

inContact, Inc.  
Form 10-Q  
May 06, 2011  
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**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 March 31, 2011**

**Commission File No. 1-33762**

**inContact, Inc.**

(Exact name of registrant as specified in its charter)

Delaware

87-0528557

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(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)

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 April 29, 2011 |
|----------------------------------|----------------------------------|
| Common Stock, \$0.0001 par value | 35,809,178 shares                |

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**Table of Contents****INCONTACT, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS - (Unaudited)***(in thousands except share and per share data)*

|                                                                                                                                                                                   | <b>March 31,<br/>2011</b> | <b>December 31,<br/>2010</b> |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------|------------------------------|
| <b>ASSETS</b>                                                                                                                                                                     |                           |                              |
| Current assets:                                                                                                                                                                   |                           |                              |
| Cash and cash equivalents                                                                                                                                                         | \$ 10,223                 | \$ 10,321                    |
| Restricted cash                                                                                                                                                                   | 246                       | 246                          |
| Accounts and other receivables, net of allowance for uncollectible accounts of \$634 and \$749, respectively                                                                      | 9,676                     | 9,303                        |
| Other current assets                                                                                                                                                              | 2,759                     | 2,293                        |
| <b>Total current assets</b>                                                                                                                                                       | <b>22,904</b>             | <b>22,163</b>                |
| Property and equipment, net                                                                                                                                                       | 13,715                    | 12,041                       |
| Intangible assets, net                                                                                                                                                            | 1,801                     | 1,938                        |
| Goodwill                                                                                                                                                                          | 4,086                     | 4,073                        |
| Other assets                                                                                                                                                                      | 314                       | 370                          |
| <b>Total assets</b>                                                                                                                                                               | <b>\$ 42,820</b>          | <b>\$ 40,585</b>             |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>                                                                                                                                       |                           |                              |
| Current liabilities:                                                                                                                                                              |                           |                              |
| Trade accounts payable                                                                                                                                                            | \$ 7,861                  | \$ 7,295                     |
| Accrued liabilities                                                                                                                                                               | 2,620                     | 2,079                        |
| Accrued commissions                                                                                                                                                               | 997                       | 1,058                        |
| Current portion of deferred revenue                                                                                                                                               | 1,034                     | 898                          |
| Current portion of long-term debt and capital lease obligations                                                                                                                   | 1,761                     | 1,334                        |
| Warrant liability                                                                                                                                                                 | 196                       | 246                          |
| <b>Total current liabilities</b>                                                                                                                                                  | <b>14,469</b>             | <b>12,910</b>                |
| Long-term debt and capital lease obligations                                                                                                                                      | 9,944                     | 8,653                        |
| Deferred rent                                                                                                                                                                     | 258                       | 286                          |
| Deferred revenue                                                                                                                                                                  | 93                        | 34                           |
| <b>Total liabilities</b>                                                                                                                                                          | <b>24,764</b>             | <b>21,883</b>                |
| Commitments and contingencies                                                                                                                                                     |                           |                              |
| Stockholders' equity:                                                                                                                                                             |                           |                              |
| Common stock, \$0.0001 par value; 100,000,000 shares authorized; 35,757,513 and 35,713,810 shares issued and outstanding as of March 31, 2011 and December 31, 2010, respectively | 4                         | 3                            |
| Additional paid-in capital                                                                                                                                                        | 84,829                    | 84,474                       |
| Accumulated deficit                                                                                                                                                               | (66,777)                  | (65,775)                     |
| <b>Total stockholders' equity</b>                                                                                                                                                 | <b>18,056</b>             | <b>18,702</b>                |
| <b>Total liabilities and stockholders' equity</b>                                                                                                                                 | <b>\$ 42,820</b>          | <b>\$ 40,585</b>             |

See accompanying notes to condensed consolidated financial statements.



**Table of Contents****INCONTACT, INC.****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS - (Unaudited)***(in thousands except per share data)*

|                                             | <b>Three months<br/>ended March 31,</b> |             |
|---------------------------------------------|-----------------------------------------|-------------|
|                                             | <b>2011</b>                             | <b>2010</b> |
| Revenue:                                    |                                         |             |
| Software                                    | \$ 9,334                                | \$ 8,330    |
| Telecom                                     | 12,001                                  | 12,791      |
| Total revenue                               | 21,335                                  | 21,121      |
| Costs of revenue:                           |                                         |             |
| Software                                    | 3,590                                   | 2,722       |
| Telecom                                     | 8,898                                   | 9,116       |
| Total costs of revenue                      | 12,488                                  | 11,838      |
| Gross profit                                | 8,847                                   | 9,283       |
| Operating expenses:                         |                                         |             |
| Selling and marketing                       | 5,210                                   | 4,135       |
| Research and development                    | 1,400                                   | 1,128       |
| General and administrative                  | 3,129                                   | 2,619       |
| Total operating expenses                    | 9,739                                   | 7,882       |
| (Loss) income from operations               | (892)                                   | 1,401       |
| Other income (expense):                     |                                         |             |
| Interest expense                            | (132)                                   | (69)        |
| Change in fair value of warrants            | 50                                      | 184         |
| Other expense                               | (13)                                    |             |
| Total other (expense) income                | (95)                                    | 115         |
| (Loss) income before income taxes           | (987)                                   | 1,516       |
| Income tax expense                          | (15)                                    | (14)        |
| Net (loss) income                           | \$ (1,002)                              | \$ 1,502    |
| Net (loss) income per common share:         |                                         |             |
| Basic                                       | \$ (0.03)                               | \$ 0.04     |
| Diluted                                     | \$ (0.03)                               | \$ 0.04     |
| Weighted average common shares outstanding: |                                         |             |
| Basic                                       | 36,121                                  | 34,823      |
| Diluted                                     | 36,121                                  | 35,993      |

See accompanying notes to condensed consolidated financial statements.



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**INCONTACT, INC.**

**CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY - (Unaudited)**

*(in thousands)*

|                                                            | <b>Common Stock</b> |               | <b>Additional<br/>Paid-in<br/>Capital</b> | <b>Accumulated<br/>Deficit</b> | <b>Total</b> |
|------------------------------------------------------------|---------------------|---------------|-------------------------------------------|--------------------------------|--------------|
|                                                            | <b>Shares</b>       | <b>Amount</b> |                                           |                                |              |
| Balance at December 31, 2010                               | 35,714              | \$ 3          | \$ 84,474                                 | \$ (65,775)                    | \$ 18,702    |
| Common stock issued for options exercised                  | 24                  | 1             | 53                                        |                                | 54           |
| Common stock issued under the employee stock purchase plan | 14                  |               | 39                                        |                                | 39           |
| Issuance of restricted stock for services                  | 6                   |               | 19                                        |                                | 19           |
| Stock-based compensation                                   |                     |               | 244                                       |                                | 244          |
| Net loss                                                   |                     |               |                                           | (1,002)                        | (1,002)      |
| Balance at March 31, 2011                                  | 35,758              | \$ 4          | \$ 84,829                                 | \$ (66,777)                    | \$ 18,056    |

See accompanying notes to condensed consolidated financial statements.

