

inContact, Inc.
Form 10-K
March 07, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-K

x Annual report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934
For the fiscal year ended December 31, 2013
Or

Transition report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from to
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, Utah 84047

(Address of principal executive offices and Zip Code)

(801) 320-3200

(Registrant's telephone number, including area code)

Securities registered under Section 12(b) of the Act: Common Stock, Par Value \$0.0001

Securities registered under Section 12(g) of the Act:

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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 Website, 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to the this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company.

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

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of the last business day of the registrant's most recently completed second fiscal quarter: \$409,131,256.

The number of shares outstanding of the registrant's class of \$0.0001 par value common stock as of February 20, 2014 was 55,863,802.

DOCUMENTS INCORPORATED BY REFERENCE: Information required by Items 10 through 14 of Part III of this Form 10-K, to the extent not set forth herein, is incorporated herein by reference to portions of the registrant's

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definitive proxy statement for the registrant's 2014 Annual Meeting of Stockholders, which will be filed with the Securities and Exchange Commission not later than 120 days after the end of the fiscal year ended December 31, 2013. Except with respect to the information specifically incorporated by reference in this Form 10-K, the registrant's definitive proxy statement is not deemed to be filed as a part of this Form 10-K.

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FORWARD-LOOKING STATEMENTS

In addition to historical information, this annual report on Form 10-K contains forward-looking statements.

Forward-looking statements include all statements that do not relate solely to historical or current facts, and can generally be identified by the use of words such as “may,” “believe,” “will,” “expect,” “project,” “estimate,” “intend,” “anticipate,” “plan,” “continue” or similar expressions. In particular, information appearing under “Risk Factors,” “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and “Business” includes forward-looking statements. Forward-looking statements inherently involve many risks and uncertainties that could cause actual results to differ materially from those projected in these statements. Where, in any forward-looking statement, we express an expectation or belief as to future results or events, such expectation or belief is based on the current plans and expectations of our management and expressed in good faith and believed to have a reasonable basis, but there can be no assurance that the expectation or belief will result or be achieved or accomplished. The following include some, but not all, of the factors that could cause actual results or events to differ materially from those anticipated:

The highly competitive and evolving nature of the industry in which we compete;

Rapid technological changes;

Failure by us to implement our strategies;

Our ability to keep pace with changing customer needs;

Financial difficulties experienced by any of our top customers;

Our debt and debt service requirements that restrict our operating and financial flexibility, and impose interest and financing costs;

Our ability to attract and retain key personnel;

The effects of government regulation;

Claims of patent infringement by us or against us;

General economic conditions; and

Possible terrorist attacks and ongoing military action throughout the world.

There may be other factors that may cause our actual results to differ materially from the forward-looking statements.

Our actual results, performance or achievements could differ materially from those expressed in, or implied by, the forward-looking statements. We can give no assurances that any of the events anticipated by the forward-looking statements will occur or, if any of them does, what impact they will have on our results of operations and financial condition. You should carefully read the factors described in the “Risk Factors” section of this Form 10-K for a description of certain risks that could, among other things, cause our actual results to differ from these forward-looking statements.

All forward-looking statements speak only as of the date of this Form 10-K and are expressly qualified in their entirety by the cautionary statements included in this Form 10-K. We undertake no obligation to update or revise forward-looking statements that may be made to reflect events or circumstances that arise after the date made or to reflect the occurrence of unanticipated events, other than as required by law.

WHERE YOU CAN FIND MORE INFORMATION

We are subject to the informational requirements of the Securities Exchange Act of 1934. Accordingly, we file periodic reports and other information with the Securities and Exchange Commission (“SEC”). We make our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports available through our Internet site, www.inContact.com as soon as reasonably practicable after electronically filing such materials with the SEC. They may also be obtained by writing to inContact, Inc., 7730 S. Union Park Avenue, Suite 500, Salt Lake City, Utah 84047. In addition, copies of these reports may be obtained through the Securities and Exchange Commission website at www.sec.gov or by visiting the SEC’s Public Reference Room at 100 F Street, NE,

Washington, DC 20549 or by calling the SEC at 800-SEC-0330. Our common stock trades on The NASDAQ Capital Market under the symbol "SAAS."

