

inContact, Inc.
Form 10-Q
October 30, 2015

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, 2015

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.)
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)

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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 October 26, 2015 |
|----------------------------------|------------------------------------|
| Common Stock, \$0.0001 par value | 61,680,667 shares |

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INCONTACT, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS—(Unaudited)

(in thousands, except per share data)

| | September 30, 2015 | December 31, 2014 |
|---|--------------------------|-------------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$31,164 | \$32,414 |
| Restricted cash | 81 | 81 |
| Investments | 75,980 | - |
| Accounts and other receivables, net of allowance for uncollectible accounts of \$1,957 and \$1,816, respectively | 39,690 | 28,126 |
| Other current assets | 9,088 | 6,979 |
| Total current assets | 156,003 | 67,600 |
| Property and equipment, net | 40,183 | 35,077 |
| Intangible assets, net | 20,992 | 24,768 |
| Goodwill | 39,247 | 39,247 |
| Other assets | 2,087 | 2,078 |
| Total assets | \$258,512 | \$168,770 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Trade accounts payable | \$13,611 | \$11,031 |
| Accrued liabilities | 14,096 | 13,259 |
| Accrued commissions | 4,195 | 3,407 |
| Current portion of deferred revenue | 12,313 | 8,439 |
| Current portion of debt and capital lease obligations | - | 4,095 |
| Total current liabilities | 44,215 | 40,231 |
| Long-term debt and capital lease obligations | 80,940 | 18,543 |
| Deferred rent | 5 | 28 |
| Deferred tax liability | 795 | 795 |
| Deferred revenue | 6,121 | 5,749 |
| Total liabilities | 132,076 | 65,346 |
| Commitments and contingencies | | |
| Stockholders' equity: | | |
| Common stock, \$0.0001 par value; 100,000 shares authorized; 61,676 and 61,000 shares issued and outstanding as of September 30, 2015 and December 31, 2014, | 6 | 6 |

| | | |
|--|-----------|-----------|
| respectively | | |
| Additional paid-in capital | 251,100 | 209,047 |
| Accumulated deficit | (124,635) | (105,629) |
| Accumulated other comprehensive loss | (35) | - |
| Total stockholders' equity | 126,436 | 103,424 |
| Total liabilities and stockholders' equity | \$258,512 | \$168,770 |

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, | |
|---|--|------------|------------------------------------|------------|
| | 2015 | 2014 | 2015 | 2014 |
| Net revenue: | | | | |
| Software | \$36,709 | \$26,286 | \$103,227 | \$70,493 |
| Network connectivity | 19,369 | 17,909 | 57,260 | 51,867 |
| Total net revenue | 56,078 | 44,195 | 160,487 | 122,360 |
| Costs of revenue: | | | | |
| Software | 14,815 | 12,018 | 42,872 | 30,486 |
| Network connectivity | 12,278 | 11,316 | 36,072 | 33,009 |
| Total costs of revenue | 27,093 | 23,334 | 78,944 | 63,495 |
| Gross profit | 28,985 | 20,861 | 81,543 | 58,865 |
| Operating expenses: | | | | |
| Selling and marketing | 17,810 | 13,541 | 49,549 | 36,602 |
| Research and development | 7,328 | 6,316 | 21,021 | 15,554 |
| General and administrative | 7,750 | 7,500 | 25,699 | 20,525 |
| Total operating expenses | 32,888 | 27,357 | 96,269 | 72,681 |
| Loss from operations | (3,903) | (6,496) | (14,726) | (13,816) |
| Other income (expense): | | | | |
| Interest expense | (1,738) | (83) | (3,940) | (278) |
| Interest income | 125 | - | 183 | - |
| Other income (expense) | 1 | 1 | 1 | (148) |
| Total other expense | (1,612) | (82) | (3,756) | (426) |
| Loss before income taxes | (5,515) | (6,578) | (18,482) | (14,242) |
| Income tax benefit (expense) | (163) | (106) | (474) | 9,262 |
| Net loss | \$(5,678) | \$(6,684) | \$(18,956) | \$(4,980) |
| Other comprehensive loss, net of taxes: | | | | |
| Net change in unrealized losses in available- | | | | |
| for-sale investments | (15) | - | (35) | - |
| Comprehensive loss | \$(5,693) | \$(6,684) | \$(18,991) | \$(4,980) |
| Net loss per common share: | | | | |
| Basic and diluted | \$(0.09) | \$(0.11) | \$(0.31) | \$(0.09) |
| Weighted average common shares outstanding: | | | | |
| Basic and diluted | 61,688 | 60,429 | 61,407 | 58,448 |

See accompanying notes to Condensed Consolidated Financial Statements.

INCONTACT, INC.

CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY—(Unaudited)

(in thousands)

| | Common Stock Shares | Additional Paid-in Amount Capital | Treasury Stock Shares | Treasury Stock Amount | Accumulated Deficit | Accumulated Other Comprehensive Loss | Total | |
|--|------------------------|---|--------------------------|--------------------------|------------------------|---|----------|------------|
| Balance at December 31, 2014 | 61,000 | \$ 6 | \$ 209,047 | - | \$ - | \$(105,629) | \$ - | \$ 103,424 |
| Common stock received for settlement of taxes and forfeited restricted stock | - | - | - | (121) | (643) | - | - | (643) |
| Common stock issued for options exercised | 467 | - | 2,314 | 98 | 471 | (182) | - | 2,603 |
| Common stock issued under the employee stock purchase plan | 132 | - | 945 | 22 | 160 | 144 | - | 1,249 |
| Issuance of restricted stock awards | 77 | - | - | 1 | 12 | (12) | - | - |
| Stock-based compensation | - | - | 6,510 | - | - | - | - | 6,510 |
| Equity component of convertible note issuance, net of issuance costs | - | - | 32,284 | - | - | - | - | 32,284 |
| Other comprehensive loss | - | - | - | - | - | - | (35) | (35) |
| Net loss | - | - | - | - | - | (18,956) | - | (18,956) |
| Balance at September 30, 2015 | 61,676 | \$ 6 | \$ 251,100 | - | \$ - | \$(124,635) | \$ (35) | \$ 126,436 |

See accompanying notes to Condensed Consolidated Financial Statements.

INCONTACT, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

(in thousands)

| | Nine Months Ended September 30, | |
|--|------------------------------------|------------|
| | 2015 | 2014 |
| Cash flows from operating activities: | | |
| Net loss | \$(18,956) | \$(4,980) |
| Adjustments to reconcile net loss to net cash from operating activities: | | |
| Depreciation of property and equipment | 7,601 | 5,447 |
| Amortization of software development costs | 4,876 | 4,300 |
| Amortization of intangible assets | 3,776 | 2,316 |
| Amortization of deferred debt issuance costs | 391 | 24 |
| Stock-based compensation | 6,510 | 5,790 |
| Loss on disposal of property and equipment | - | 626 |
| Interest accretion of debt discount | 1,843 | - |
| Amortization of investment premium | 148 | - |
| Loss on disposal of developed software | 148 | - |
| Write-off of contingent liability | - | (146) |
| Deferred income taxes | - | (9,368) |
| Changes in operating assets and liabilities, net of business acquisitions: | | |
| Accounts and other receivables, net | (11,564) | (3,843) |
| Other current assets | (2,109) | (1,793) |
| Other non-current assets | 11 | (333) |
| Trade accounts payable | 2,467 | 1,875 |
| Accrued liabilities | 1,021 | (238) |
| Accrued commissions | 787 | (122) |
| Other long-term liabilities | (220) | (145) |
| Deferred revenue | 4,246 | 3,309 |
| Net cash provided by operating activities | 976 | 2,719 |
| Cash flows from investing activities: | | |
| Sales and maturities of investments | 13,716 | - |
| Purchases of investments | (89,879) | - |
| Capitalized software development costs | (7,457) | (8,052) |
| Purchases of property and equipment | (10,162) | (10,920) |
| Acquisition of a business, net of cash acquired | - | (11,992) |
| Payments made for deposits | (19) | (32) |
| Net cash used in investing activities | (93,801) | (30,996) |
| Cash flows from financing activities: | | |
| Proceeds from exercise of options | 2,603 | 2,009 |
| Proceeds from sale of stock under employee stock purchase plan | 1,249 | 566 |
| Borrowings under term loan | - | 1,000 |
| Payment of debt financing fees | - | (45) |
| Principal payments under debt and capital lease obligations | (11,824) | (3,154) |
| Purchase of treasury stock | (643) | (162) |