**Table of Contents****INCONTACT, INC.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS - (Unaudited)***(in thousands)*

|                                                                                          | <b>Three months ended<br/>March 31,</b> |             |
|------------------------------------------------------------------------------------------|-----------------------------------------|-------------|
|                                                                                          | <b>2011</b>                             | <b>2010</b> |
| Cash flows from operating activities:                                                    |                                         |             |
| Net (loss) income                                                                        | \$ (1,002)                              | \$ 1,502    |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: |                                         |             |
| Depreciation of property and equipment                                                   | 869                                     | 806         |
| Amortization of software development costs                                               | 575                                     | 377         |
| Amortization of intangible assets                                                        | 137                                     | 146         |
| Amortization of note financing costs                                                     | 24                                      | 14          |
| Interest accretion                                                                       | 5                                       |             |
| Stock-based compensation                                                                 | 244                                     | 167         |
| Stock issued for services                                                                | 19                                      | 51          |
| Change in fair value of warrants                                                         | (50)                                    | (184)       |
| Loss on disposal of property and equipment                                               | 13                                      |             |
| Changes in operating assets and liabilities:                                             |                                         |             |
| Accounts and other receivables, net                                                      | (373)                                   | 347         |
| Other current assets                                                                     | (481)                                   | (264)       |
| Other non-current assets                                                                 | 56                                      | 41          |
| Trade accounts payable                                                                   | 724                                     | 422         |
| Accrued liabilities                                                                      | 597                                     | (536)       |
| Accrued commissions                                                                      | (61)                                    | (22)        |
| Deferred rent                                                                            | (19)                                    | (20)        |
| Deferred revenue                                                                         | 195                                     | (183)       |
| Net cash provided by operating activities                                                | 1,472                                   | 2,664       |
| Cash flows from investing activities:                                                    |                                         |             |
| Contingent purchase price payments                                                       | (135)                                   | (207)       |
| Proceeds from sale of auction rate preferred securities                                  |                                         | 125         |
| Capitalized software development costs                                                   | (1,129)                                 | (862)       |
| Purchases of property and equipment                                                      | (1,098)                                 | (85)        |
| Net cash used in investing activities                                                    | (2,362)                                 | (1,029)     |
| Cash flows from financing activities:                                                    |                                         |             |
| Proceeds from exercise of options and warrants                                           | 53                                      | 172         |
| Proceeds from sale of stock under employee stock purchase plan                           | 39                                      |             |
| Principal payments on long-term debt and capital lease obligations                       | (530)                                   | (531)       |
| Borrowings under the revolving credit notes                                              | 5,230                                   | 5,500       |
| Payments under the revolving credit notes                                                | (4,000)                                 | (7,000)     |
| Net cash provided by (used in) financing activities                                      | 792                                     | (1,859)     |
| Net decrease in cash and cash equivalents                                                | (98)                                    | (224)       |
| Cash and cash equivalents at the beginning of the period                                 | 10,321                                  | 10,852      |
| Cash and cash equivalents at the end of the period                                       | \$ 10,223                               | \$ 10,628   |

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### Supplemental schedule of non-cash investing and financing activities:

|                                                                         |          |        |
|-------------------------------------------------------------------------|----------|--------|
| Property and equipment included in trade accounts payable               | \$ 41    | \$ 145 |
| Contingent purchase price payments included in trade accounts payable   | \$       | \$ 52  |
| Property and equipment and other assets financed through capital leases | \$ 1,005 | \$     |

See accompanying notes to condensed consolidated financial statements.

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**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-based call center applications through our inContact® suite, an advanced contact handling and performance management software platform. Cloud-based is a term to refer to computing, data storage and delivery of technology services through the Internet, which includes software-as-a-service ( SaaS ). Our services provide a variety of connectivity options for carrying inbound calls to our inContact suite or linking agents to our inContact applications. We provide customers the ability to monitor agent effectiveness and customer satisfaction through our user survey tools. We are also an aggregator and provider of telecommunications services. We contract with a number of third party providers for the right to resell the various telecommunication services and products they provide, and then offer all of these services to the customers. These services and products allow customers to buy only the telecommunications services they need, combine those services in a customized enhanced contact center package, receive one bill for those services, and call a single point of contact if a service problem or billing issue arises.

*Basis of Presentation*

These unaudited condensed consolidated financial statements of inContact and its subsidiaries have been prepared in accordance with the rules and regulations of the United States Securities and Exchange Commission ( SEC ). Such rules and regulations allow the omission of certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States, so long as the statements are not misleading. In the opinion of management, these financial statements and accompanying notes contain all adjustments (consisting of normal recurring adjustments) necessary to present fairly the financial position and results of operations for the periods presented herein. These condensed consolidated financial statements should be read in conjunction with the consolidated audited financial statements and notes thereto contained in the Annual Report on Form 10-K for the year ended December 31, 2010, filed with the SEC on March 11, 2011. The results of operations for the three month period ended March 31, 2011 are not necessarily indicative of the results to be expected for the year ending December 31, 2011. Our significant accounting policies are set forth in Note 1 to the consolidated financial statements in the 2010 Annual Report on Form 10-K.

*Recent Accounting Pronouncements*

Effective January 1, 2011, the Company adopted the Financial Accounting Standards Board ( FASB ) revised accounting guidance related to revenue arrangements with multiple deliverables. The guidance applies to all deliverables under contractual arrangements in which a vendor will perform multiple revenue-generating activities. The guidance addresses how arrangement consideration should be allocated to the separate units of accounting, when applicable. The new guidance retains the criteria when delivered items in a multiple-deliverable arrangement should be considered separate units of accounting, but it removes the previous separation criterion that objective and reliable evidence of fair value of any undelivered items must exist for the delivered items to be considered a separate unit or separate units of accounting. Adoption of this guidance did not have a significant impact on the timing or amount of revenue recognized as we only have one unit of accounting for our arrangements that contain both our inContact suite of services and professional services.

**NOTE 2. REVENUE RECOGNITION**

Revenue is recognized when all of the following four criteria are met: (1) persuasive evidence of an arrangement exists, (2) the fee is fixed or determinable, (3) collection is reasonably assured, and (4) delivery has occurred or services have been rendered.

