance at December 31, 2010	$ (246)
Total change in fair value	(158)
Total redemptions	404

Balance at September 30, 2011	$

Warrants

We had issued 385,000 warrants, which were exercised in May 2011, with provisions that protected holders from a decline in the stock price instrument if we issued equity shares for a price that was lower than the exercise price of those instruments or issued new warrants or convertible instruments that had a lower exercise price. In accordance with accounting guidance, these warrants were recognized as liabilities and recorded at fair value on each reporting date. We measured the estimated fair value of these warrants as of date of exercise, May 5, 2011, and recorded a $158,000 loss during the nine months ended September 30, 2011 to record the liabilities associated with these warrants at their estimated fair value totaling $404,000 as of the date of exercise as compared to their estimated fair value of $246,000 at December 31, 2010. The estimated fair value of these securities on the date of exercise was the difference between the stock price on the date of exercise and the warrants exercise price. The estimated fair value of the securities was calculated using a Black-Scholes valuation model, which approximated a lattice valuation model, at December 31, 2010. The assumptions used in the Black-Scholes model at December 31, 2010 were as follows: a volatility rate of 41%, a risk-free interest rate of 0.19%, an expected life of 0.39 years and no dividend yield.

Fair Value Estimates

We did not have any transfers of assets and liabilities between Level 1 and Level 2 of the fair value measurement hierarchy during the three and nine months ended September 30, 2012 and 2011. No financial assets or liabilities were measured at fair value on a recurring basis or a non-recurring basis at September 30, 2012 and December 31, 2011.

Fair Value of Other Financial Instruments

The carrying amounts reported in the accompanying condensed consolidated balance sheets for cash and cash equivalents approximate fair values because of the immediate or short-term maturities of these financial instruments. The estimated fair values of the revolving credit note and promissory notes payable were computed using a discounted cash flow model and approximated the carrying amount as the individual notes bear interest at market interest rates and are considered to be classified within Level 2 of the fair value hierarchy.

NOTE 5. INTANGIBLE ASSETS

Intangible assets consisted of the following (*in thousands*):

	September 30, 2012			December 31, 2011		
	Gross assets	Accumulated amortization	Intangible assets, net	Gross assets	Accumulated amortization	Intangible assets, net
Customer lists acquired	$ 16,495	$ 16,262	$ 233	$ 16,495	$ 16,222	$ 273
Technology and patents	10,231	10,051	180	10,231	9,966	265
Trade names and trade marks	1,194	452	742	1,194	392	802
Domain name	54		54	54		54
Patents in process	133		133			
Total	$ 28,107	$ 26,765	$ 1,342	$ 27,974	$ 26,580	$ 1,394

We recorded amortization expense as follows (*in thousands*):

	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
Amortization expense	$ 52	$ 135	$ 185	$ 409

Based on the recorded intangibles at September 30, 2012, estimated amortization expense is expected to be $53,000 during the remainder of 2012, $210,000 in 2013, $210,000 in 2014, $140,000 in 2015, $133,000 in 2016 and $409,000 thereafter.

NOTE 6. ACCRUED LIABILITIES

Accrued liabilities consisted of the following (*in thousands*):

	September 30, 2012	December 31, 2011
Accrued vendor charges	$ 399	$ 342
Accrued payroll and other compensation	1,701	1,895
Current portion of deferred rent	1	150
Other	487	382
Total	$ 2,588	$ 2,769

NOTE 7. LONG-TERM DEBT AND CAPITAL LEASE OBLIGATIONS

We drew $6.0 million under our revolving credit loan agreement of $8.5 million (Revolving Credit Agreement) with Zions First National Bank (Zions) and paid down $8.5 million on the Revolving Credit Agreement during the nine months ended September 30, 2012. We had no outstanding balance on our Revolving Credit Agreement at September 30, 2012. The interest rate under the Revolving Credit Agreement is 4.5% per annum above the ninety day London InterBank Offered Rate (LIBOR), from time to time in effect, adjusted as of the date of any change in the ninety day LIBOR. Interest under the Revolving Credit Agreement is paid monthly in arrears, and all principal is due in July 2014.

The Zions Revolving Credit Agreement contains certain covenants, which were established by amendment to the Revolving Credit Agreement in April 2012. As of September 30, 2012, the most significant covenants require that the aggregate value of cash, cash equivalents and marketable securities shall not be less than the outstanding balance on the Revolving Credit Agreement plus $2.5 million, and if at any time the aggregate value is less than the minimum liquidity position, a minimum quarterly EBITDA of $1.8 million, calculated as of the last day of each calendar quarter, is required. We are in compliance with the covenants at September 30, 2012 and expect to be in compliance with the covenants through the end of 2012.

In April 2012, we entered into a term loan agreement (Term Loan) with Zions for $4.0 million, which matures on May 1, 2016. We are allowed to draw up to the total of $4.0 million through April 30, 2013. We have not drawn from the Term Loan as of September 30, 2012. Interest, if any, will be paid monthly in arrears, commencing the month following a draw, and the principal will be paid in 36 equal monthly installments commencing on September 1, 2013. The interest rate under the Term Loan is 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 are the same as the Revolving Credit Agreement.

During the nine months ended September 30, 2012, we paid $625,000 of the $2.5 million promissory note payable (Promissory Note) entered into with Zions in October 2011. The Promissory Note balance was $1.7 million at September 30, 2012.