PART I

ITEM 1. BUSINESS

Overview

What We Do

inContact, Inc. (“inContact,” “we,” “us,” “our,” or the “Company”) 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 portfolio of cloud contact center call routing, self-service and agent optimization solutions. The Company’s 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.

We operate under two business segments: Software and Network connectivity. The Software segment includes all services related to the delivery of our cloud contact center software solutions. The Network connectivity segment includes all voice and data long distance services provided to customers. Software segment revenue was 53% of total revenue in 2013, 50% in 2012, and 45% in 2011. Please see the financial information on our segments presented in Part IV, Item 15 “Financial Statements” – Note 16 – “Segments.”

Business Developments

In 2011, we entered into reseller agreements for our cloud contact center software solutions, including minimum revenue purchase commitments, with Unify, Inc. (“Unify”) (formerly Siemens Enterprise Communications). During 2013, Unify resold substantially fewer software services than it had originally anticipated. In February 2013, we amended certain provisions of our reseller agreement with Unify, allowing Unify more time to implement a revised go to market sales plan, with the objective of increasing contract revenue progressively to a level commensurate with the amount of the quarterly minimum purchase commitments. The revised minimum purchase commitments total \$4.5 million of net software revenue in 2012, \$7.0 million in 2013 and up to \$5.0 million in 2014, which may be credited up to \$1.0 million in 2014, in consideration for up to \$1.0 million investment by Unify in sales and marketing of our cloud contact center software solutions.

As of December 31, 2013, Unify continues to resell our software services and has met its obligations under the revised reseller agreement; however, we believe that resold recurring software revenue will not meet the final quarterly minimum purchase commitment of \$1.5 million in the third quarter of 2014.

To provide additional funding for our cloud software growth initiatives and infrastructure investment, we raised \$37.3 million in a Common Stock offering in September 2012, and drew \$4.0 million in April 2013 and \$3.0 million in December 2013 from term loans with Zions First National Bank (“Zions”).

Products and Services

The inContact Cloud Portfolio

The inContact portfolio consists of the following integrated software solutions:

inContact ACD™: The goal of an Automatic Call Distributor (“ACD”) is to get callers to the right agent as quickly as possible. inContact provides advanced contact handling and routing functionality along with the management services required for our customers to monitor and manage the process. The inContact ACD includes skills-based routing, universal contact queues, automatic call back, and inbound/outbound call blending. Dynamic connections with the database enhance the call routing even further by leveraging real-time data for routing decisions to improve the caller experience. inContact ACD is also capable of aggregating multiple contact center sites into a single entity for improved management and reporting of large, complex contact center operations.

inContact CTI™: Computer Telephony Integration (“CTI”) leverages the customer database to deliver a caller experience based on data relevant to the caller. inContact CTI integrates with customer data servers to provide agents with pre-

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populated customer data that reduce contact handling times. The inContact CTI can also link Interactive Voice Response applications with transaction databases, enabling caller self-service and reducing the need for agents where appropriate.

inContact IVR™: inContact Interactive Voice Response (“IVR”) is a robust IVR that delivers a typical initial caller experience. IVR is the key to good self-service and assists the caller to get to the appropriate live-agent service. inContact IVR is unique because of the robust drag-and-drop utility that is used to create specialized call flows that are unique to each customer. Customers can retain control and develop the call flows for themselves or engage our professional services team to create a tailor made solution to create unique workflows.

InContact Dialer: The inContact Dialer combines state-of-the art inbound contact handling with full-featured campaign-based outbound dialing to maximize agent productivity. At the heart of the inContact Dialer is a highly sophisticated simulation-based dialing engine that determines the optimal balance between wait times and abandoned calls.

inContact Personal Connection Outbound: inContact Personal Connection software is a patented technology which eliminates legacy dialers’ awkward delays in greeting the caller. Since the agent is connected before the customer answers, the telltale pause and delayed hello are avoided. Agents can have more productive conversations with customers which translates into higher contact center revenues.

inContact Integrations: inContact was designed from the ground up to be open and integrate with various hardware and software solutions already in place at our customers’ sites. inContact can overlay an existing private branch exchange (“PBX”), while communicating hand-in-hand with the customer relationship management (“CRM”) solutions used by our customers.