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

*inContact suite of services.* Revenue is derived from the use of any of our inContact suite that are provided on a monthly recurring basis. The all-in-one inContact solution includes features such as skills-based routing; automated call distribution; self-service

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menus; speech recognition based automated interactive voice response; database integration with contact handling technology; multimedia contact management (voice, fax, e-mail and chat); management reporting features; workforce management features; performance optimization benchmarking; custom call routing and call flow design; and new hire screening and online training tools. Monthly recurring charges are generally billed in arrears and recognized for the period in which they are earned. In addition to the monthly recurring revenue, revenue is also received on a non-recurring basis for professional services included in implementing or improving a customer's inContact suite experience. For sales contracts with multiple elements (hosted software, training, installation and long distance services), we follow the guidance provided in ASC 605-25, *Revenue Recognition for Multiple-Element Arrangements*, because customers do not have the right to take possession of our hosted software. As such, these arrangements are

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considered service contracts and are not within the scope of Industry Topic 985, *Software*. Because our professional services are not considered to have standalone value, we defer revenue for upfront fees received for professional services, such as training and installation, and recognize such fees as revenue over the term of the contract, which is generally 12 to 36 months. Accordingly, we have recorded \$1.1 million and \$932,000 of deferred revenue at March 31, 2011 and December 31, 2010, respectively. Fees for long distance services in multiple element arrangements with the inContact suite are based on usage and are recognized as revenue in the same manner as fees for traditional long distance services discussed in the following paragraph.

*Traditional long distance services.* Revenue is derived from traditional telecommunications services, such as dedicated transport, switched long distance and data services. These services are provided over our network or through third party telecommunications providers. Our network is the backbone of our inContact suite and allows us to provide the all-in-one inContact solution. Revenue for the transactional long distance 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 accrued for incurred usage to date.

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

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

The following table sets forth the computation of basic and diluted earnings per common share for the three month periods ended March 31, 2011 and 2010 (in thousands, except per share amounts):

|                                                    | <b>Three months ended<br/>March 31,</b> |                |
|----------------------------------------------------|-----------------------------------------|----------------|
|                                                    | <b>2011</b>                             | <b>2010</b>    |
| <b>Numerator:</b>                                  |                                         |                |
| Net (loss) income                                  | \$ (1,002)                              | \$ 1,502       |
| <b>Denominator:</b>                                |                                         |                |
| Basic weighted average shares outstanding          | 36,121                                  | 34,823         |
| <b>Effect of dilutive securities:</b>              |                                         |                |
| Stock warrants                                     |                                         | 264            |
| Stock options                                      |                                         | 588            |
| Restricted stock units                             |                                         | 318            |
| <b>Diluted weighted average shares outstanding</b> | <b>36,121</b>                           | <b>35,993</b>  |
| <b>Net (loss) income per share</b>                 |                                         |                |
| <b>Basic</b>                                       | <b>\$ (0.03)</b>                        | <b>\$ 0.04</b> |
| <b>Diluted</b>                                     | <b>\$ (0.03)</b>                        | <b>\$ 0.04</b> |

As a result of incurring a net loss for the three months ended March 31, 2011, no potentially dilutive securities are included in the calculation of diluted earnings per share because such effect would be anti-dilutive. We had potentially dilutive securities representing approximately 5.6 million shares of common stock at March 31, 2011.

Potentially dilutive securities representing approximately 2.5 million shares of common stock at March 31, 2010 were excluded from the computation of diluted earnings per common share because their effect would have been anti-dilutive.



**Table of Contents****NOTE 4. FAIR VALUE OF FINANCIAL INSTRUMENTS**

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

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

Level 2: Observable market based inputs or unobservable inputs that are corroborated by market data.

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

*Fair Value Estimates*

We did not have any transfers of assets and liabilities between Level 1 and Level 2 of the fair value measurement hierarchy during the three months ended March 31, 2011.

The following tables set forth the financial liabilities that we measured at fair value on a recurring basis by level within the fair value hierarchy. We classify assets and liabilities measured at fair value in their entirety based on the lowest level of input that is significant to their fair value measurement. No financial assets were measured on a recurring basis.

Liabilities measured at fair value on a recurring basis consisted of the following at March 31, 2011 and December 31, 2010 (*in thousands*):

|              | Level 1    | Level 2    | Level 3 | Fair value<br>at<br>March 31,<br>2011    |
|--------------|------------|------------|---------|------------------------------------------|
| Liabilities: |            |            |         |                                          |
| Warrants     | \$         | \$         | \$ 196  | \$ 196                                   |
|              |            |            |         |                                          |
|              | Level<br>1 | Level<br>2 | Level 3 | Fair value<br>at<br>December 31,<br>2010 |
| Liabilities: |            |            |         |                                          |
| Warrants     | \$         | \$         | \$ 246  | \$ 246                                   |

*Recurring Level 3 Activity*

The table below provides a reconciliation of the beginning and ending balances for the major classes of assets and liabilities measured at fair value using significant unobservable inputs (Level 3). The table reflects activity for the quarter for all financial assets and liabilities categorized as Level 3 during the periods ended March 31, 2011 and 2010 (*in thousands*):

|                              | Auction Rate<br>Preferred<br>Securities | Warrants |
|------------------------------|-----------------------------------------|----------|
| Balance at December 31, 2009 | \$ 125                                  | \$ (496) |

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|                              |       |          |
|------------------------------|-------|----------|
| Total redemptions            | (125) |          |
| Total change in fair value   |       | 184      |
| Balance at March 31, 2010    | \$    | \$ (312) |
| Balance at December 31, 2010 | \$    | \$ (246) |
| Total change in fair value   |       | 50       |
| Balance at March 31, 2011    | \$    | \$ (196) |

**Table of Contents***Auction Rate Preferred Securities*

Auction Rate Preferred Securities ( ARPS ) were our only assets measured at fair value on a recurring basis subject to the guidance at December 31, 2009. We classified the investment in ARPS as a Level 3 investment as these securities had significant unobservable inputs. The fair value of the investment in ARPS as of December 31, 2009 was \$125,000, calculated utilizing a discounted cash flow analysis. In February 2010, all of the remaining ARPS were redeemed by the issuer and we received cash proceeds of \$125,000.