During the nine months ended September 30, 2012, we utilized the remaining $1.3 million of the $3.0 million equipment leasing facility commitment entered into with Zions Credit Corporation in March 2011. In July 2012, we entered into a capital lease obligation for certain software licensing, which requires monthly payments of $4,000 beginning in August 2012.

We paid $1.8 million of capital lease obligations during the nine months ended September 30, 2012. The balance of the capital lease obligations was $3.6 million at September 30, 2012.

NOTE 8. CAPITAL TRANSACTIONS

In September 2012, we sold 8.0 million shares of common stock in the open market for net proceeds of $37.3 million.

We received proceeds of $3.0 million from the exercise of 1.1 million options during the nine months ended September 30, 2012. We issued 47,000 shares of common stock for proceeds of $197,000 under the employee stock purchase plan to eligible employees during the nine months ended September 30, 2012.

NOTE 9. COMMITMENTS AND CONTINGENCIES

In May 2009, the Company was served in a lawsuit titled *California College, Inc., et al., v. UCN, Inc., et al.* In the lawsuit, California College alleges that (1) the Company made intentional and/or negligent misrepresentations in connection with the sale of the Company s services from Insidesales.com, Inc., another defendant in the lawsuit, (2) that the Company breached its service contract with California College and the contract between California College and Insidesales.com 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 the Company interfered with prospective economic business relations of California College with respect to enrolling students. California College is seeking damages, in an amount to be proven at trial, in excess of $20 million. Pursuant to a motion filed by Insidesales.com, California College filed an amended complaint that has been answered by Insidesales.com and us. 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. The Company has denied all of the substantive allegations of the complaint and cross-claim and intends to defend the claims vigorously. Management believes the claims against inContact are without merit and no liability has been recorded.

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

NOTE 10. 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. As stock-based compensation expense recognized in the results for the year is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures.

We recorded stock-based compensation expense (including stock options, warrants, restricted stock, restricted stock units and employee stock purchase plan) as follows (*in thousands*):

	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
Costs of revenue	$ 68	$ 74	$ 276	$ 183
Selling and marketing	138	125	308	309
Research and development	122	90	357	169
General and administrative	202	261	439	506
Total stock-based compensation expense	$ 530	$ 550	$ 1,380	$ 1,167

We utilize the Black-Scholes model to determine the estimated fair value for grants of stock options and warrants. The Black-Scholes model requires the use of highly 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 based on our historical dividend rates. 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.

The grant date fair value of the restricted stock and restricted stock unit awards was calculated using the closing market price of the Company s common stock on the grant date, with the 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 Black-Scholes model using the following weighted-average assumptions for the nine months ended September 30, 2012 and 2011:

	Nine months ended September 30,	
	2012	2011
Dividend yield	None	None
Volatility	70%	67%
Risk-free interest rate	0.53%	1.18%
Expected life (years)	4.2	3.9

During the nine months ended September 30, 2012, we granted 461,000 stock options with exercise prices ranging from $4.44 to $6.66 and a weighted-average fair value of $2.72. During the nine months ended September 30, 2011, we granted 1.2 million stock options with exercise prices ranging from $3.10 to $4.95 and a weighted-average fair value of $1.92.

In July 2012 and 2011, we granted 52,000 and 58,000 restricted stock units, respectively, valued at $280,000 each to our Board of Directors as part of their annual compensation for Board and Board Committee service.

As of September 30, 2012, there was $1.5 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 1.2 years.

NOTE 11. RELATED PARTY TRANSACTIONS

We paid the Chairman of the Board of Directors (the Chairman) $7,000 per month during the nine months ended September 30, 2012 and 2011 for consulting, marketing and capital raising activities. We owed the Chairman $7,000 at September 30, 2012 and December 31, 2011. We recognized $1.25 million and $3.0 million of software revenue during the three and nine months ended September 30, 2012, respectively, under an arrangement with a reseller, a principal shareholder of inContact, which includes revenue from resold software services and amounts up to the quarterly minimum purchase commitments. Under the arrangement, revenue from resold software services reduces the reseller s obligation up to the amount of the quarterly minimum purchase commitments. These quarterly minimum purchase commitments expire at the end of 2013.

NOTE 12. SEGMENTS

We operate under two business segments: Software and Telecom. The Software segment includes all monthly recurring revenue related to the delivery of our software applications, plus the associated professional services and setup fees, and revenue related to quarterly minimum purchase commitments through the year ended 2013, from a related party reseller. The Telecom 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. In evaluating segment performance, 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.