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| | | |
|--|-----------|----------|
| Payments under the revolving credit agreement | (11,000) | 10,000 |
| Proceeds from issuance of convertible notes, net | 111,190 | - |
| Net cash provided by financing activities | 91,575 | 10,214 |
| Net decrease in cash and cash equivalents | (1,250) | (18,063) |
| Cash and cash equivalents at the beginning of the period | 32,414 | 49,148 |
| Cash and cash equivalents at the end of the period | \$31,164 | \$31,085 |

Supplemental schedule of non-cash investing and financing activities:

| | | |
|---|-------|----------|
| Payments due for property and equipment included in trade accounts payable | \$472 | \$640 |
| Property and equipment financed through capital leases | \$- | \$1,702 |
| Issuance of common stock for acquisition of a business | \$- | \$31,951 |
| Consideration for acquisition of business included in accrued liabilities likely to be paid | | |
| in cash based on the final calculation of net closing current assets | \$- | \$1,252 |

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® suite, 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.

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, 2014, filed with the SEC on March 4, 2015. The results of operations for the three and nine months ended September 30, 2015 are not necessarily indicative of the results to be expected for the year ending December 31, 2015. Our significant accounting policies are set forth in Note 1 to the Consolidated Financial Statements in the 2014 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 suite of 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 suite of 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 suite of 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 suite of 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 suite of 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.

Certain 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-in” basis). We have historically experienced insignificant product returns from resellers, and our payment terms for these customers are similar to those granted to our end-users. If a reseller develops a pattern of payment delinquency, or seeks payment terms longer than generally accepted, we defer the revenue until the receipt of cash. Our arrangements with resellers are periodically reviewed as our business and products change.

Through the quarter ended September 30, 2014, software revenue also includes the quarterly minimum purchase commitments from a related party reseller (Note 12).

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 suite of 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.

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 fiscal 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. We are currently evaluating the impact of adopting the new revenue standard on our consolidated financial statements.

In April 2015, the FASB issued ASU 2015-03, “Simplifying the Presentation of Debt Issuance Costs,” which requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. This ASU requires retrospective adoption and will be effective in fiscal year 2016.

Early adoption is permitted and the Company has elected to adopt this ASU in the first quarter of 2015 (Note 8). The early adoption has resulted in debt transaction fees to be recorded in the balance sheet as a direct deduction from the carrying amount of our debt liability.

In April 2015, the FASB issued ASU 2015-05, “Intangibles - Goodwill and Other - Internal-Use Software (Subtopic 350-40): Customer’s Accounting for Fees Paid in a Cloud Computing Arrangement.” This ASU provides guidance regarding the accounting for fees paid by a customer in cloud computing arrangements. If a cloud computing arrangement includes a software license, then the customer would account for the payment of fees as an acquisition of software. If there is no software license, the payment of fees would be accounted for as a service contract. This ASU is effective in fiscal years beginning after December 15, 2015 and early adoption is permitted. The Company is currently assessing the impact of this new standard on our 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 nine months ended September 30, 2015 and 2014, 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):

| | September 30, | |
|---|---------------|-------|
| | 2015 | 2014 |
| Stock options | 2,765 | 3,142 |
| Restricted stock awards | 1,317 | 1,397 |
| Potential shares from Convertible Notes | 8,082 | - |
| Total potentially dilutive shares | 12,164 | 4,539 |

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.

Fair Value of Other Financial Instruments

The carrying amounts reported in the accompanying Condensed Consolidated Balance Sheets for cash and cash equivalents (other than the available-for-sale investments which are recorded on a fair value basis disclosed below), accounts and other receivables, and trade accounts payable approximate fair value because of the immediate or short-term maturities of these financial instruments and are considered to be classified within Level 2 of the fair value hierarchy, except for cash and cash equivalents which is Level 1.

We held no investments as of December 31, 2014. The following table summarizes our investments measured at fair value using the above input categories as of September 30, 2015 (in thousands):

| | Level | | |
|-------------------------------------|---------|----------|----------|
| | 1 | Level 2 | Total |
| Cash equivalents: | | | |
| Money market funds | \$4,132 | \$- | \$4,132 |
| Total cash equivalents | 4,132 | - | 4,132 |
| Investments: | | | |
| Commercial paper | - | 34,084 | 34,084 |
| Corporate debt securities | - | 38,487 | 38,487 |
| Municipal bonds | - | 3,409 | 3,409 |
| Total investments | - | 75,980 | 75,980 |
| Total assets measured at fair value | \$4,132 | \$75,980 | \$80,112 |

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. We consider these inputs to be within Level 2 of the fair value hierarchy. The fair values of the Revolving Credit Note and Term Loans were computed using a discounted cash flow model using estimated market rates adjusted for our credit risk as of December 31, 2014. We consider the input related to our credit risk to be within Level 3 of the fair value hierarchy due to the limited number of our debt holders as of December 31, 2014 and our inability to observe current market information. We estimated our current credit risk as of December 31, 2014 based on recent transactions with our creditors. The carrying value and estimated fair value of our Convertible Notes, revolving credit agreement and term loans are as follows (in thousands):

| | September 30, 2015 | | December 31, 2014 | |
|----------------------------|--------------------|----------------------|-------------------|----------------------|
| | Carrying Value | Estimated Fair Value | Carrying Value | Estimated Fair Value |
| Convertible notes | \$80,940 | \$97,526 | \$- | \$- |
| Revolving credit agreement | - | - | 11,000 | 11,000 |
| Term loans | - | - | 10,458 | 10,458 |

NOTE 4. INVESTMENTS

Our investments generally consist of money market funds, commercial paper and corporate debt securities and municipal bonds. All of our investments have original maturity (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 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."

We did not hold investments as of December 31, 2014 and our investments as of September 30, 2015 were as follows (in thousands):

| | Amortized Cost | Unrealized Gains | Unrealized Losses | Fair Value/Net Carrying Value | Cash and Cash Equivalents | Investments |
|---------------------------|-------------------|---------------------|----------------------|--|---------------------------------|-------------|
| Money market funds | \$ 4,132 | \$ - | \$ - | \$ 4,132 | \$ 4,132 | \$ - |
| Commercial paper | 34,084 | - | - | 34,084 | - | 34,084 |
| Corporate debt securities | 38,526 | 6 | (45) | 38,487 | - | 38,487 |
| Municipal bonds | 3,405 | 4 | - | 3,409 | - | 3,409 |
| | \$ 80,147 | \$ 10 | \$ (45) | \$ 80,112 | \$ 4,132 | \$ 75,980 |

At September 30, 2015, we had \$45,000 of gross unrealized losses on certain investments. 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 September 30, 2015 that were other-than-temporarily impaired. For the nine months ended September 30, 2015, proceeds from sales and maturities of investments were \$27.3 million for an immaterial realized gain, \$13.5 million of these sales were securities included in cash equivalents.