*Warrants*

We have 385,000 warrants, expiring in May 2011, with provisions that protect holders from a decline in the stock price instrument if we issue equity shares for a price that is lower than the exercise price of those instruments or issue new warrants or convertible instruments that have a lower exercise price. In accordance with accounting guidance, these warrants are recognized as liabilities and recorded at fair value on each reporting date. We measured the estimated fair value of these warrants as of March 31, 2011 and recorded a \$50,000 gain during the three months ended March 31, 2011 to record the liabilities associated with these warrants at their estimated fair value totaling \$196,000 as of that date as compared to their estimated fair value of \$246,000 at December 31, 2010. We estimated the fair value of these securities using a Black-Scholes valuation model, which approximated a lattice valuation model. The assumptions used in the Black-Scholes model at March 31, 2011 were as follows: a volatility rate of 46%, a risk-free interest rate of 0.15%, an expected life of 0.15 years and no dividend yield. The assumptions used in the Black-Scholes model at December 31, 2010 were as follows: a volatility rate of 41%, a risk-free interest rate of 0.19%, an expected life of 0.39 years and no dividend yield.

*Fair Value of Other Financial Instruments*

The carrying amounts reported in the accompanying consolidated balance sheets for cash and cash equivalents, accounts and other receivables and trade accounts payable approximate fair values because of the immediate or short-term maturities of these financial instruments. The estimated fair values of the revolving credit note and promissory notes payable were computed using a discounted cash flow model and approximated the carrying amount as the individual notes bear interest at market interest rates.

**NOTE 5. GOODWILL AND INTANGIBLES**

The changes in the carrying amount of goodwill for the three months ended March 31, 2011 consisted of the following (*in thousands*):

|                                 |          |
|---------------------------------|----------|
| Balance as of December 31, 2010 | \$ 4,073 |
| Goodwill adjustment             | 13       |
| Balance as of March 31, 2011    | \$ 4,086 |

The goodwill adjustment of \$13,000 in the first quarter of 2011 was a result of contingent purchase price payments related to acquisitions in previous years. Goodwill from acquisitions is attributable to the Software segment.

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

|                           | Gross     | March 31, 2011<br>Accumulated | Intangible<br>assets,<br>net | Gross     | December 31, 2010<br>Accumulated | Intangible<br>assets,<br>net |
|---------------------------|-----------|-------------------------------|------------------------------|-----------|----------------------------------|------------------------------|
|                           | assets    | amortization                  |                              | assets    | amortization                     |                              |
| Customer lists acquired   | \$ 16,495 | \$ 16,178                     | \$ 317                       | \$ 16,495 | \$ 16,161                        | \$ 334                       |
| Technology and patents    | 10,231    | 9,664                         | 567                          | 10,231    | 9,563                            | 668                          |
| Tradenames and trademarks | 1,194     | 331                           | 863                          | 1,194     | 312                              | 882                          |
| Domain name               | 54        |                               | 54                           | 54        |                                  | 54                           |
| Total                     | \$ 27,974 | \$ 26,173                     | \$ 1,801                     | \$ 27,974 | \$ 26,036                        | \$ 1,938                     |

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Amortization expense was \$137,000 and \$146,000 during the three months ended March 31, 2011 and 2010, respectively.

Based on the recorded intangibles at March 31, 2011, estimated amortization expense is expected to be \$408,000 during the remainder of 2011, \$238,000 in 2012, \$210,000 in 2013, \$210,000 in 2014, \$140,000 in 2015 and \$541,000 thereafter.

**Table of Contents****NOTE 6. ACCRUED LIABILITIES**

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

|                                        | March 31,<br>2011 | December 31,<br>2010 |
|----------------------------------------|-------------------|----------------------|
| Accrued payphone and carrier charges   | \$ 187            | \$ 222               |
| Accrued payroll and other compensation | 1,953             | 1,204                |
| Accrued professional fees              | 142               | 284                  |
| Current portion of deferred rent       | 122               | 112                  |
| Other                                  | 216               | 257                  |
| Total accrued liabilities              | \$ 2,620          | \$ 2,079             |

**NOTE 7. LONG-TERM DEBT AND CAPITAL LEASE OBLIGATIONS**

We drew \$5.2 million from our revolving credit loan agreement ( *Revolving Credit Agreement* ) with Zions First National Bank ( *Zions* ) and paid down \$4.0 million on the Revolving Credit Agreement during the three months ended March 31, 2011. The balance of our Revolving Credit Agreement was \$8.5 million at March 31, 2011. The interest rate under the Revolving Credit Agreement is 4.5% per annum above the ninety day London InterBank Offered Rate ( *LIBOR* ), from time to time in effect, adjusted as of the date of any change in the ninety day LIBOR. Interest under the Revolving Credit Agreement is paid monthly in arrears, and all principal is due in July 2013. In April 2011, we paid \$3.5 million of the outstanding Revolving Credit Agreement.

The Zions Revolving Credit Agreement contains certain covenants, with the most significant covenants being a requirement to maintain a specified minimum EBITDA (defined as earnings before interest expense, income tax expense, depreciation, amortization and other non-cash charges), a requirement to maintain a minimum working capital balance and a requirement to maintain a minimum cash balance. In August 2010 and March 2011, Zions agreed to amend the Revolving Credit Agreement to reduce the required minimum EBITDA covenant levels, in order to allow the Company to pursue its strategic objectives without breaching the covenant. Remaining in compliance with loan covenants is critical to the Company's operations. Based on our projections, we believe we will maintain compliance with our loan covenants through 2011, however if future operating results are less favorable than currently anticipated, the Company may need to seek further amendments to modify its loan covenants. If we are unable to modify the loan covenants on acceptable terms, we would intend to reduce spending levels or take other restructuring actions. As of March 2011, the EBITDA covenant requires minimum EBITDA levels of \$300,000 for the first three quarters of 2011 and \$1.0 million for each quarter thereafter. The minimum working capital covenant requires minimum working capital of \$1 million at all times during the term of the agreement and the minimum cash balance covenant requires a minimum cash balance of \$3.5 million or the amount available under the line is reduced to 75 percent of billed accounts receivable. We were in compliance with all financial covenants related to the Revolving Credit Agreement for the period ended March 31, 2011.

We have \$3.2 million of capital lease obligations at March 31, 2011 related to equipment leasing facilities entered into during prior years. During the three months ended March 31, 2011, we extended one of the capital leases an additional 12 months and paid \$115,000 to the lessor so that the Company will receive title and interest of the property leased upon final payment of the extended lease in April 2012. The capital lease obligation related to the extension was \$200,000 at March 31, 2011.

In March 2011, we entered into an equipment leasing facility commitment with Zions. Under the terms of the leasing facility commitment, Zions has agreed to provide us with financing of up to \$3.0 million to lease computer related equipment for our business operations, which Zions will lease to us in the form of a capital lease. The term of the facility is 36 months upon acceptance of the leased property by us. The calculated interest rate is subject to change based on the three year LIBOR plus 4.5%. We had not utilized the additional equipment leasing facility at March 31, 2010.