Operating segment revenues and profitability for the three and nine months ended September 30, 2012 and 2011 were as follows (*in thousands*):

	Three months ended September 30, 2012			Three months ended September 30, 2011		
	Software	**Telecom**	**Consolidated**	**Software**	**Telecom**	**Consolidated**
Net revenue	$ 13,976	$ 13,886	$ 27,862	$ 10,015	$ 12,137	$ 22,152
Costs of revenue	5,623	9,195	14,818	4,488	9,049	13,537
Gross profit	8,353	4,691	13,044	5,527	3,088	8,615
Gross margin	*60%*	*34%*	*47%*	*55%*	*25%*	*39%*
Operating expenses:						
Direct selling and marketing	5,807	744	6,551	5,428	856	6,284
Direct research and development	2,252		2,252	1,412		1,412
Indirect	4,301	688	4,989	3,193	778	3,971
Total operating expenses	12,360	1,432	13,792	10,033	1,634	11,667
(Loss) income from operations	$ (4,007)	$ 3,259	$ (748)	$ (4,506)	$ 1,454	$ (3,052)

	Nine months ended September 30, 2012			Nine months ended September 30, 2011		
	Software	**Telecom**	**Consolidated**	**Software**	**Telecom**	**Consolidated**
Net revenue	$ 39,106	$ 40,646	$ 79,752	$ 28,852	$ 36,378	$ 65,230
Costs of revenue	15,972	27,618	43,590	12,071	26,680	38,751
Gross profit	23,134	13,028	36,162	16,781	9,698	26,479
Gross margin	*59%*	*32%*	*45%*	*58%*	*27%*	*41%*
Operating expenses:						
Direct selling and marketing	17,330	2,354	19,684	14,248	2,520	16,768
Direct research and development	5,954		5,954	3,886		3,886
Indirect	12,129	2,202	14,331	9,169	2,365	11,534
Total operating expenses	35,413	4,556	39,969	27,303	4,885	32,188
(Loss) income from operations	$ (12,279)	$ 8,472	$ (3,807)	$ (10,522)	$ 4,813	$ (5,709)

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, 2011 consolidated financial statements and notes thereto, along with the Management s Discussion and Analysis of Financial Condition and Results of Operations included in our 2011 Annual Report on Form 10-K, filed separately with the U.S. Securities and Exchange Commission.

OVERVIEW

inContact began in 1997 as a reseller of telecommunications 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 portfolio of cloud contact center contact routing, self-service and agent optimization software solutions. Our services and software solutions enable contact centers to operate more efficiently, optimize the cost and quality of every customer interaction, create new pathways to profit and ensure ongoing customer-centric business improvement and growth.

We began offering cloud contact center software solutions to the contact center market in 2005. Our dynamic technology platform provides our customers a solution without the costs and complexities of premise-based systems. Our proven delivery model provides compelling cost savings by removing the complexities of deploying and maintaining a premise-based solution, while providing flexibility to change with business needs.

DEVELOPMENTS

To provide additional funding for our infrastructure investment and cloud software growth initiatives, we sold 8.0 million shares of common stock in the open market for net proceeds of $37.3 million in September 2012.

In 2011, we entered into reseller agreements for our cloud contact center software solutions with Siemens Enterprise Communications (Siemens) and Verizon Business Communications (Verizon). We have the opportunity to leverage the marketing and sales capacity of these large enterprises selling to contact center owners and operators to increase our business in North America and establish our business overseas all of which we believe will generate growth in our recurring cloud contact center software revenue.

The new opportunity requires us to invest in the infrastructure to deliver our cloud contact center software solutions to new and larger mid-market enterprise and international customers and increase our customer service and support capacity. We began making that investment in 2011 and have continued in 2012. The investments have increased our cost of services and other operating expenses beginning in 2011 and continuing into 2012, which have adversely affected our margins and results of operations ahead of the anticipated revenue. Our ability to recoup that investment depends on how successful our reseller strategy is in 2012 and beyond, but we were able to mitigate the risk associated with future realization of sales, in part, by obtaining minimum purchase commitments from Siemens to generate $5.0 million of net software revenue in 2012 and $10.0 million in 2013.

During the nine months ended September 30, 2012, Siemens resold substantially fewer software services than they had originally anticipated. In October 2012, Siemens informed us that they are reviewing new measures, including the addition of dedicated incremental resources, and a revised go to market approach in an effort to increase sales of our software services under the agreement, and thereby increase contract revenue progressively to a level commensurate with the amount of the quarterly minimum purchase commitments. While positive, no assurances can be given that such plans will be implemented or be successful.

SOURCES OF REVENUE

We derive our revenues from two major business activities: (1) hosting and support of our inContact portfolio of cloud software solutions and associated professional services and (2) reselling telecommunication services. Our primary business focus is marketing and selling our inContact portfolio.

Software

Software delivery and support of our inContact portfolio is provided on a monthly recurring subscription basis. Monthly recurring charges are billed in arrears and recognized for 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 included in implementing or improving a user s inContact portfolio experience. Customers access cloud software and data through a secure Internet connection. Support services include technical assistance for our software products and product upgrades and enhancements on a when and if available basis. Our telecommunications and data network is fundamental to our inContact portfolio and allows us to provide the all-in-one inContact solution. Software service revenue also includes revenue related to quarterly minimum purchase commitments through the year ended 2013, from a related party reseller.

Telecom

We continue to derive revenue from traditional telecommunications services such as dedicated transport, switched long distance and data services. These services are provided over our network or through third party telecommunications providers. Revenue for transactional long distance usage is derived based on user specific rate plans and the user s call usage and is recognized in the period the call is initiated. Users 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.

COSTS OF REVENUE AND OPERATING EXPENSES

Costs of Revenue

Costs of revenue consist primarily of payments to third party long distance service providers for resold telecommunication services to our customers. Costs of revenue also include salaries (including stock-based compensation) and related expenses for our software services delivery, support and professional services organizations, equipment depreciation relating to our services, 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. The cost associated with providing professional services is significantly higher as a percentage of revenue than the cost associated with delivering our software services due to the labor costs associated with providing professional services. We anticipate that we will incur additional costs for long distance service providers, hosting, support, employee salaries and related expenses, to support delivery of our software solutions in the future.