NOTE 5. ACQUISITIONS

Uptivity Acquisition

On May 6, 2014, we acquired 100% of the outstanding shares of CallCopy, Inc., a Delaware corporation doing business as Uptivity (“Uptivity”). Uptivity provides a complete mid-market workforce optimization suite of software products and services to call centers comprised of speech and desktop analytics, agent coaching, call and desktop recording, as well as quality, performance, workforce management and satisfaction surveys. inContact acquired Uptivity for an aggregate purchase price of \$48.9 million of primarily cash and stock. The purchase consideration was paid with cash in the amount of \$15.0 million, estimated fair market value of vested stock options converted to cash of \$1.9 million and 3,821,933 shares of the Company’s common stock valued at approximately \$32.0 million. An additional 434,311 shares of restricted common stock were issued, but not included in the purchase consideration because the shares are subject to repurchase rights, which will lapse as services are provided over a three year period. The acquisition of Uptivity 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 total purchase price was allocated as follows (in thousands):

| | Amount |
|--|-----------------|
| Assets acquired: | |
| Cash | \$3,894 |
| Accounts receivable | 742 |
| Other current assets | 1,363 |
| Property, plant and equipment and other assets | 584 |
| Intangible assets | 24,448 |
| Goodwill | 32,684 |
| Total assets acquired | 63,715 |
| Liabilities assumed: | |
| Trade accounts payable | 1,124 |
| Accrued liabilities | 1,934 |
| Current portion of deferred revenue | 1,516 |
| Long-term portion of deferred revenue | 353 |
| Deferred tax liability | 9,884 |
| Total liabilities assumed | 14,811 |
| Net assets acquired | \$48,904 |

In connection with the acquisition, we incurred professional fees of \$934,000, 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 combining operations and assembled workforce acquired. 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 trade name and trademarks, which are amortized on a straight-line basis. The

fair values of the intangible assets were determined primarily using the income approach and the discount rates range from 17.0% to 20.6%. The following sets forth the intangible assets purchased as part of the Uptivity 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 | \$11,460 | 8 |
| Trade name and trademarks | 1,942 | 5 |
| Technology | 7,686 | 7 |
| In-process research and development | 3,360 | Indefinite |
| Total intangible assets | \$24,448 | |

The Company recorded a deferred tax benefit of \$9.4 million at the time of the acquisition. The tax benefit related to recording a deferred tax liability upon acquisition of Uptivity related to a reduction of carrying value of deferred revenue and 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.

For the quarter ended September 30, 2015, our Condensed Consolidated Financial Statements include approximately \$5.2 million and \$406,000 of net revenue and net loss, respectively, related to the operations of Uptivity. For the nine months ended September 30, 2015, our Condensed Consolidated Financial Statements include approximately \$15.2 million and \$5.2 million of net revenue and net loss, respectively, related to the operations of Uptivity. The following table presents our unaudited pro forma results of operations of the Company and Uptivity as if the companies had been combined as of January 1, 2013, and includes pro forma adjustments related to the fair value of deferred revenue, amortization of acquired intangible assets and share-based compensation expense. Direct and incremental transaction costs and the tax benefit are excluded from the three and nine months ended September 30, 2015 and 2014 pro forma condensed combined financial information presented below.

| | Three Months Ended September 30, 2015 | | Nine Months Ended September 30, 2015 | |
|---|---------------------------------------|-----------|--------------------------------------|-----------|
| | As Reported | Pro forma | As Reported | Pro forma |
| Net revenue | \$56,078 | \$56,078 | \$160,487 | \$160,487 |
| Net loss | (5,678) | (5,358) | (18,956) | (16,826) |
| Basic and diluted net loss per common share | (0.09) | (0.09) | (0.31) | (0.27) |

| | Three Months Ended September 30, 2014 | | Nine Months Ended September 30, 2014 | |
|---|---------------------------------------|-----------|--------------------------------------|-----------|
| | As Reported | Pro forma | As Reported | Pro forma |
| Net revenue | \$44,195 | \$44,170 | \$122,360 | \$129,469 |
| Net loss | (6,684) | (6,470) | (4,980) | (16,912) |
| Basic and diluted net loss per common share | (0.11) | (0.11) | (0.09) | (0.29) |

The unaudited pro forma information set forth above is for informational purposes only. The pro forma information should not be considered indicative of actual results that would have been achieved had Uptivity been acquired at the beginning of 2013 or of results that may be obtained in any future period.

NOTE 6. INTANGIBLE ASSETS

Intangible assets consisted of the following (in thousands):

| | September 30, 2015 | | | December 31, 2014 | | |
|-------------------------------|--------------------|-----------------------------|------------------------------|-------------------|-----------------------------|------------------------------|
| | Gross Assets | Accumulated Amortization | Intangible Assets, Net | Gross Assets | Accumulated Amortization | Intangible Assets, Net |
| Customer lists acquired | \$28,123 | \$ (20,296) | \$ 7,827 | \$28,123 | \$ (18,368) | \$ 9,755 |
| Technology and patents | 24,358 | (13,142) | 11,216 | 24,358 | (11,645) | 12,713 |
| Trade names and trademarks | 3,190 | (1,241) | 1,949 | 3,190 | (890) | 2,300 |
| Total intangible assets | \$55,671 | \$ (34,679) | \$ 20,992 | \$55,671 | \$ (30,903) | \$ 24,768 |

Amortization expense was \$3.8 million and \$2.3 million during the nine months ended September 30, 2015 and 2014, respectively.

Based on the recorded intangibles at September 30, 2015, estimated amortization expense is expected to be \$1.2 million during the remainder of 2015, \$4.4 million in 2016, \$3.8 million in 2017, \$3.3 million in 2018, \$2.9 million in 2019 and \$5.4 million thereafter.

NOTE 7. ACCRUED LIABILITIES

Accrued liabilities consisted of the following (in thousands):

| | September 30, 2015 | December 31, 2014 |
|--|--------------------------|-------------------------|
| Accrued payroll and other compensation | \$ 4,974 | \$ 6,254 |
| Accrued state sales taxes | 4,122 | 3,881 |
| Accrued vendor charges | 1,141 | 713 |
| Other | 3,859 | 2,411 |
| Total accrued liabilities | \$ 14,096 | \$ 13,259 |

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. 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; 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 September 30, 2015, the Convertible Notes were not convertible.

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 September 30, 2015, the if-converted value of the Convertible Notes was less than the aggregate principal amount of the Convertible Notes and has the following balance (in thousands):

| | September 30, 2015 |
|---|--------------------------|
| 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 discount | (31,549) |
| Debt issuance costs | (2,511) |
| Net Convertible Notes | \$ 80,940 |

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. Under the terms of the Revolving Credit Agreement, Zions agreed to loan up to \$15.0 million. The Revolving Credit Agreement is collateralized by substantially all the assets of inContact. The balance outstanding under the Revolving Credit Agreement cannot 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 is 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. There was \$15.0 million of unused commitment at September 30, 2015, based on the maximum available advance amount calculated on the September 20, 2015 borrowing base certificate. Interest under the Revolving Credit Agreement is paid monthly in arrears. In August 2014, we amended certain terms of the Revolving Credit Agreement with Zions (“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 is 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. There was no balance on the Revolving Credit Agreement at September 30, 2015.