**NOTE 8. CAPITAL TRANSACTIONS**

In July 2010, we entered into a consulting agreement with a third party to provide investor relations services, which was subsequently amended in August 2010. Under the agreement, we agreed to issue as partial consideration for services a total of 36,000 shares of our common stock, earned monthly in arrears in equal monthly installments during the 18-month period commencing July 1, 2010. We issued 6,000 shares of common stock valued at \$19,000 to this third party during the three months ended March 31, 2011, pursuant to the consulting agreement.

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We received proceeds of \$53,000 from the exercise of 24,000 options during the three months ended March 31, 2011. We issued 14,000 shares of common stock for proceeds of \$39,000 under the employee stock purchase plan to eligible employees during the three month period ended March 31, 2011.

**Table of Contents****NOTE 9. COMMITMENTS AND CONTINGENCIES**

In May 2009, the Company was served in a lawsuit titled *California College, Inc., et al., v. UCN, Inc., et al.* In the lawsuit, California College allege that (1) the Company made intentional and/or negligent misrepresentations in connection with the sale of the Company's services from Insidesales.com, Inc, another defendant in the lawsuit, (2) that the Company breached its service contract with California College and the contract between California College and Insidesales.com by failing to deliver contracted services and product and failing to abide by implied covenants of good faith and fair dealing, and (3) the conduct of the Company interfered with prospective economic business relations of California College with respect to enrolling students. California College is seeking damages, in an amount to be proven at trial, in excess of \$20 million. Pursuant to a motion filed by Insidesales.com, California College filed an amended complaint that has been answered by Insidesales.com and us. Furthermore, Insidesales.com and inContact have filed cross-claims against one another alleging breach of contract with respect to a sales agent agreement between them and that the Company is obligated to indemnify Insidesales.com for any loss arising from the claims made by California College. The Company has denied all of the substantive allegations of the complaint and cross-claim and intends to defend the claims vigorously. Management believes the claims against inContact are without merit and no liability has been recorded.

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

**NOTE 10. STOCK-BASED COMPENSATION**

Stock-based compensation cost is measured at the grant date based on the fair value of the award granted and recognized as expense using the graded-vesting method over the period in which the award is expected to vest. Stock-based compensation expense recognized during a period is based on the value of the portion of stock-based awards that is ultimately expected to vest during the period. As stock-based compensation expense recognized in the results for the year is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures.

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

|                            | <b>Three months ended March 31,</b> |               |
|----------------------------|-------------------------------------|---------------|
|                            | <b>2011</b>                         | <b>2010</b>   |
| Costs of revenue           | \$ 56                               | \$ 31         |
| Selling and marketing      | 44                                  | 59            |
| Research and development   | 33                                  | (122)         |
| General and administrative | 130                                 | 250           |
| <b>Total</b>               | <b>\$ 263</b>                       | <b>\$ 218</b> |

We utilize the Black-Scholes model to determine the estimated fair value for grants of stock options and warrants. The Black-Scholes model requires the use of highly subjective and complex assumptions to determine the fair value of stock-based awards, including the option's expected term, expected dividend yield, the risk-free interest rate and the price volatility of the underlying stock. The expected dividend yield is based on our historical dividend rates. Risk-free interest rates are based on U.S. treasury rates. Volatility is based on historical stock prices over a period equal to the estimated life of the option.

The grant date fair value of the restricted stock and restricted stock unit awards was calculated using the closing market price of the Company's common stock on the grant date, with the compensation expense amortized over the vesting period of the restricted stock awards, net of estimated forfeitures.

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We estimated the fair value of options granted under our employee stock-based compensation arrangements at the date of grant using the Black-Scholes model using the following weighted-average assumptions for the quarters ended March 31, 2011 and 2010:

|                         | Three months ended March 31, |       |
|-------------------------|------------------------------|-------|
|                         | 2011                         | 2010  |
| Dividend yield          | None                         | None  |
| Volatility              | 70%                          | 71%   |
| Risk-free interest rate | 1.52%                        | 1.97% |
| Expected life (years)   | 4.2                          | 4.0   |

During the three months ended March 31, 2011, we granted 481,000 stock options with exercise prices ranging from \$3.10 to \$3.42 and a weighted-average fair value of \$1.78. During the three months ended March 31, 2010, we granted 459,000 stock options with exercise prices ranging from \$2.76 to \$3.42 and a weighted-average fair value of \$1.75.

As of March 31, 2011, there was \$1.3 million of unrecognized compensation cost related to non-vested stock-based compensation awards granted under our stock-based compensation plans. The compensation cost is expected to be recognized over a weighted average period of 1.3 years.

**NOTE 11. RELATED PARTY TRANSACTIONS**

We paid the Chairman of the Board of Directors (the "Chairman") \$7,000 per month during the three months ended March 31, 2011 and \$6,000 per month during the three months ended March 31, 2010 for consulting, marketing and capital raising activities. We owed the Chairman \$7,000 at March 31, 2011 and December 31, 2010.

**NOTE 12. SEGMENTS**

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

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

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

Operating segment revenues and profitability for the three months ended March 31, 2011 and 2010 were as follows (*in thousands*):

|                                 | Three months ended March 31, 2011 |           |              | Three months ended March 31, 2010 |           |              |
|---------------------------------|-----------------------------------|-----------|--------------|-----------------------------------|-----------|--------------|
|                                 | Software                          | Telecom   | Consolidated | Software                          | Telecom   | Consolidated |
| Revenue                         | \$ 9,334                          | \$ 12,001 | \$ 21,335    | \$ 8,330                          | \$ 12,791 | \$ 21,121    |
| Costs of revenue                | 3,590                             | 8,898     | 12,488       | 2,722                             | 9,116     | 11,838       |
| Gross profit                    | 5,744                             | 3,103     | 8,847        | 5,608                             | 3,675     | 9,283        |
| Gross margin                    | 62%                               | 26%       | 42%          | 67%                               | 29%       | 44%          |
| Operating expenses:             |                                   |           |              |                                   |           |              |
| Direct selling and marketing    | 4,149                             | 754       | 4,903        | 2,936                             | 964       | 3,900        |
| Direct research and development | 1,239                             |           | 1,239        | 966                               |           | 966          |
| Indirect                        | 2,844                             | 753       | 3,597        | 2,184                             | 832       | 3,016        |

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|                               |            |          |          |          |          |          |
|-------------------------------|------------|----------|----------|----------|----------|----------|
| (Loss) income from operations | \$ (2,488) | \$ 1,596 | \$ (892) | \$ (478) | \$ 1,879 | \$ 1,401 |
|-------------------------------|------------|----------|----------|----------|----------|----------|

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### **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 December 31, 2010 consolidated financial statements and notes thereto, along with the Management's Discussion and Analysis of Financial Condition and Results of Operations included in our 2010 Annual Report on Form 10-K, filed separately with the U.S. Securities and Exchange Commission.