Selling and Marketing

Selling and marketing expenses consist primarily of salaries (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 the resellers added in 2011. Accordingly, we expect selling and marketing expenses to increase in absolute dollars as we continue to support growth initiatives.

Research and Development

Research and development expenses consist primarily of the non-capitalized portion of salary (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.

General and Administrative

General and administrative expenses consist primarily of salary (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 and operations in the future. As such, we expect general and administrative expenses to increase in absolute dollars.

RESULTS OF OPERATIONS

Three Months Ended September 30, 2012 and 2011

The following is a tabular presentation of our condensed consolidated operating results for the three months ended September 30, 2012 compared to our condensed consolidated operating results for the three months ended September 30, 2011 (*in thousands*):

	2012	2011	$ Change	% Change
Net revenue	$ 27,862	$ 22,152	$ 5,710	26%
Costs of revenue	14,818	13,537	1,281	9%
Gross profit	13,044	8,615	4,429	
Gross margin	*47%*	*39%*		
Operating expenses:				
Selling and marketing	6,956	6,641	315	5%
Research and development	2,495	1,575	920	58%
General and administrative	4,341	3,451	890	26%
Total operating expenses	13,792	11,667	2,125	
Loss from operations	(748)	(3,052)	(2,304)	
Other expense	(184)	(101)	83	82%
Loss before income taxes	(932)	(3,153)	(2,221)	
Income tax expense	(21)	(17)	4	
Net loss	$ (953)	$ (3,170)	$ (2,217)	

Revenue

Total revenues increased $5.7 million or 26% to $27.9 million during the three months ended September 30, 2012 compared to revenues of $22.2 million for the same period in 2011. The increase relates primarily to revenue generated from our inContact portfolio of cloud contact center solutions and the associated Telecom revenue and is due to our continued focus and investment in sales and marketing through our direct sales initiatives and referral partner arrangements. We recognized $1.25 million of software revenue during the three months ended September 30, 2012, under an arrangement with a reseller, a principal shareholder of inContact, which includes revenue from resold software services and amounts up to the quarterly minimum purchase commitments. Under the arrangement, revenue from resold software services reduces the reseller s obligation up to the amount of the quarterly minimum purchase commitments. These minimum purchase commitments were negotiated, in part, to mitigate the risks associated with the investment in infrastructure to support our expanded reseller sales and marketing efforts initiated in 2011 and expire at the end of 2013. If revenue from resold software services does not meet the quarterly minimum purchase commitment at the end of 2013, there will be a reduction in software revenue from that reseller at the beginning of 2014 to the extent the revenue from resold software services is less than the quarterly minimum purchase commitment at the end 2013.

During the nine months ended September 30, 2012, Siemens resold substantially fewer software services than they had originally anticipated. In October 2012, Siemens informed us that they are reviewing new measures, including the addition of dedicated incremental resources, and a revised go to market approach in an effort to increase sales of our software services under the agreement, and thereby increase contract revenue progressively to a level commensurate with the amount of the quarterly minimum purchase commitments. While positive, no assurances can be given that such plans will be implemented or be successful.

Costs of revenue and gross margin

Costs of revenue increased $1.3 million or 9% to $14.8 million during the three months ended September 30, 2012 compared to $13.5 million for the same period in 2011. Our gross margin increased eight percentage points to 47% during the three months ended September 30, 2012 from 39% during the three months ended September 30, 2011. The increase in revenue from our inContact portfolio and the minimum purchase commitment offset increased costs attributable to greater professional service and customer service personnel costs incurred to service larger mid-market and enterprise customers and to support resellers, international infrastructure investments initiated in 2011 and increased amortization of previously capitalized software development costs. In addition, lower Telecom costs due to increased efficiencies in call routing related to a 2011 investment in technology and lower negotiated direct costs contributed to the gross margin increase.

Selling and marketing

Selling and marketing expenses increased $315,000 or 5% to $7.0 million during the three months ended September 30, 2012 from $6.6 million for the same period in 2011. This increase is primarily a result of headcount additions for direct and channel sales employees and higher levels of investment in marketing efforts to create increased awareness of our inContact portfolio of cloud contact center solutions.

Research and development

Research and development expense increased $920,000 or 58% to $2.5 million during the three months ended September 30, 2012 from $1.6 million during the same period in 2011. The increase relates to our efforts to expand our content offerings, upgrade and extend our service offerings and develop new technologies.

General and administrative

General and administrative expense increased $890,000 or 26% to $4.3 million during the three months ended September 30, 2012 compared to $3.5 million during the same period in 2011. The increase is primarily due to increased personnel costs and costs incurred to support our international business expansion.

Other expense

Other expense increased $83,000 to $184,000 during the three months ended September 30, 2012 from $101,000 for the same period in 2011. The increase is primarily due to an increase in interest expense of $70,000 for the third quarter of 2012 compared to the comparable period in 2011 due to a higher outstanding balance on our debt facilities for the three months ended September 30, 2012 as compared to the same period in 2011.