inContact ECHO®: inContact ECHO gathers the opinion of the user and presents the analysis of the feedback directly to supervisors and agents to identify gaps in service and processes. Most companies try to gather user feedback, but many find it difficult to translate user opinion into meaningful data that promotes better service delivery. inContact ECHO is an essential component of the portfolio to close the loop between offering service and evaluating the results of the service for continuous improvement.

inContact Workforce Management™: inContact Workforce Management (“WFM”) helps our customers forecast demand, workforce scheduling, analyze and optimize staffing and report real-time adherence in their contact centers. inContact WFM includes analysis to predict service levels, abandon rates and queue times as well as a break/lunch optimization wizard to improve staffing efficiency. In addition, agents can review their schedule, set up schedule preferences, request time off, and swap shifts with other agents on their own.

inContact Quality Monitoring™: inContact’s Quality Management Software provides insights into agent performance and customer satisfaction. It works by scoring agent performance against objectives that a customer can define and monitor. The Quality Management scorecard then provides specific details about each agent’s performance that can be used to guide training and coaching programs.

inContact Analytics-Drive Quality (ADQ): inContact Analytics-Drive Quality Software helps customers capture, evaluate, and learn from customer interactions using audio files. This speech analytics solution examines unstructured audio files and automatically surfaces customer behavior indicators. This helps our customers increase revenue, manage performance, processes, and costs, and enhance their customers’ satisfaction.

inContact inView: inContact inView is an optimization solution that aggregates performance data from disparate systems and acts on the data with proven business improvement processes.

InContact Screen Recording™: inContact Screen Recording provides compliance level screen recording functionality for all voice channel interactions. It captures and stores recordings for quick playback to meet legal and regulatory requirements. The inContact ACD communicates directly with the screen recording gateway server to initiate the start and stop of screen recording activity of the agent desktop.

inContact Reports 2.0: inContact Reports 2.0 is an interactive reporting tool that provides insight into contact center operations by providing our customers with the business intelligence needed to make informed decisions. Reports 2.0 allows customers to access, filter, and report on over 100 metrics applicable to our customer contact centers and enables them to drill down into the data and discover the root cause of a problem and act on it immediately.

Professional Services and Support: inContact offers professional support services from contact center experts who help customers establish, set up and optimize their contact centers for user satisfaction and revenue optimization. Our contact center experts assist customers maximizing the benefits of the inContact portfolio of services for their unique contact center needs. We maintain a contact center in Salt Lake City, Utah for receiving customer service and billing inquiries. Our customer service personnel are available during extended business hours and also provide emergency service 24 hours a day, seven days a week. We place a high priority on customer service since we believe it is a primary factor in acquiring and retaining customers.

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InContact Network Connectivity Products and Services

inContact runs a national carrier-class connectivity network providing both time-division multiplexing (“TDM”) and voice over internet protocol (“VoIP”) connectivity as well as toll-free and local-number services. Incoming calls are routed through a portfolio of partners specially selected for call-quality as well as low-cost services to benefit our customers. All outgoing calls are handled on the inContact network that was designed from the ground up to support a broad range of software applications.

Our connectivity network is the backbone of the inContact platform as our customers’ calls are routed across our carrier-grade network. Our ability to provide network connectivity as well as cloud software services creates a strong competitive advantage for those customers who are looking for a single source supplier for both these services.

As a domestic and international network connectivity reseller and aggregator, we contract with a number of third party network connectivity service providers for the right to resell connectivity services to our customers. Our primary providers are Level 3, Verizon, AT&T and CenturyLink. The variety of traditional connectivity services we offer enables our customers to:

- buy most of the connectivity services they need from one source;
- combine those services into a customized package including our all-in-one, contact center solution;
- receive one bill for those services;
- contact us at a single point of contact if service problems or billing issues arise; and
- depend on our professional team of employees to manage their network and contact center solution, end-to-end, so our customers can focus on their business operations.

The contracts with our third party network connectivity service providers are customary in the industry and designate inContact as the point of contact for all customer service calls. These agreements stand for one to three years and are generally renewable at the end of each contract term, when rates are often renegotiated on the basis of prevailing rates in the industry.

We also acquire from our third party network connectivity service providers dedicated long distance service, toll-free 800/888/877/866 services, and dedicated data transmission service. These services and fees are billed to us as stated in our contracts with our providers and are payable on the same terms as switched long distance service.