#### **OVERVIEW**

We began in 1997 as a reseller of telecommunications services and have evolved to become a leading provider of end-to-end, cloud-based contact center services and network connectivity. We strive to deliver the most proven solutions quickly and with ease, helping our customers reduce the cost and improve the quality of every user interaction.

In 2005 we began offering cloud-based call center solutions to the call center market. Our dynamic technology platform provides our customers a solution without the costs and complexities of legacy systems. Our proven delivery model provides cost savings and removes the complexities of deploying and maintaining a premised-based solution, while providing flexibility to change with business needs.

We provide software which includes automatic call distribution with skills-based routing, interactive voice response with speech recognition, computer telephony integration capabilities, reporting, workforce optimization, e-learning, call center agent hiring and customer feedback measurement tools. Taken together, the inContact cloud-based platform creates an integrated solution for call centers, including those with distributed workforces either at-home or multi-site.

#### **SOURCES OF REVENUE**

We derive our revenues from two major business activities: (1) hosting and support of our inContact suite and associated professional services and (2) reselling telecommunication services. Since 2005, our primary business focus has been on selling and marketing our inContact suite.

##### **Software**

Software hosting and support of our inContact suite is provided on a monthly basis. Monthly recurring charges are billed in arrears and recognized for the period in which they are earned. In addition to the monthly recurring revenue, revenue is also received on a non-recurring basis for professional services included in implementing or improving a user's inContact suite experience. Our hosting services provide remote management and maintenance of our software and customers' data. Customers access hosted software and data through a secure Internet connection. Support services include technical assistance for our software products and product upgrades and enhancements on a when and if available basis. Our telecommunications and data network is fundamental to our inContact suite and allows us to provide the all-in-one inContact solution.

##### **Telecom**

We continue to derive revenue from traditional telecommunications services such as dedicated transport, switched long distance and data services. These services are provided over our network or through third party telecommunications providers. Revenue for the transactional long distance usage is derived based on user specific rate plans and the user's call usage and is recognized in the period the call is initiated. Users are also billed monthly charges in arrears and revenue is recognized for such charges over the billing period. If the billing period spans more than one month, earned but unbilled revenues are accrued for incurred usage to date.

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

##### **Costs of Revenue**

Costs of revenue consist primarily of payments to third party long distance service providers for resold telecommunication services to our customers. Costs of revenue also include salaries (including stock-based compensation) and related expenses for our hosting, support and professional services organizations, equipment depreciation relating to our hosting services, and amortization of acquired intangible assets, amortization of capitalized 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.



**Table of Contents****Selling and Marketing**

Selling and marketing expenses consist primarily of salaries (including stock-based compensation) and related expenses for employees in sales and marketing, including commissions and bonuses, advertising, marketing events, corporate communications, expenses, travel costs and allocated overhead. We intend to continue to invest in selling and marketing. Accordingly, selling and marketing expenses could increase in absolute dollars depending on our investment decisions in line with our ongoing assessment of the market opportunity to support additional growth.

**Research and Development**

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

**General and Administrative**

General and administrative expenses consist primarily of salary (including stock-based compensation) and related expenses for management, finance and accounting, legal, information systems and human resources personnel, professional fees, other corporate expenses and allocated overhead. We expect general and administrative expenses as a percentage of revenue to decrease as we continue to leverage our existing general and administrative personnel and other expenses to support our anticipated growth. General and administrative expenses in absolute dollars may increase or decrease depending upon investments we make to support the size of our business.

**RESULTS OF OPERATIONS****Three Months Ended March 31, 2011 and 2010**

The following is a tabular presentation of our condensed consolidated operating results for the three months ended March 31, 2011 compared to our condensed consolidated operating results for the three months ended March 31, 2010 (*in thousands*):

|                                   | 2011       | 2010      | \$ Change  | % Change |
|-----------------------------------|------------|-----------|------------|----------|
| Revenue                           | \$ 21,335  | \$ 21,121 | 214        | 1%       |
| Costs of revenue                  | 12,488     | 11,838    | 650        | 5%       |
| Gross profit                      | 8,847      | 9,283     | (436)      |          |
| Gross margin                      | 42%        | 44%       |            |          |
| Operating expenses:               |            |           |            |          |
| Selling and marketing             | 5,210      | 4,135     | 1,075      | 26%      |
| Research and development          | 1,400      | 1,128     | 272        | 24%      |
| General and administrative        | 3,129      | 2,619     | 510        | 19%      |
| Total operating expenses          | 9,739      | 7,882     | 1,857      |          |
| (Loss) income from operations     | (892)      | 1,401     | (2,293)    |          |
| Other (expense) income            | (95)       | 115       | (210)      | 183%     |
| (Loss) income before income taxes | (987)      | 1,516     | (2,503)    |          |
| Income tax expense                | (15)       | (14)      | (1)        |          |
| Net (loss) income                 | \$ (1,002) | \$ 1,502  | \$ (2,504) |          |

*Revenue*

Total revenues increased \$214,000 or 1% to \$21.3 million during the three months ended March 31, 2011 compared to revenues of \$21.1 million during the same period in 2010. The increase relates to an increase of \$1.0 million in Software segment revenue due to our focus on sales and marketing efforts on our all-in-one hosted inContact suite. This increase is offset by a decrease of \$790,000 in Telecom segment revenue due to expected attrition of our telecom-only customers.

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### *Costs of revenue and gross margin*

Costs of revenue increased \$650,000 or 5% to \$12.5 million during the three months ended March 31, 2011 compared to \$11.8 million during the same period of 2010. As a result, our gross margin decreased two percentage points to 42% during the three months ended March 31, 2011 from 44% during the three months ended March 31, 2010. The decrease in gross profit is primarily driven by greater customer service personnel costs as we employ more personnel and more qualified personnel to service larger mid-market and enterprise customers, greater direct Telecom costs attributable to international infrastructure and call traffic and greater amortization of increasing previously capitalized software development costs.

### *Selling and marketing*

Selling and marketing expense increased \$1.1 million or 26% to \$5.2 million during the three months ended March 31, 2011 from \$4.1 million during the same period in 2010. This increase is a result of headcount additions for direct and channel sales employees and our marketing efforts to create increased awareness of our products and services as well as increased lead generation for our Software segment. The increase in our Software segment selling and marketing efforts was partially offset by reduced commission expense related to our Telecom segment.