Income taxes

Income taxes consist primarily of minimum state income taxes due and remained consistent for the three months ended September 30, 2012 compared to the same period in 2011.

Nine Months Ended September 30, 2012 and 2011

The following is a tabular presentation of our condensed consolidated operating results for the nine months ended September 30, 2012 compared to our condensed consolidated operating results for the nine months ended September 30, 2011 (*in thousands*):

	2012	2011	$ Change	% Change
Net revenue	$ 79,752	$ 65,230	$ 14,522	22%
Costs of revenue	43,590	38,751	4,839	12%
Gross profit	36,162	26,479	9,683	
Gross margin	*45%*	*41%*		
Operating expenses:				
Selling and marketing	20,874	17,738	3,136	18%
Research and development	6,611	4,347	2,264	52%
General and administrative	12,484	10,103	2,381	24%
Total operating expenses	39,969	32,188	7,781	
Loss from operations	(3,807)	(5,709)	(1,902)	
Other expense	(529)	(553)	(24)	4%
Loss before income taxes	(4,336)	(6,262)	(1,926)	
Income tax expense	(51)	(48)	3	
Net loss	$ (4,387)	$ (6,310)	$ (1,923)	

Revenue

Total revenues increased $14.5 million or 22% to $79.8 million during the nine months ended September 30, 2012 compared to revenues of $65.2 million for the same period in 2011. The increase relates primarily to revenue generated from our inContact portfolio of cloud contact center solutions and the associated Telecom revenue and is due to our continued focus and investment in sales and marketing through our direct sales initiatives and referral partner arrangements. We recognized $3.0 million of software revenue during the nine months ended September 30, 2012, under an arrangement with a reseller, a principal shareholder of inContact, which includes revenue from resold software services and amounts up to the quarterly minimum purchase commitments. Under the arrangement, revenue from resold software services reduces the reseller s obligation up to the amount of the quarterly minimum purchase commitments. These minimum purchase commitments were negotiated, in part, to mitigate the risks associated with the investment in infrastructure to support our expanded reseller sales and marketing efforts initiated in 2011 and expire at the end of 2013. If revenue from resold software services does not meet the quarterly minimum purchase commitment at the end of 2013, there will be a reduction in software revenue from that reseller at the beginning of 2014 to the extent the revenue from resold software services is less than the quarterly minimum purchase commitment at the end 2013.

During the nine months ended September 30, 2012, Siemens resold substantially fewer software services than they had originally anticipated. In October 2012, Siemens informed us that they are reviewing new measures, including the addition of dedicated incremental resources, and a revised go to market approach in an effort to increase sales of our software services under the agreement, and thereby increase contract revenue progressively to a level commensurate with the amount of the quarterly minimum purchase commitments. While positive, no assurances can be given that such plans will be implemented or be successful.

Costs of revenue and gross margin

Costs of revenue increased $4.8 million or 12% to $43.6 million during the nine months ended September 30, 2012 compared to $38.8 million for the same period in 2011. Our gross margin increased four percentage points to 45% during the nine months ended September 30, 2012 from 41% during the nine months ended September 30, 2011. The increase in revenue from our inContact portfolio and the minimum purchase commitment offset increased costs attributable to greater professional service and customer service personnel costs incurred to service larger mid-market and enterprise customers and to support resellers, international infrastructure investments initiated in 2011 and increased amortization of previously capitalized software development costs. In addition, lower Telecom costs due to increased efficiencies in call routing related to a 2011 investment in technology and lower negotiated direct costs contributed to the gross margin increase.

Selling and marketing

Selling and marketing expense increased $3.1 million or 18% to $20.9 million during the nine months ended September 30, 2012 from $17.7 million for the same period in 2011. This increase is primarily a result of headcount additions for direct and channel sales employees and higher levels of investment in marketing efforts to create increased awareness of our inContact portfolio of cloud contact center solutions.

Research and development

Research and development expense increased $2.3 million or 52% to $6.6 million during the nine months ended September 30, 2012 from $4.3 million for the same period in 2011. The increase relates to our efforts to expand our content offerings, upgrade and extend our service offerings and develop new technologies.

General and administrative

General and administrative expense increased $2.4 million or 24% to $12.5 million during the nine months ended September 30, 2012 compared to $10.1 million for the same period in 2011. The increase is primarily due to increased personnel costs and costs incurred to support our international business expansion.

Other expense

Other expense decreased $24,000 to $529,000 during the nine months ended September 30, 2012 from $553,000 for the same period in 2011. The difference is primarily due to the $158,000 increase in fair value of the warrants during the nine months ended September 30, 2011 as compared to no change in fair value of warrants during 2012 as the associated warrants were exercised in 2011. Net interest expense decreased $9,000 and was relatively consistent for the nine months ended September 30, 2012 compared to the same period in 2011. The decreases were offset by an increase in other expenses of $201,000 from losses on the disposal of property and equipment.

Income taxes

Income taxes consist primarily of minimum state income taxes due and remained consistent for the nine months ended September 30, 2012 compared to the same period in 2011.

SEGMENT REPORTING

We operate under two business segments: Software and Telecom. The Software segment includes all monthly recurring revenue related to the delivery of our software applications, plus the associated professional services and setup fees and revenue related to quarterly minimum purchase commitments through the year ended 2013 from a related party reseller. The Telecom segment includes all voice and data long distance services provided to customers.