The Power of the Cloud Model

The cloud model enables subscribers to access a wide variety of software solutions that are developed specifically for delivery over the Internet on a pay-as-you-go basis. Purchasing cloud software solutions offers advantages to businesses over traditional software licensing and delivery models, including the following:

- Operational expense rather than a capital expense;
- Overlay existing infrastructure without additional investment;
- Low up-front expenditure reduces risk and is especially appealing in a challenging economic climate;
- Remove complexity of day-to-day management;
- Ability to use at-home agents or multi-site workforces because the service is delivered over the Internet and can be accessed from any location;
- Continued access to state-of-the-art technology with no need to install and manage third-party hardware and software in-house and avoidance of technology lock-in;
- Ability to scale as business needs change; and
- Instant built-in scalability, redundancy, security, service delivery and IT expertise.

This type of lower cost subscription service is particularly attractive for start-up companies and medium-sized businesses. However, the model also is becoming increasingly appealing to larger organizations. While the total cost of ownership benefits of the cloud are important, these large enterprise customers are moving to the cloud to improve their business agility. This business agility enables enterprises to react to changing market conditions quickly, change service processes or offerings on the fly, scale up and down as seasonality or volumes indicate, and use their technology as a growth driver for their business.

For companies selling software solutions under the cloud model, such as inContact, sales generally result in lower initial revenues than traditional software licensing and delivery models. However, because customers generally subscribe to this kind of product for

multiple years, future revenues are more predictable than traditional software sales models where license revenue may be recognized in the quarter when signed. As a result of our use of the cloud subscription model, we depend on monthly recurring revenues from our customers, which provide us with a much more predictable and stable revenue stream than if we sold our inContact contact center software solution as a premise-based product.

Market Opportunity

We believe that customers have more choice and voice than ever before and goods and products are rapidly becoming commoditized. Service has become a key competitive differentiator, but today's contact centers are often missing the mark in providing a consistent, high quality experience across the customer's channel of choice. Voice continues to dominate, but new channels like social and mobile are rapidly coming into the mix. We believe the world of the contact center is changing rapidly and is becoming an important way for companies to differentiate their businesses. We believe that the next five years will bring significant changes to the contact center market, as the following four macro trends converge:

Self Service—where customers are willing to perform all possible customer service functions themselves;
Social Media—listening and responding to service issues in the blogosphere where customers have more voice and choice than ever before;
Smart Phone—with more smart phones than computers accessing the net, multi-channel contact options—including SMS, chat, web and social—are in increasing demand by customers; and
Big Data Analytics—using the huge store of contact center data to drive intelligent action, better enterprise alignment and more successful customer service outcomes.

We feel that as these trends continue to emerge, the cloud delivery model will continue to grow in acceptance. According to DMG Consulting's 2013 Cloud-Based Contact Center Infrastructure Market Report, 80% of contact centers will turn to the cloud as they adopt the new channels of communication listed above, creating strong opportunity for inContact.

We believe inContact continues to be the only cloud provider of solutions and services to the contact center market that offers both connectivity services with contact handling and workforce optimization solutions. We believe the trend in the mid-size and enterprise contact center market is for companies to prefer purchasing all-in-one solutions over purchasing multiple point solutions. These companies are looking for software available in a portfolio that they believe will save money, reduce implementation and integration complexity, and allow them to focus on dealing with one vendor.

Target Market Segments

Using research from our own customer base and third party market data, we have identified the following as key target market attributes for inContact's portfolio:

Mid-sized to small enterprise contact centers in growth companies;
Between 20 and 500 seats;
Multiple, geographically-dispersed contact center locations (both US and abroad);
Contact volumes scale up and down;
A mix of traditional contact center-based and at-home agents; and
Aging premise call center infrastructure.

These target customers are most often found in the following five key vertical markets:

Business Process Outsourcers (BPOs)—key drivers are adding capacity quickly for new campaigns and customers and decreasing cost, but enhancing quality and service levels;

Retail and Direct Response—key drivers are seasonality and increasing cross-sell and up-sell opportunities;
Healthcare Providers—key drivers are health care laws, HIPPA and increased competition for consumer dollar;
Utilities—key drivers are regulatory pressures, increased competition and proactive service communications; and
State and Local Government – key driver is increased need for cost-effective citizen services.
We believe these five vertical markets have market dynamics or regulatory requirements that help drive cloud adoption.