The Zions Revolving Credit Agreement contains certain covenants, which were established by amendment to the Revolving Credit Agreement in August 2014. As of September 30, 2015, 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 \$2.9 million, and if at any time the aggregate value is less than the minimum liquidity position, a minimum quarterly EBITDA of \$2.9 million, calculated as of the last day of each calendar quarter, is required. We are in compliance with the Revolving Credit Agreement's covenants at September 30, 2015.

The Revolving Credit Agreement imposes certain restrictions on inContact's ability, without the approval of Zions, to incur additional debt, make distributions to stockholders, or acquire other businesses or assets.

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 is 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 nine months ended September 30, 2015, we paid \$10.4 million of total term loan principal to Zions. There was no balance on the term loans at September 30, 2015.

Capital Leases

During the nine months ended September 30, 2015, we paid \$1.4 million of capital lease obligations. There was no capital lease obligation as of September 30, 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 Ended September 30, 2015 | Nine Months Ended September 30, 2015 |
|--|---|--|
| 2.50% Convertible Notes: | | |
| Interest expense at 2.50% coupon rate | \$ 725 | \$ 1,449 |
| Interest accretion of debt discount | 921 | 1,843 |
| Amortization of deferred debt issuance costs | 92 | 193 |
| Total interest from 2.50% Convertible Notes | 1,738 | 3,485 |
| Other Borrowings: | | |
| Interest from other borrowings | - | 455 |
| Total interest | \$ 1,738 | \$ 3,940 |

| | Three Months Ended September 30, 2014 | Nine Months Ended September 30, 2014 |
|--------------------------------|---|--|
| Other Borrowings: | | |
| Interest from other borrowings | \$ 83 | \$ 278 |
| Total interest | \$ 83 | \$ 278 |

NOTE 9. CAPITAL TRANSACTIONS

During the nine months ended September 30, 2015, we received 121,000 shares of our common stock from cancelled restricted stock awards from separated employees and for the settlement of \$643,000 in payroll taxes, associated with the lapsing of the selling restriction of restricted stock awards.

From the exercise of stock options, we issued 467,000 shares of common stock and 98,000 shares of treasury stock for proceeds of \$2.6 million during the nine months ended September 30, 2015. We issued 77,000 shares of common stock and 1,000 shares of treasury stock as a result of the vesting of restricted stock awards. We issued 132,000 shares of common stock and 22,000 shares of treasury stock for proceeds of \$1.2 million under the employee stock purchase plan during the nine months ended September 30, 2015.

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. inContact filed a motion to exclude the statistical and economic experts on damages retained by California College, which was partially granted by excluding California College's statistical expert due to unreliable data provided by California College to perform the statistical analysis related to alleged damages. The trial scheduled for June 11, 2015 was rescheduled due to judicial transfers. The new trial date is scheduled for February 25, 2016. 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 of the 509 Patent in January 2015 before the United States Patent and Trademark Office Patent Trial and Appeal board, and the PTAB has instituted the Inter Partes Review for the 509 Patent on all claims included in our petition. We are defending the claims vigorously. However, no estimate of the loss or range of loss can be made at this time.

On March 20, 2014, Pragmatus Telecom, LLC ("Pragmatus") filed a patent infringement suit against inContact in the United States District Court for the District of Delaware, Case No. 14-360, alleging that inContact is infringing one or more claims made in U.S. Patent No. 6,311,231 (the "'231 Patent"), entitled "Method and System for Coordinating Data and Voice Communications Via Customer Contact Channel Changing System Using Voice over IP"; U.S. Patent No. 6,668,286 (the "'286 Patent"), entitled "Method and System for Coordinating Data and Voice Communications Via Customer Contact Channel Changing System Using Voice over IP"; U.S. Patent No. 7,159,043 (the "'043 Patent"), entitled "Method and System for Coordinating Data and Voice Communications Via Customer Contact Channel Changing System"; and U.S. Patent No. 8,438,314 (the "'314 Patent"), entitled "Method and System for Coordinating Data and Voice Communications Via Customer Contract Channel Changing System". Pragmatus is seeking a declaratory judgment, injunctive relief, damages and costs, including attorney's fees and expenses. We are defending the claims vigorously. On July 9, 2015 the United States District Court for the District of Delaware granted defendants Motion to Dismiss the Amended Complaint for failing to claim patent-eligible subject matter in relation to one of the four patent claims. The Court has scheduled oral argument on the Defendant motion to Dismiss the amended complaints as to the remaining asserted patents for failure to claim patent-eligible subject matter. At this time, no estimate of loss or range of loss can be made.

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. Management believes the allegations and alleged damages set forth in IDI's Arbitration Demand to be without merit. We are defending the claims vigorously. However, at this time, no estimate of loss or range of loss can be made.

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):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|--|---------|---------------------------------------|---------|
| | 2015 | 2014 | 2015 | 2014 |
| Costs of revenue | \$272 | \$217 | \$810 | \$599 |
| Selling and marketing | 419 | 962 | 1,024 | 1,713 |
| Research and development | 627 | 586 | 1,809 | 1,340 |
| General and administrative | 983 | 1,072 | 2,867 | 2,138 |
| Total stock-based compensation expense | \$2,301 | \$2,837 | \$6,510 | \$5,790 |

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. Prior to December 31, 2013, stock options were generally subject to a three-year vesting period with a contractual term of five years. Stock options issued subsequent to December 31, 2013 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:

| | Nine Months Ended September 30, | |
|-------------------------|---------------------------------------|-------|
| | 2015 | 2014 |
| Dividend yield | None | None |
| Volatility | 49% | 63% |
| Risk-free interest rate | 1.70% | 1.95% |
| Expected life (years) | 5.7 | 5.6 |

During the nine months ended September 30, 2015, we granted 648,000 stock options with exercise prices ranging from \$8.54 to \$11.90 and a weighted-average fair value of \$4.35 and 750,000 restricted stock awards and units with a weighted-average fair value of \$9.41.

As of September 30, 2015, there was \$6.1 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 2.0 years.

NOTE 12. RELATED PARTY TRANSACTIONS

We paid our Chairman of the Board of Directors (the "Chairman") \$7,000 per month during the nine months ended September 30, 2015, and 2014 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 at September 30, 2015 and December 31, 2014.

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 \$262,000 for the three and nine months ended September 30, 2015, respectively, and related accounts receivable at September 30, 2015 was \$3,000.

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 \$239,000 and \$626,000 for the three and nine months ended September 30, 2015, respectively.

In October 2015, inContact entered into a referral agreement with a sales lead generation company in which two employees and other minority shareholders have individual minority ownership interests. We will pay commissions under this agreement based on sales generated. As the agreement was not executed prior to September 30, 2015, there were no transactions under this agreement.

Concurrent with selling 7.2 million shares of common stock to an investor in June 2011, we entered into a world-wide reseller agreement with Unify, Inc. ("Unify") (formerly Siemens Enterprise Communications), a subsidiary of the investor, whereby Unify became a reseller of inContact's suite of cloud solutions with minimum revenue purchase commitments.

In February 2013, we amended the Unify reseller agreement which modified Unify's minimum purchase commitments to be \$4.5 million for 2012, \$7.0 million for 2013 and extended the minimum purchase commitment obligation into 2014 in the amount of up to \$5.0 million, which may be credited up to \$1.0 million in 2014 in consideration for up to a \$1.0 million investment by Unify in sales and marketing of our cloud contact center software solutions. Under the amendment, Unify relinquished exclusivity in EMEA. Additionally, sales made by other resellers and inContact in EMEA would go toward satisfying and therefore reduce Unify's obligation up to the amount of the quarterly minimum purchase commitment obligation.