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 compensation, 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 three and nine months ended September 30, 2012 and 2011 (*in thousands*):

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2012	**2011**	**$ Change**	**% Change**	**2012**	**2011**	**$ Change**	**% Change**
Net revenue	$ 13,976	$ 10,015	$ 3,961	40%	$ 39,106	$ 28,852	$ 10,254	36%
Costs of revenue	5,623	4,488	1,135	25%	15,972	12,071	3,901	32%
Gross profit	8,353	5,527			23,134	16,781		
Gross margin	*60%*	*55%*			*59%*	*58%*		
Operating expenses:								
Direct selling and marketing	5,807	5,428	379	7%	17,330	14,248	3,082	22%
Direct research and development	2,252	1,412	840	59%	5,954	3,886	2,068	53%
Indirect	4,301	3,193	1,108	35%	12,129	9,169	2,960	32%
Loss from operations	$ (4,007)	$ (4,506)			$ (12,279)	$ (10,522)		

Three Months Ended September 30, 2012 and 2011

The Software segment revenue increased by $4.0 million or 40% to $14.0 million during the three months ended September 30, 2012 from $10.0 million for the same period in 2011. The increase relates primarily to revenue generated from our inContact portfolio of cloud contact center solutions and is due to our continued focus and investment in sales and marketing through our direct sales initiatives and referral partner arrangements. We recognized $1.25 million of software revenue during the three months ended September 30, 2012, under an arrangement with a reseller, a principal shareholder of inContact, which includes revenue from resold software services and amounts up to the quarterly minimum purchase commitments. Under the arrangement, revenue from resold software services reduces the reseller s obligation up to the amount of the quarterly minimum purchase commitments. These minimum purchase commitments were negotiated, in part, to mitigate the risks associated with the investment in infrastructure to support our expanded reseller sales and marketing efforts initiated in 2011 and expire at the end of 2013. If revenue from resold software services does not meet the quarterly minimum purchase commitment at the end of 2013, there will be a reduction in software revenue from that reseller at the beginning of 2014 to the extent the revenue from resold software services is less than the quarterly minimum purchase commitment at the end 2013.

During the nine months ended September 30, 2012, Siemens resold substantially fewer software services than they had originally anticipated. In October 2012, Siemens informed us that they are reviewing new measures, including the addition of dedicated incremental resources, and a revised go to market approach in an effort to increase sales of our software services under the agreement, and thereby increase contract revenue progressively to a level commensurate with the amount of the quarterly minimum purchase commitments. While positive, no assurances can be given that such plans will be implemented or be successful.

Software segment revenue also includes revenue from professional services of $785,000 for the three months ended September 30, 2012 compared to $529,000 for the same period in 2011.

Gross margin increased five percentage points to 60% for the three months ended September 30, 2012 compared to 55% for the same period in 2011. The increase in revenue from our inContact portfolio and the minimum purchase commitment offset increased costs attributable to greater professional service and customer service personnel costs incurred to service larger mid-market and enterprise customers and to support resellers, international infrastructure investments initiated in 2011 and increased amortization of previously capitalized software development costs.

Direct selling and marketing expenses in the Software segment increased $379,000 or 7% to $5.8 million during the three months ended September 30, 2012 compared to $5.4 million for the same period in 2011. This increase is a result of headcount additions for direct and channel sales employees and employees focused on managing and enhancing our partner relationships and higher levels of investment in marketing efforts to create increased awareness of our inContact portfolio of 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 September 30, 2012, we incurred $2.3 million in direct research and development costs compared to $1.4 million for the same period in 2011 and have capitalized an additional $1.4 million of costs incurred during the three months ended September 30, 2012 related to our internally developed software compared to $1.4 million for the same period in 2011.

Indirect expenses, which consist of overhead, such as compensation, rent, utilities and depreciation on property and equipment, increased $1.1 million or 35% to $4.3 million during the three months ended September 30, 2012 from $3.2 million for the same period in 2011 due to more indirect costs being allocated to the Software segment with the continued shift in revenue and direct expense mix from the Telecom segment to the Software segment and the general increase in indirect expenses.

Nine Months Ended September 30, 2012 and 2011

The Software segment revenue increased by $10.3 million or 36% to $39.1 million during the nine months ended September 30, 2012 from $28.9 million for the same period in 2011. The increase relates primarily to revenue generated from our inContact portfolio of cloud contact center solutions and is due to our continued focus and investment in sales and marketing through our direct sales initiatives and referral partner arrangements. We recognized $3.0 million of software revenue during the nine months ended September 30, 2012, under an arrangement with a reseller, a principal shareholder of inContact, which includes revenue from resold software services and amounts up to the quarterly minimum purchase commitments. Under the arrangement, revenue from resold software services reduces the reseller s obligation up to the amount of the quarterly minimum purchase commitments. These minimum purchase commitments were negotiated, in part, to mitigate the risks associated with the investment in infrastructure to support our expanded reseller sales and marketing efforts initiated in 2011 and expire at the end of 2013. If revenue from resold software services does not meet the quarterly minimum purchase commitment at the end of 2013, there will be a reduction in software revenue from that reseller at the beginning of 2014 to the extent the revenue from resold software services is less than the quarterly minimum purchase commitment at the end 2013.