### *Research and development*

Research and development expense increased \$272,000 or 24% to \$1.4 million during the three months ended March 31, 2011 from \$1.1 million during the same period in 2010. The increase relates to our efforts to expand our content offerings, upgrade and extend our service offerings and develop new technologies. Research and development expense for the three months ended March 31, 2010 was positively impacted by of one-time personnel expense reductions of approximately \$240,000.

### *General and administrative*

General and administrative expense increased \$510,000 or 19% to \$3.1 million during the three months ended March 31, 2011 compared to \$2.6 million during the same period in 2010. The increase is primarily due to increased personnel costs incurred to support our international business expansion.

### *Other income (expense)*

Other income (expense) decreased \$210,000 to a net other expense of \$95,000 during the three months ended March 31, 2011 from a net other income of \$115,000 during the same period in 2010. Net interest expense increased \$63,000 for the first quarter of 2011 compared to the comparable period in 2010 due to a higher outstanding balance on our revolving credit agreement in 2011 as compared to 2010. The remaining decrease is primarily due to the change in fair value of our warrant liability. During the three months ended March 31, 2011, the fair value of the warrants decreased \$50,000 as compared to a decrease in fair value of the warrants of \$184,000 during the three months ended March 31, 2010.

### *Income taxes*

Income taxes consist of state income taxes and remained relatively flat for the quarter ended March 31, 2011 as compared to comparable period of 2010.

## **SEGMENT REPORTING**

We operate under two business segments: Software and Telecom. The Software segment includes all monthly recurring revenue related to the delivery of our software applications plus the associated professional services and setup fees related to the software services product features (referred to as cloud-based or SaaS). The Telecom segment includes all voice and data long distance services provided to customers.

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



**Table of Contents****Software Segment Results**

The following is a tabular presentation and comparison of our Software segment unaudited condensed consolidated operating results for the three months ended March 31, 2011 and 2010 (*in thousands*):

|                                 | 2011       | 2010     | \$ Change | % Change |
|---------------------------------|------------|----------|-----------|----------|
| Revenue                         | \$ 9,334   | \$ 8,330 | 1,004     | 12%      |
| Costs of revenue                | 3,590      | 2,722    | 868       | 32%      |
| Gross profit                    | 5,744      | 5,608    |           |          |
| Gross margin                    | 62%        | 67%      |           |          |
| Operating expenses:             |            |          |           |          |
| Direct selling and marketing    | 4,149      | 2,936    | 1,213     | 41%      |
| Direct research and development | 1,239      | 966      | 273       | 28%      |
| Indirect                        | 2,844      | 2,184    | 660       | 30%      |
| Loss from operations            | \$ (2,488) | \$ (478) |           |          |

The Software segment revenue increased by \$1.0 million or 12% to \$9.3 million during the three months ended March 31, 2011 from \$8.3 million during the same period in 2010. The increase is a result of the selling and marketing efforts we have undertaken to expand the inContact suite in the market. Software segment revenue includes revenue from professional services of \$503,000 for the first quarter of 2011 compared to \$436,000 for the first quarter of 2010.

Gross margin decreased five percentage points to 62% in 2011 compared to 67% in 2010. The decrease in gross margin is primarily attributable to greater customer service personnel costs as we employ more personnel and more qualified personnel to service larger mid-market and enterprise customers and greater amortization of increasing previously capitalized software development costs.

Direct selling and marketing expenses in the Software segment increased \$1.2 million or 41% to \$4.1 million during the three months ended March 31, 2011 compared to \$2.9 million during the same period in 2010. This increase is a result of headcount additions for employees focused on managing and enhancing our partner relationships. We also continue to develop the services provided in the Software segment by investing in research and development. During the three months ended March 31, 2011 we incurred \$1.2 million in direct research and development costs compared to \$1.0 million during the same period in 2010 and have capitalized an additional \$1.1 million of costs incurred during the three months ended March 31, 2011 related to our internally developed software compared to \$862,000 during the three months ended March 31, 2010. Indirect expenses, which consist of overhead, such as compensation, rent, utilities and depreciation on property and equipment, increased \$660,000 or 30% to \$2.8 million during the three months ended March 31, 2011 from \$2.2 million for the same period in 2010 due to more indirect costs being allocated to the Software segment with the continued shift in revenue mix from the Telecom segment to the Software segment.

**Telecom Segment Results**

The following is a tabular presentation and comparison of our Telecom segment condensed consolidated operating results for the three months ended March 31, 2011 and 2010 (*in thousands*):

|                  | 2011      | 2010      | \$ Change | % Change |
|------------------|-----------|-----------|-----------|----------|
| Revenue          | \$ 12,001 | \$ 12,791 | (790)     | (6%)     |
| Costs of revenue | 8,898     | 9,116     | (218)     | (2%)     |
| Gross profit     | 3,103     | 3,675     |           |          |

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|                                 |          |          |       |       |
|---------------------------------|----------|----------|-------|-------|
| <i>Gross margin</i>             | 26%      | 29%      |       |       |
| Operating expenses:             |          |          |       |       |
| Direct selling and marketing    | 754      | 964      | (210) | (22%) |
| Direct research and development |          |          |       |       |
| Indirect                        | 753      | 832      | (79)  | (9%)  |
| Income from operations          | \$ 1,596 | \$ 1,879 |       |       |

We continue to see decreases in Telecom segment revenue as we focus our efforts on the Software segment. Overall Telecom segment revenue decreased \$790,000 or 6% to \$12.0 million during three months ended March 31, 2011 from \$12.8 million for the same period in 2010. This decrease is due to the expected attrition of our telecom-only customers as we focus our efforts on our inContact suite of services. With the decline in revenues from the Telecom segment, we reduced overall costs in the segment as well. Our costs of revenue decreased 2% due to the decrease in revenue, which was offset by higher direct Telecom costs attributable to international

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infrastructure and call traffic. Selling and marketing expenses decreased \$210,000 or 22% during the three months ended March 31, 2011 as compared to the same period in 2010, primarily due to a decrease in commissions as we continue to focus more on our selling and marketing efforts of the Software segment. Indirect expenses, which consist of overhead, such as compensation, rent, utilities and depreciation on property and equipment, decreased \$79,000 or 9% during the three months ended March 31, 2011 compared to the same period in 2010. The reduction of indirect expenses is primarily due to more indirect costs being allocated to the Software segment.