In February 2013, we agreed that through 2013, Unify could make payment of its obligations with shares of our common stock held by Unify's parent company at a price per share, discounted 9.0% from the volume weighted average price, averaged over a specified period of five trading days prior to the payment date. \$2.7 million in revenue earned from Unify during 2012 was paid by the delivery of 492,000 shares of our common stock by Unify in 2013. In May 2013, the parent company of Unify sold its remaining 6.4 million shares of our common stock in the open market. Also, Unify paid to inContact a total of \$3.5 million in May 2013, which was applied to outstanding amounts owed and the minimum commitment payment obligations of Unify under the reseller agreement through the end of 2013. The unapplied balance of the \$3.5 million payment was zero at September 30, 2015. The remaining future minimum commitment payment obligations were paid by Unify in cash.

Under this arrangement, we recognized software revenue of \$360,000 and \$3.8 million during the three and nine months ended September 30, 2014, respectively, which included revenue from resold software services and amounts up to the quarterly minimum revenue 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. Under this arrangement, we recognized no revenue during the three and nine months ended September 30, 2015.

As of September 30, 2015, Unify continues to resell our software services and has met its obligations under the revised reseller agreement; however, during the year ended December 31, 2014, actual revenue from resold software services was less than the net minimum purchase commitments during the same period. Therefore, we experienced a reduction in software revenue from Unify in the three and nine months ended September 30, 2015, as compared to the same periods in 2014.

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, and revenue related to quarterly minimum purchase commitments, from a related party reseller (Note 12). 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.

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Operating segment revenues and profitability for the three and nine months ended September 30, 2015 and 2014 were as follows (in thousands, except percentages):

| | Three Months Ended September 30, 2015 | | | | | | Three Months Ended September 30, 2014 | | | | | |
|---------------------------------|---------------------------------------|---|--------------|---|--------------|---|---------------------------------------|---|--------------|---|--------------|---|
| | | | Network | | Consolidated | | | | Network | | Consolidated | |
| | Software | | Connectivity | | | | Software | | Connectivity | | | |
| Net revenue | \$36,709 | | \$ 19,369 | | \$ 56,078 | | \$26,286 | | \$ 17,909 | | \$ 44,195 | |
| Costs of revenue | 14,815 | | 12,278 | | 27,093 | | 12,018 | | 11,316 | | 23,334 | |
| Gross profit | 21,894 | | 7,091 | | 28,985 | | 14,268 | | 6,593 | | 20,861 | |
| Gross margin | 60 | % | 37 | % | 52 | % | 54 | % | 37 | % | 47 | % |
| Operating expenses: | | | | | | | | | | | | |
| Direct selling and marketing | 16,075 | | 895 | | 16,970 | | 12,087 | | 856 | | 12,943 | |
| Direct research and development | 6,866 | | - | | 6,866 | | 5,961 | | - | | 5,961 | |
| Indirect | 7,943 | | 1,109 | | 9,052 | | 7,615 | | 838 | | 8,453 | |
| Total operating expenses | 30,884 | | 2,004 | | 32,888 | | 25,663 | | 1,694 | | 27,357 | |
| Income (Loss) from operations | \$(8,990) | | \$ 5,087 | | \$ (3,903) | | \$(11,395) | | \$ 4,899 | | \$ (6,496) | |

| | Nine Months Ended September 30, 2015 | | | | | | Nine Months Ended September 30, 2014 | | | | | |
|---------------------------------|--------------------------------------|---|--------------|---|--------------|---|--------------------------------------|---|--------------|---|--------------|---|
| | | | Network | | Consolidated | | | | Network | | Consolidated | |
| | Software | | Connectivity | | | | Software | | Connectivity | | | |
| Net revenue | \$103,227 | | \$ 57,260 | | \$ 160,487 | | \$70,493 | | \$ 51,867 | | \$ 122,360 | |
| Costs of revenue | 42,872 | | 36,072 | | 78,944 | | 30,486 | | 33,009 | | 63,495 | |
| Gross profit | 60,355 | | 21,188 | | 81,543 | | 40,007 | | 18,858 | | 58,865 | |
| Gross margin | 58 | % | 37 | % | 51 | % | 57 | % | 36 | % | 48 | % |
| Operating expenses: | | | | | | | | | | | | |
| Direct selling and marketing | 44,729 | | 2,654 | | 47,383 | | 32,401 | | 2,546 | | 34,947 | |
| Direct research and development | 19,818 | | - | | 19,818 | | 14,584 | | - | | 14,584 | |
| Indirect | 25,673 | | 3,395 | | 29,068 | | 20,389 | | 2,761 | | 23,150 | |
| Total operating expenses | 90,220 | | 6,049 | | 96,269 | | 67,374 | | 5,307 | | 72,681 | |
| Income (Loss) from operations | \$(29,865) | | \$ 15,139 | | \$ (14,726) | | \$(27,367) | | \$ 13,551 | | \$ (13,816) | |

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, 2014 Consolidated Financial Statements and notes thereto, along with Management's Discussion and Analysis of Financial Condition and Results of Operations included in our 2014 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. 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 in our 2014 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 (formerly 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 suite of 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.

DEVELOPMENTS

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 pursuant to their terms by the holders. 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.

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 suite of 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 suite of cloud software solutions.

(2) Perpetual product and services revenues are primarily derived from the sale of licenses to our workforce optimization suite of 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.

Certain 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 derived from shipments to customers who purchase our products for resale is generally recognized when such products are shipped (on a “sell-in” basis). We have historically experienced insignificant product returns from resellers, and our payment terms for these customers are similar to those granted to our end-users. If a reseller develops a pattern of payment delinquency, or seeks payment terms significantly longer in duration than our customary arrangements, we defer the revenue until the receipt of cash. Our arrangements with resellers are periodically reviewed as our business and products change.

Through the quarter ended September 30, 2014, software revenue also includes the quarterly minimum purchase commitments from a related party reseller referred to in Part I, Item 1 “Financial Statements” - Note 12 – Related Party Transactions.

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 suite of 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 and customer support 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 network connectivity service providers, hosting, support, employee labor costs and related expenses, to support delivery of our software solutions and services in the future.

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 as we continue to support growth initiatives.

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 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 labor 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 and operations in the future. As such, we expect general and administrative expenses to increase in absolute dollars in the future.

RESULTS OF OPERATIONS

Three Months Ended September 30, 2015 and 2014

The following is a tabular presentation of our condensed consolidated operating results for the three months ended September 30, 2015 compared to our condensed consolidated operating results for the three months ended September 30, 2014 (in thousands, except percentages):

| | 2015 | 2014 | \$ Change | % Change |
|----------------------------|------------|------------|--------------|-------------|
| Net revenue | \$56,078 | \$44,195 | \$11,883 | 27% |
| Costs of revenue | 27,093 | 23,334 | 3,759 | 16% |
| Gross profit | 28,985 | 20,861 | 8,124 | |
| Gross margin | 52 % | 47 % | | |
| Operating expenses: | | | | |
| Selling and marketing | 17,810 | 13,541 | 4,269 | 32% |
| Research and development | 7,328 | 6,316 | 1,012 | 16% |
| General and administrative | 7,750 | 7,500 | 250 | 3% |
| Total operating expenses | 32,888 | 27,357 | 5,531 | |
| Loss from operations | (3,903) | (6,496) | 2,593 | |
| Other expense | (1,612) | (82) | (1,530) | |
| Loss before income taxes | (5,515) | (6,578) | 1,063 | |
| Income tax expense | (163) | (106) | (57) | |
| Net loss | \$(5,678) | \$(6,684) | \$1,006 | |

Net revenue

Net revenues increased \$11.9 million or 27% to \$56.1 million during the three months ended September 30, 2015 compared to net revenues of \$44.2 million during the same period in 2014. The increase to net revenue relates to an increase of \$10.4 million in Software segment revenue due to continued focus and investment in selling and marketing efforts of our inContact suite of cloud contact center solutions through our direct sales and referral and reseller partner arrangements. Network connectivity segment revenue increased \$1.5 million as the increase of Network connectivity revenue associated with our inContact suite of cloud software solution customers exceeded the attrition of our Network connectivity-only customers.