During the nine months ended September 30, 2012, Siemens resold substantially fewer software services than they had originally anticipated. In October 2012, Siemens informed us that they are reviewing new measures, including the addition of dedicated incremental resources, and a revised go to market approach in an effort to increase sales of our software services under the agreement, and thereby increase contract revenue progressively to a level commensurate with the amount of the quarterly minimum purchase commitments. While positive, no assurances can be given that such plans will be implemented or be successful.

Software segment revenue also includes revenue from professional services of $2.0 million for the nine months ended September 30, 2012 compared to $1.5 million for the same period in 2011.

Gross margin increased one percentage point to 59% in nine months ended September 30, 2012 compared to 58% for the same period in 2011. The increase in revenue from our inContact portfolio and the minimum purchase commitment offset increased costs attributable to greater professional service and customer service personnel costs incurred to service larger mid-market and enterprise customers and to support resellers, international infrastructure investments initiated in 2011 and increased amortization of previously capitalized software development costs.

Direct selling and marketing expenses in the Software segment increased $3.1 million or 22% to $17.3 million during the nine months ended September 30, 2012 compared to $14.2 million for the same period in 2011. This increase is a result of headcount additions for direct and channel sales employees and employees focused on managing and enhancing our partner relationships and higher levels of investment in marketing efforts to create increased awareness of our inContact portfolio of cloud contact center solutions

We also continue to develop the services provided in the Software segment by investing in research and development. During the nine months ended September 30, 2012, we incurred $6.0 million in direct research and development costs compared to $3.9 million during the same period in 2011 and have capitalized an additional $4.2 million of costs incurred during the nine months ended September 30, 2012 related to our internally developed software compared to $3.5 million during the nine months ended September 30, 2011.

Indirect expenses, which consist of overhead, such as compensation, rent, utilities and depreciation on property and equipment, increased $3.0 million or 32% to $12.1 million during the nine months ended September 30, 2012 from $9.2 million for the same period in 2011 due to more indirect costs being allocated to the Software segment with the continued shift in revenue and direct expense mix from the Telecom segment to the Software segment and the general increase in indirect expenses.

Telecom Segment Results

The following is a tabular presentation and comparison of our Telecom segment condensed consolidated operating results for the three and nine months ended September 30, 2012 and 2011 (*in thousands*):

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2012	**2011**	**$ Change**	**% Change**	**2012**	**2011**	**$ Change**	**% Change**
Net revenue	$ 13,886	$ 12,137	$ 1,749	14%	$ 40,646	$ 36,378	$ 4,268	12%
Costs of revenue	9,195	9,049	146	2%	27,618	26,680	938	4%
Gross profit	4,691	3,088			13,028	9,698		

Gross margin	*34%*	*25%*			*32%*	*27%*		
Operating expenses:								
Direct selling and marketing	744	856	(112)	-13%	2,354	2,520	(166)	-7%
Indirect	688	778	(90)	-12%	2,202	2,365	(163)	-7%
Income from operations	$ 3,259	$ 1,454			$ 8,472	$ 4,813		

Three Months Ended September 30, 2012 and 2011

Telecom segment revenue increased $1.8 million or 14% to $13.9 million during the three months ended September 30, 2012 compared to $12.1 million for the same period in 2011 due to the increase of Telecom revenue associated with our inContact portfolio customers exceeding the attrition of our Telecom only customers. Our costs of revenue increased 2% due to the increase in revenue, but Telecom gross margin increased 9% due to increased efficiencies in call routing related to a 2011 investment in technology and lower negotiated direct costs, which resulted in lower Telecom costs. Selling and marketing expenses decreased $112,000 or 13% during the three months ended September 30, 2012 as compared to the same period in 2011, primarily due to lower third-party commissions associated with Telecom only customer revenue. Indirect expenses, which consist of overhead, such as compensation, rent, utilities and depreciation on property and equipment decreased $90,000 or 12% during the three months ended September 30, 2012 compared to the same period in 2011 as a result of more indirect costs being allocated to the Software segment with the continued shift in revenue and direct expense mix from the Telecom segment to the Software segment.

Nine Months Ended September 30, 2012 and 2011

Overall Telecom segment revenue increased $4.3 million or 12% to $40.7 million during the nine months ended September 30, 2012 from $36.4 million for the same period in 2011 due to the increase of Telecom revenue associated with our inContact portfolio customers exceeding the attrition of our Telecom only customers. Our costs of revenue increased 4% due to the increase in revenue, but Telecom gross margin increased 5% due to increased efficiencies in call routing related to a 2011 investment in technology and lower negotiated direct costs, which resulted in lower Telecom costs. Selling and marketing expenses decreased $166,000 or 7% during the nine months ended September 30, 2012 as compared to the same period in 2011, primarily due to lower third-party commissions associated with Telecom only customer revenue. Indirect expenses, which consist of overhead, such as compensation, rent, utilities and depreciation on property and equipment, decreased $163,000 or 7% during the nine months ended September 30, 2012 compared to the same period in 2011 as a result of more indirect costs being allocated to the Software segment with the continued shift in revenue and direct expense mix from the Telecom segment to the Software segment.