## **LIQUIDITY AND CAPITAL RESOURCES**

Our principal sources of liquidity are cash and cash equivalents and available borrowings under our revolving credit note, which expires in July 2013. At March 31, 2011, we had \$10.2 million of cash and cash equivalents and no availability of borrowings under our revolving credit note. The balance of our revolving credit note at March 31, 2011 was \$8.5 million, the maximum available advance amount. In April 2011, we paid \$3.5 million of the \$8.5 million balance.

The Zions Revolving Credit Agreement contains certain covenants, with the most significant covenants being a requirement to maintain a specified minimum EBITDA (defined as earnings before interest expense, income tax expense, depreciation, amortization and other non-cash charges), a requirement to maintain a minimum working capital balance and a requirement to maintain a minimum cash balance. In August 2010 and March 2011, Zions agreed to amend the Revolving Credit Agreement to reduce the required minimum EBITDA covenant levels, in order to allow the Company to pursue its strategic objectives without breaching the covenant. Remaining in compliance with loan covenants is critical to the Company's operations. Based on our projections, we believe we will maintain compliance with our loan covenants through 2011, however if future operating results are less favorable than currently anticipated, the Company may need to seek further amendments to modify its loan covenants. If we are unable to modify the loan covenants on acceptable terms, we would intend to reduce spending levels or take other restructuring actions. As of March 2011, the EBITDA covenant requires minimum EBITDA levels of \$300,000 for the first three quarters of 2011 and \$1.0 million for each quarter thereafter. The minimum working capital covenant requires minimum working capital of \$1 million at all times during the term of the agreement and the minimum cash balance covenant requires a minimum cash balance of \$3.5 million or the amount available under the line is reduced to 75 percent of billed accounts receivable. We were in compliance with all financial covenants related to the Revolving Credit Agreement for the period ended March 31, 2011.

We experienced a net loss of \$1.0 million during the three months ended March 31, 2011. Significant non-cash expenses affecting operations during the three months ended March 31, 2011 were \$1.6 million of depreciation and amortization and \$263,000 of stock-based compensation offset by a non-cash gain of \$50,000 for the change in the fair value of certain warrants. Our operating activities provided cash flows of \$1.5 million during the three months ended March 31, 2011.

In March 2011, we entered into an equipment leasing facility commitment with Zions. Under the terms of the leasing facility commitment, Zions has agreed to provide us with financing of up to \$3.0 million to lease computer related equipment for our business operations, which Zions will lease to us in the form of a capital lease. The term of the facility is 36 months upon acceptance of the leased property by us. The calculated interest rate is subject to change based on the three year LIBOR plus 4.5%. We had not utilized the additional equipment leasing facility at March 31, 2011.

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 facility and our equipment leasing facility to finance operations and capital requirements. We believe that existing cash and cash equivalents, cash from operations, available borrowings under our revolving credit note and available borrowings under our equipment leasing facility will be sufficient to meet our cash requirements during at least the next twelve months.

## **CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

A summary of our significant accounting policies and estimates is discussed in Management's Discussion and Analysis of Financial Condition and Results of Operations and in Note 1 of our Annual Report on Form 10-K for the year ended December 31, 2010. The preparation of the financial statements in accordance with U.S. generally accepted accounting principles requires us to make judgments, estimates and assumptions regarding uncertainties that affect the reported amounts of assets and liabilities. Significant areas of uncertainty that require judgments, estimates and assumptions include the accounting for income taxes and other contingencies as well as asset impairment and collectability of accounts receivable. We use historical and other information that we consider to be relevant to make these judgments and estimates. However, actual results may differ from those estimates and assumptions that are used to prepare our financial statements.

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

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

Interest rates on our new leasing facility and revolving credit facility are variable so market fluctuations in interest rate may increase our interest expense.

### **ITEM 4. CONTROLS AND PROCEDURES**

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

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

Disclosure controls and procedures (as defined in Rule 13a-15(e) under the Exchange Act) are designed to ensure that information required to be disclosed in reports filed or submitted under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in rules and forms adopted by the Securities and Exchange Commission, and that such information is accumulated and communicated to management, including the Chief Executive Officer and the Chief Financial Officer, to allow timely decisions regarding required disclosures.

In connection with the preparation of this report, our management, under the supervision and with the participation of the Chief Executive Officer and Chief Financial Officer, reassessed the effectiveness of the design and operation of our disclosure controls and procedures. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures were effective as of March 31, 2011.

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

There were no changes in our internal control over financial reporting that occurred during the first quarter of 2011 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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### **PART II**

#### **ITEM 1. LEGAL PROCEEDINGS**

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

During the quarter ended March 31, 2011, there were no material developments in any pending legal proceedings previously reported. Please see the discussion of legal proceedings under Part I, Item 3 of our 2010 Annual Report on Form 10-K, filed with the Securities and Exchange Commission on March 11, 2011.

#### **ITEM 1A. RISK FACTORS**

The Private Securities Litigation Reform Act of 1995 provides a safe harbor for forward-looking statements made by us, except where such statements are made in connection with an initial public offering. All statements, other than statements of historical fact, which address activities, actions, goals, prospects, or new developments that we expect or anticipate will or may occur in the future, including such things as expansion and growth of our operations and other such matters are forward-looking statements. Any one or a combination of factors could materially affect our operations and financial condition. These factors include competitive pressures, success or failure of marketing programs, changes in pricing and availability of services and products offered to customers, legal and regulatory initiatives affecting software or long distance service, and conditions in the capital markets. Forward-looking statements made by us are based on knowledge of our business and the environment in which we operate as of the date of this report. Because of the factors discussed in the 2010 Annual Report on Form 10-K under Item 1A Risk Factors, actual results may differ from those in the forward-looking statements.

#### **ITEM 6. EXHIBITS**

| <b>Exhibit No.</b> | <b>Title of Document</b>                                                                                                            |
|--------------------|-------------------------------------------------------------------------------------------------------------------------------------|
| 10.1               | Second Note Modification Agreement and Allonge between inContact and Zions dated March 1, 2011 (1)                                  |
| 10.2               | Third Amendment to Loan Agreement between inContact and Zions dated March 1, 2011 (1)                                               |
| 10.3               | Master Finance Lease Agreement No. 0012773 with Zions dated July 23, 2009 (1)                                                       |
| 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 |

- (1) These documents were filed as exhibits to the annual report on Form 10-K for 2010 filed by inContact with the Securities and Exchange Commission on March 11, 2011, and are incorporated herein by this reference.

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**SIGNATURES**

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

**inContact, INC.**

Date: May 6, 2011

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

Date: May 6, 2011

By: /s/ Gregory S. Ayers  
Gregory S. Ayers  
  
Principal Financial and Accounting Officer