We recognized \$360,000 of software revenue during the three months ended September 30, 2014 under our reseller agreement with Unify, which principally represents revenue from Unify's minimum purchase commitments. We did not recognize any revenue from Unify's minimum purchase commitments during the three months ended September

30, 2015, as the minimum purchase commitment expired in the third quarter of 2014. See additional information about the Unify relationship in Part 1, Item 1 “Financial Statements” – Note 12 – Related Party Transactions. The growth in Software revenue during the period more than offset the decrease in Unify minimum purchase commitment revenue.

Costs of revenue and gross margin

Costs of revenue increased \$3.8 million or 16% to \$27.1 million during the three months ended September 30, 2015 compared to \$23.3 million for the same period in 2014. Gross margin increased five percentage points to 52% for the three months ended September 30, 2015 from 47% for the same period in 2014. Gross margin primarily increased as a result of higher gross margin Software revenue growing at a greater rate than Network connectivity revenue, which has comparatively lower gross margin. The growth in Software gross margin more than offset the decrease in the Unify revenue minimum purchase commitment gross margin, increased amortization of intangible assets from business acquisitions, greater professional service personnel costs incurred to service larger mid-market and enterprise customers and to support resellers and increased costs related to the sale of third party vendor software services.

Selling and marketing

Selling and marketing expenses increased \$4.3 million or 32% to \$17.8 million during the three months ended September 30, 2015 from \$13.5 million for the same period in 2014. This increase is primarily a result of headcount additions for direct and channel sales employees and increased commissions as a result of increased revenue and headcount.

Research and development

Research and development expense increased \$1.0 million or 16% to \$7.3 million during the three months ended September 30, 2015 from \$6.3 million during the same period in 2014. 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.

General and administrative

General and administrative expense increased \$250,000 or 3% to \$7.8 million during the three months ended September 30, 2015 compared to \$7.5 million during the same period in 2014. The increase is primarily due to increased costs incurred to support our domestic and international business expansion.

Other expense

Other expense increased \$1.5 million to \$1.6 million during the three months ended September 30, 2015 from \$82,000 for the same period in 2014. The increase is primarily due to interest related to the Convertible Notes issued on March 30, 2015.

Income taxes

Income tax expense, which consists of various state income taxes and foreign taxes, was \$163,000 for the three months ended September 30, 2015 compared to \$106,000 for the same period in 2014.

Nine Months Ended September 30, 2015 and 2014

The following is a tabular presentation of our condensed consolidated operating results for the nine months ended September 30, 2015 compared to our condensed consolidated operating results for the nine months ended September 30, 2014 (in thousands, except percentages):

| | 2015 | 2014 | \$ Change | % Change |
|----------------------------|-----------|-----------|--------------|-------------|
| Net revenue | \$160,487 | \$122,360 | \$38,127 | 31% |
| Costs of revenue | 78,944 | 63,495 | 15,449 | 24% |
| Gross profit | 81,543 | 58,865 | 22,678 | |
| Gross margin | 51 % | 48 % | | |
| Operating expenses: | | | | |
| Selling and marketing | 49,549 | 36,602 | 12,947 | 35% |
| Research and development | 21,021 | 15,554 | 5,467 | 35% |
| General and administrative | 25,699 | 20,525 | 5,174 | 25% |

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| | | | |
|------------------------------|-------------|------------|------------|
| Total operating expenses | 96,269 | 72,681 | 23,588 |
| Loss from operations | (14,726) | (13,816) | (910) |
| Other expense | (3,756) | (426) | (3,330) |
| Loss before income taxes | (18,482) | (14,242) | (4,240) |
| Income tax benefit (expense) | (474) | 9,262 | (9,736) |
| Net loss | \$(18,956) | \$(4,980) | \$(13,976) |

Revenue

Total revenues increased \$38.1 million or 31% to \$160.5 million during the nine months ended September 30, 2015 compared to revenues of \$122.4 million during the same period in 2014. The increase relates to an increase of \$32.7 million in Software segment revenue due to continued focus and investment in selling and marketing efforts of our inContact portfolio of cloud contact center solutions through our direct sales and referral and reseller partner arrangements. Network connectivity segment revenue increased

\$5.4 million as the increase of Network connectivity revenue associated with our inContact portfolio customers exceeded the attrition of our Network connectivity only customers.

We recognized \$3.8 million of software revenue during the nine months ended September 30, 2014 under our reseller agreement with Unify, which principally represents revenue from Unify's minimum purchase commitments. We did not recognize any revenue from Unify's minimum purchase commitments during the nine months ended September 30, 2015, as the minimum purchase commitment expired in the third quarter of 2014. See additional information about the Unify relationship in Part 1, Item 1 "Financial Statements" – Note 12 – Related Party Transactions. The growth in Software revenue during the period more than offset the decrease in Unify minimum purchase commitment revenue.

Costs of revenue and gross margin

Costs of revenue increased \$15.4 million or 24% to \$78.9 million during the nine months ended September 30, 2015 compared to \$63.5 million for the same period in 2014. Gross margin increased three percentage points to 51% for the nine months ended September 30, 2015 compared to 48% for the same period in 2014. Gross margin primarily increased as a result of higher gross margin Software revenue growing at a greater rate than Network connectivity revenue, which has comparatively lower gross margin. The growth in Software gross margin more than offset the decrease in Unify minimum purchase commitment gross margin, increased amortization of intangible assets from business acquisitions, greater professional service personnel costs incurred to service larger mid-market and enterprise customers and to support resellers and increased costs related to the sale of third party vendor software services.

Selling and marketing

Selling and marketing expenses increased \$12.9 million or 35% to \$49.5 million during the nine months ended September 30, 2015 from \$36.6 million for the same period in 2014. This increase is primarily a result of headcount additions, including Uptivity acquisition headcount additions, for direct and channel sales employees and increased commissions as a result of increased revenue and headcount.

Research and development

Research and development expense increased \$5.5 million or 35% to \$21.0 million during the nine months ended September 30, 2015 from \$15.6 million during the same period in 2014. The increase relates to headcount additions, including the Uptivity acquisition, reflecting our efforts to expand our content offerings, upgrade and extend our service offerings and develop new technologies primarily through headcount additions.

General and administrative

General and administrative expense increased \$5.2 million or 25% to \$25.7 million during the nine months ended September 30, 2015 compared to \$20.5 million during the same period in 2014. The increase is primarily due to increased costs incurred to support our domestic and international business expansion, including Uptivity acquisition headcount additions.

Other expense

Other expense increased \$3.3 million to \$3.8 million during the nine months ended September 30, 2015 from \$426,000 for the same period in 2014. The increase is primarily due to interest related to the Convertible Notes issued on March 30, 2015.

Income taxes

The provision for income taxes for the nine months ended September 30, 2015 was \$474,000 compared to \$9.3 million benefit for the same period in 2014. The income tax benefit in the nine months ended September 30, 2014 was due to recording a deferred tax liability upon acquisition of Uptivity related to a reduction of carrying value of deferred revenue and acquisition of intangibles for which no tax benefit will be derived. The reduction of carrying value and acquired intangibles resulted in a partial reversal of the valuation allowance upon consolidation.