LIQUIDITY AND CAPITAL RESOURCES

Our principal sources of liquidity are cash and cash equivalents and available borrowings under our revolving credit note, which expires in July 2014. At September 30, 2012, we had $48.5 million of cash and cash equivalents. In addition to our $48.5 million of cash and cash equivalents, subject to meeting covenant requirements, we have access to additional available borrowings under our revolving credit note with Zions entered into in July 2009. The available borrowings under the revolving credit note are $8.5 million at September 30, 2012, based on the maximum available advance amount calculated on the September 20, 2012 borrowing base certificate, resulting in total cash and additional availability under the revolving credit note of $57.0 million at September 30, 2012. We had no outstanding balance on our revolving credit note at September 30, 2012. The outstanding balance ranged from $0 to $3.0 million during the first nine months of 2012.

The Zion s Revolving Credit Agreement contains certain covenants, with the most significant covenant being a requirement that the aggregate value of cash, cash equivalents and marketable securities shall not be less than the outstanding balance on the Revolving Credit Agreement plus $2.5 million, and if at any time the aggregate value is less than the minimum liquidity position, a minimum quarterly EBITDA of $1.8 million, calculated as of the last day of each calendar quarter, is required. We were in compliance with all financial covenants related to the Revolving Credit Agreement for the period ended September 30, 2012.

In September 2012, we sold 8.0 million shares of common stock in the open market for net proceeds of $37.3 million.

We experienced a net loss of $4.4 million during the nine months ended September 30, 2012. Significant non-cash expenses affecting operations during the nine months ended September 30, 2012 were $6.9 million of depreciation and amortization and $1.4 million of stock compensation. The non-cash expenses were partially offset by an increase in accounts receivable and other assets resulting in cash operating activities providing $2.3 million of cash during the nine months ended September 30, 2012.

We paid $625,000 of the $2.5 million Promissory Note to Zions during the nine months ended September 30, 2012. The balance of our Promissory Note was $1.7 million at September 30, 2012, of which $833,000 is classified as a current liability. During the nine months ended September 30, 2012, we utilized the remaining $1.3 million of the $3.0 million equipment leasing facility commitment leasing entered into with Zions Credit Corporation. In July 2012, we entered into a capital lease obligation for certain software licensing, which requires monthly payments of $4,000 beginning in August 2012. We paid $1.8 million of capital lease obligations during the nine months ended September 30, 2012. The balance of capital lease obligations was $3.6 million at September 30, 2012, of which $2.0 million is current.

In April 2012, we entered into a term loan agreement (Term Loan) with Zions for $4.0 million, which matures on May 1, 2016. We are allowed to draw up to the total of $4.0 million through April 30, 2013. We have not drawn from the Term Loan as of September 30, 2012. Interest, if any, will be paid monthly in arrears, commencing the month following a draw, and the principal will be paid in 36 equal monthly installments commencing on September 1, 2013. The interest rate under the Term Loan is 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 are the same as the Revolving Credit Agreement.

We continue to take a proactive approach in managing our operating expenditures and cash flow from operations. We expect to rely on our existing cash, our Revolving Credit Agreement and our Term Loan to finance operations and capital requirements. We believe that existing cash and cash equivalents, cash from operations, available borrowings under our Revolving Credit Agreement and our Term Loan will be sufficient to meet our cash requirements during at least the next twelve months.

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, 2011. The preparation of the financial statements in accordance with U.S. generally accepted accounting principles 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

Our cash and cash equivalents are invested with high-quality issuers and limit the amount of credit exposure to any one issuer. Due to the short-term nature of the cash equivalents, we believe that we are not subject to any material interest rate risk as it relates to interest income.

Interest rates on our term loan and revolving credit agreement are variable so market fluctuations in interest rate may increase our interest expense.

ITEM 4. 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.

Evaluation of Disclosure Controls and Procedures

Disclosure controls and procedures (as defined in Rule 13a-15(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 September 30, 2012.

Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting that occurred during the third quarter of 2012 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II

ITEM 1. LEGAL PROCEEDINGS

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

During the nine months ended September 30, 2012, there were no material developments in any pending legal proceedings previously reported. Please see the discussion of legal proceedings under Part I, Item 3 of our 2011 Annual Report on Form 10-K, filed with the Securities and Exchange Commission on March 9, 2012.

ITEM 1A. RISK FACTORS

The Private Securities Litigation Reform Act of 1995 provides a safe harbor for forward-looking statements made by us, except where such statements are made in connection with an initial public offering. 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 vendor 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 in the 2011 Annual Report on Form 10-K under Item 1A Risk Factors, actual results may differ from those in the forward-looking statements.

ITEM 6. EXHIBITS

Exhibit No.	Title of Document
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	The following financial statements, formatted in XBRL: (i) Condensed Consolidated Balance Sheets as of September 30, 2012 and December 31, 2011, (ii) Condensed Consolidated Statements of Operations and Comprehensive Loss for the three and nine months ended September 30, 2012 and 2011, (iii) Condensed Consolidated Statements of Cash Flows for the nine months ended September 30, 2012 and 2011; and (iv) Notes to the Consolidated Financial Statements. The information in Exhibit 101 is furnished and not filed, as provided in Rule 402 of Regulation S-T.

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: November 2, 2012

By: /s/ Paul Jarman
Paul Jarman
Chief Executive Officer

Date: November 2, 2012

By: /s/ Gregory S. Ayers
Gregory S. Ayers

Chief Financial Officer