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 and revenue related to

quarterly minimum purchase commitments from Unify through July 2014. 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.

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, 2015 and 2014 (in thousands, except percentages):

| | Three Months Ended September 30, | | | | Nine Months Ended September 30, | | | |
|---------------------------------|----------------------------------|-------------|-----------|----------|---------------------------------|-------------|------------|----------|
| | 2015 | 2014 | \$ Change | % Change | 2015 | 2014 | \$ Change | % Change |
| Net revenue | \$36,709 | \$26,286 | \$ 10,423 | 40% | \$103,227 | \$70,493 | \$ 32,734 | 46% |
| Costs of revenue | 14,815 | 12,018 | 2,797 | 23% | 42,872 | 30,486 | 12,386 | 41% |
| Gross profit | 21,894 | 14,268 | 7,626 | | 60,355 | 40,007 | 20,348 | |
| Gross margin | 60 % | 54 % | | | 58 % | 57 % | | |
| Operating expenses: | | | | | | | | |
| Direct selling and marketing | 16,075 | 12,087 | 3,988 | 33% | 44,729 | 32,401 | 12,328 | 38% |
| Direct research and development | 6,866 | 5,961 | 905 | 15% | 19,818 | 14,584 | 5,234 | 36% |
| Indirect | 7,943 | 7,615 | 328 | 4% | 25,673 | 20,389 | 5,284 | 26% |
| Loss from operations | \$(8,990) | \$(11,395) | \$ 2,405 | | \$(29,865) | \$(27,367) | \$(2,498) | |

Three Months Ended September 30, 2015 and 2014

The Software segment revenue increased by \$10.4 million or 40% to \$36.7 million during the three months ended September 30, 2015 from \$26.3 million for the same period in 2014. The increase relates primarily to revenue generated from our inContact suite of 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.

We recognized \$360,000 of software revenue during the three months ended September 30, 2014 under our reseller agreement with Unify, which principally represents revenue from Unify’s minimum purchase commitments. We did not recognize any revenue from Unify’s minimum purchase commitments during the three months ended September 30, 2015, as the minimum purchase commitment expired in the third quarter of 2014. See additional information about the Unify relationship in Part 1, Item 1 “Financial Statements” – Note 12 – Related Party Transactions. The growth in Software revenue during the period more than offset the decrease in Unify minimum purchase commitment revenue.

Gross margin increased six percentage points to 60% for the three months ended September 30, 2015 from 54% for the same period in 2014. Gross margin increased primarily as a result of Software revenue growth that was partially offset by the decrease in the Unify minimum purchase commitment gross margin, increased amortization of intangible assets from business acquisitions, greater professional service personnel costs incurred to service larger mid-market and enterprise customers and to support resellers and increased costs related to the sale of third party vendor software services.

Direct selling and marketing expenses in the Software segment increased \$4.0 million or 33% to \$16.1 million during the three months ended September 30, 2015 compared to \$12.1 million for the same period in 2014. The increase in direct selling and marketing expenses in the Software segment 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 suite 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, 2015, we incurred \$6.9 million in direct research and development costs

compared to \$6.0 million for the same period in 2014 and have capitalized an additional \$3.0 million of costs incurred during the three months ended September 30, 2015 related to our internally developed software compared to \$3.0 million for the same period in 2014.

Indirect expenses, which consist of overhead, such as allocated general and administrative expenses, rent, utilities and depreciation on property and equipment, increased \$328,000 or 4% to \$7.9 million during the three months ended September 30, 2015 from \$7.6 million for the same period in 2014 due to the general increase in direct expenses and more indirect costs being allocated to the Software segment with the increasing investment in the Software segment.

Nine Months Ended September 30, 2015 and 2014

The Software segment revenue increased by \$32.7 million or 46% to \$103.2 million during the nine months ended September 30, 2015 from \$70.5 million for the same period in 2014. 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 and referral and reseller partner arrangements. The increase is also the result of the addition of revenue generated from the sale of Uptivity products and services since the acquisition in May 2014.

We recognized \$3.8 million of software revenue during the nine months ended September 30, 2014 under our reseller agreement with Unify, which principally represents revenue from Unify's minimum purchase commitments. We did not recognize any revenue from Unify's minimum purchase commitments during the nine months ended September 30, 2015, as the minimum purchase commitment expired in the third quarter of 2014. See additional information about the Unify relationship in Part 1, Item 1 "Financial Statements" – Note 12 – Related Party Transactions. The growth in Software revenue during the period more than offset the decrease in Unify minimum purchase commitment revenue.

Gross margin increased by one percentage point to 58% for the nine months ended September 30, 2015 compared to 57% for the same period in 2014. Gross margin increased primarily as a result of Software revenue growth that more than offset the decrease in revenue related to the expiration of the minimum purchase commitment in the third quarter of 2014, increased amortization of intangible assets from business acquisitions, greater professional service personnel costs incurred to service larger mid-market and enterprise customers and to support resellers and increased costs related to the sale of third party vendor software services.

Direct selling and marketing expenses in the Software segment increased \$12.3 million or 38% to \$44.7 million during the nine months ended September 30, 2015 compared to \$32.4 million for the same period in 2014. This increase is a result of headcount additions, including Uptivity acquisition 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 nine months ended September 30, 2015, we incurred \$19.8 million in direct research and development costs, including direct research and development costs generated by Uptivity, compared to \$14.6 million for the same period in 2014 and have capitalized an additional \$7.5 million of costs incurred during the nine months ended September 30, 2015 related to our internally developed software compared to \$8.1 million for the same period in 2014.

Indirect expenses, which consist of overhead, such as allocated general and administrative expenses, rent, utilities and depreciation on property and equipment, increased \$5.3 million or 26% to \$25.7 million during the nine months ended September 30, 2015 from \$20.4 million for the same period in 2014 due to the general increase in indirect expenses

and more indirect costs being allocated to the Software segment with the continued shift in revenue and direct expense mix from the Network connectivity segment to the Software segment.

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Network Connectivity Segment Results

The following is a tabular presentation and comparison of our Network connectivity segment condensed consolidated operating results for the three months ended September 30, 2015 and 2014 (in thousands, except percentages):

| | Three Months Ended September 30, | | | | Nine Months Ended September 30, | | | |
|------------------------------|----------------------------------|----------|-----------|----------|---------------------------------|----------|-----------|----------|
| | 2015 | 2014 | \$ Change | % Change | 2015 | 2014 | \$ Change | % Change |
| Net revenue | \$19,369 | \$17,909 | \$ 1,460 | 8% | \$57,260 | \$51,867 | \$ 5,393 | 10% |
| Costs of revenue | 12,278 | 11,316 | 962 | 9% | 36,072 | 33,009 | 3,063 | 9% |
| Gross profit | 7,091 | 6,593 | 498 | | 21,188 | 18,858 | 2,330 | |
| Gross margin | 37 | % 37 | % | | 37 | % 36 | % | |
| Operating expenses: | | | | | | | | |
| Direct selling and marketing | 895 | 856 | 39 | 5% | 2,654 | 2,546 | 108 | 4% |
| Indirect | 1,109 | 838 | 271 | 32% | 3,395 | 2,761 | 634 | 23% |
| Income from operations | \$5,087 | \$4,899 | \$ 188 | | \$15,139 | \$13,551 | \$ 1,588 | |

Three Months Ended September 30, 2015 and 2014

Network connectivity segment revenue increased \$1.5 million or 8% to \$19.4 million during the three months ended September 30, 2015 compared to \$17.9 million for the same period in 2014 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 9% due to the increase in revenue. Network connectivity gross margin remained constant at 37%. 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 increased \$271,000 or 32% during the three months ended September 30, 2015 compared to the same period in 2014.

Nine Months Ended September 30, 2015 and 2014

Network connectivity segment revenue increased \$5.4 million or 10% to \$57.3 million during the nine months ended September 30, 2015 compared to \$51.9 million for the same period in 2014 due to the increase of network connectivity revenue associated with our inContact portfolio customers exceeding the attrition of our Network connectivity-only customers. Our costs of revenue increased 9% due to the increase in revenue. Network connectivity gross margin increased by 1% due to increased efficiencies in call routing related to a continued investment in technology and lower negotiated direct costs. Selling and marketing expenses increased \$108,000 or 4% during the nine months ended September 30, 2015 as compared to the same period in 2014. Indirect expenses, which consist of overhead, such as allocated general and administrative expense, rent, utilities and depreciation on property and equipment increased \$634,000 or 23% during the nine months ended September 30, 2015 compared to the same period in 2014.

LIQUIDITY AND CAPITAL RESOURCES

Current Financial Condition

Our principal sources of liquidity are cash and cash equivalents, short-term investments and cash available from borrowings under our Revolving Credit Agreement, which expires in July 2016. At September 30, 2015, we had \$31.2 million of cash and cash equivalents and \$76.0 million of short-term investments. In addition, we have access to additional available borrowings of \$15.0 million under our Revolving Credit Agreement with Zions, subject to meeting our covenant requirements. The Revolving Credit Agreement is collateralized by substantially all our assets.

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.

We experienced a net loss of \$19.0 million during the nine months ended September 30, 2015. Significant non-cash expenses affecting operations during the nine months ended September 30, 2015 included \$16.3 million of depreciation and amortization and \$6.5 million of stock-based compensation. The primary uses of our working capital was an increase in accounts receivable of \$11.6 million due to an increase in sales and the timing of collection and an increase in other current assets of \$2.1 million largely due to an increase in prepaid software maintenance. Sources of working capital primarily related to maturities of investments of \$13.7 million, an

increase of \$4.2 million in PCS related deferred revenue associated to the delivery of perpetual licenses as of September 30, 2015, and an increase in accounts payable of \$2.5 million due to the timing of the receipt and payment of vendor invoices.

We used \$93.8 million in investing activities related primarily to purchases of investments and purchases of equipment and capitalized internally developed software costs.

Financing activity provided \$91.6 million related primarily to the borrowings under the Convertible Notes and the exercise of stock options, partially offset by principal payments on term debt and capital lease obligations, which were fully paid as of September 30, 2015.

We continue to take a proactive approach in managing our operating expenditures and cash flow from operations. We expect to rely on internally generated cash, our Revolving Credit Agreement and the proceeds from the Convertible Notes to finance operations and capital requirements. We believe that existing cash and cash equivalents, investments, cash from operations and available borrowings under our Revolving Credit Agreement will be sufficient to meet our cash requirements during 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, 2014. 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

Other than the items below, market risks at September 30, 2015 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, 2015.

Cash and Cash Equivalents and Investments

We maintain a portfolio of cash equivalents and investments in a variety of money market funds, commercial paper and marketable debt securities of corporations and municipalities securities. The primary objective of our investment activities is to maintain the safety of principal and preserve liquidity while maximizing yields without significantly increasing risk. We do not enter into investments for trading or speculative purposes. Fixed-rate securities are subject to market risk so changes in prevailing interest rates may adversely impact their fair market value should interest rates rise. While we do not intend to sell these fixed rate securities prior to maturity based on a sudden change in market interest rates, should we choose to sell these securities in the future, our consolidated operating results or cash flows may be adversely affected. We do not use derivatives or similar instruments to manage our interest rate risk. Due to the high investment quality and relatively short duration of these investments, we do not believe that they present any material exposure to changes in fair market value as a result of changes in interest rates.

Long-Term Debt

The interest rate on our Revolving Credit Agreement is variable so market fluctuations in interest rates may increase our interest expense.

A change in interest rates on our Convertible Notes would not impact the interest expense or carrying value of the Convertible Notes as the coupon rate is fixed. However, the fair market value of the Convertible Notes is exposed to interest rate risk. Generally, the fair market value of the Convertible Notes will increase as interest rates fall and decrease as interest rates rise. For further discussion regarding the fair value of the Convertible Notes see Part I, Item 1 “Financial Statements” - Note 3.

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 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, 2015.

Material Weakness Previously Identified

We previously reported a material weakness in internal control over financial reporting related to the calculation and assessment of state sales tax for certain of our products and services and the appropriate accounting for the related state sales tax obligations in “Item 9A. Controls and Procedures” in our Annual Report on Form 10-K /A for the year ended December 31, 2013, Form 10-K for the year ended December 31, 2014, and Quarterly Reports on Form 10-Q for the quarters during the subsequent period.

Remediation Efforts on Previously Identified Material Weakness

Prior to the end of the third quarter of 2015, we re-assessed and revised our control activities to address the material weakness in our internal control over financial reporting related to the calculation and assessment of state sales tax for certain of our products and services. Specifically, we have implemented a new billing system and a new tax vendor to ensure that tax rates are accurate and updated timely. We have also implemented new controls related to training our billing and finance teams and testing the accuracy and completeness of the tax inputs and outputs of the billing system. Management has tested these new controls and found them to be effective and has concluded that as of September 30, 2015, this material weakness has been remediated. In addition, the Company will continue to test the ongoing operating effectiveness of the new controls in future periods and will be subject to review and oversight by the Audit Committee of our Board of Directors.

Changes in Internal Control Over Financial Reporting

Other than the changes noted above to remediate the previously reported material weakness, there have been no changes in our internal control over financial reporting during the quarter ended September 30, 2015 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. 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.

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

Repurchases of Securities

Stock repurchases for the three months ended September 30, 2015, were as follows (in thousands, except per share data):

| Period | Total number of shares purchased | Average price per share | Total number of shares purchased as part of publicly announced plans or programs | Maximum number of shares that may yet be purchased under the plans or programs |
|------------------------------------|----------------------------------|-------------------------|--|--|
| July 1 - 31, 2015 ⁽¹⁾ | \$ 44 | \$ 2.31 | - | - |
| August 1 - 31, 2015 ⁽²⁾ | 1 | \$ 7.07 | - | - |
| September 1 - 30, 2015 | - | \$ - | - | - |
| Total shares repurchased | \$ 45 | 3.13 | - | - |

(1) In July 2015, we received 11,000 shares of our common stock from employees for the settlement of the employees' payroll tax obligation of \$105,000 associated with the lapsing of the selling restriction of a restricted stock award. We received 33,000 shares of our common stock from an employee as a result of the cancelation of a restricted stock award upon termination of employment.

(2) In August 2015, we received 1,000 shares of our common stock from employees for the settlement of the employees' payroll tax obligation of \$18,000 associated with the lapsing of the selling restriction of a restricted

stock award.

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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.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

(1) This document was filed as exhibits to the Registration Statement on Form S-8 filed by inContact with the Securities and Exchange Commission on August 7, 2015, and is incorporated herein by this reference.

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: October 30, 2015 By: /s/ Paul Jarman
Paul Jarman
Chief Executive Officer

Date: October 30, 2015 By: /s/ Gregory S. Ayers
Gregory S. Ayers
Chief Financial Officer