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Sales and Marketing

Marketing continues to be a strategic growth engine for inContact. In 2013, we continued our targeted marketing activities to accelerate sales growth. We are driving demand for our services through the following key strategies:

Build a strong, consistent and recognizable brand across the contact center industry and consistently promote and communicate our value proposition;

Develop customer references to support the story;

Expand our PR presence and extend our relationships with key industry analysts;

Leverage social media;

Increase scale and impact of demand generation programs; and

Nurture leads for more effective conversion to qualified opportunities.

The key audiences for our message include contact center operations management, IT management and C-level executives. Our current marketing efforts are focused on: (1) continued elevation of the inContact brand to a position of industry leadership, (2) identifying, attracting and pre-qualifying prospective leads that can be converted to new sales opportunities, and (3) expanding partner support and integration offerings to enable joint marketing and selling with key partners.

We maintain a referral partner network comprised primarily of telecommunication agents and adjacent market technology and service providers. These relationships benefit inContact because they introduce us to new sales channels and they add scalability to our sales, implementation, professional services and support operations.

Also, in 2012 we debuted inCloud, a powerful API-driven partner ecosystem designed to enable customers to easily specify, implement and deploy solutions that are pre-integrated into the inContact platform. inCloud enables customers to easily specify, implement and support integrated solutions that extend the value of their inContact investment. This has created a powerful competitive advantage in winning deals and provided additional sources of leads and referrals.

Prior to 2012, inContact's cloud software solutions were sold predominately through our direct sales organization. In 2011, we established a new sales channel by entering into a reseller agreement with Unify, whereby Unify became a world-wide distributor/reseller of our portfolio of cloud contact center solutions.

In October 2011, we entered into a reseller agreement with Verizon with the goal of increasing market share in North America by leveraging their sales and distribution force to sell our portfolio of cloud software solutions.

International

In 2011, we completed the build out of our European network facilities. The European network is substantially identical to our network in the United States and features redundant data centers in Munich and Frankfurt. The European network facilities enables inContact to provide multi-national customers with regional access to cloud contact center software solutions to better serve local needs. These capabilities include regionally-stored calls and contacts, broader language support for speech applications and data handling to comply with European data security regulations.

The Frankfurt and Munich network facilities further enable multi-national customers to take advantage of a true "Follow the Sun" model, where the appropriate contacts are delivered to properly skilled and available agents regardless of geography or time zone. It offers a universal queue, combined with an intelligent contact distribution platform with global reach, to ensure that the contact is always handled by the right agent, providing a consistent customer experience.

Additionally, we expanded our voice gateway technology to Europe, the Philippines and Hong Kong. The voice gateway technology facilitates high quality interactions by routing both incoming and outgoing contact center calls through the inContact system within the continent. It eliminates static and voice delay problems frequently experienced by other providers who do not have infrastructure in the region and improves service to existing customers.

We have also continued to prudently expand our operations in the Philippines, which provides us with a low cost approach to service mid-market customers.

Technology and Research and Development

Technology

We believe that our cloud technology platform enables us to develop functionality and deliver it to customers more efficiently than traditional premise or enterprise software vendors. We do not provide software that must be written to different operating systems, database and hardware platforms, or that is dependent upon a customer's unique systems environment. Rather, we have optimized our inContact portfolio of cloud software solutions to run on a specific database and operating system using the tools and platforms best suited to serve our customers. Performance, usability and functionality of our inContact portfolio drive our technology decisions and product direction.

We build our inContact portfolio as a highly scalable, multi-tenant application written in C#, Microsoft.Net and SQL server. We use commercially available hardware and a combination of proprietary and commercially available software to provide our inContact portfolio. Our core ACD server is commercially available hardware and runs a proprietary software engine. We have other custom-built core services such as voice-stream session management, database connection pooling and user session management tuned to our specific architecture and environment, allowing us to continue to scale our inContact portfolio.

Our inContact portfolio treats all customers as logically separate tenants in central applications and databases. As a result, we are able to spread the cost of delivering our software services across our customer base. In addition, because we do not have to manage many distinct applications with their own custom business logic and database schemas, we believe we can scale our business faster than traditional software vendors, even those that have modified their products to be accessible over the Internet. This allows us to focus the majority of our resources on building new functionality to deliver to our entire customer base rather than on maintaining an infrastructure to support each of their distinct applications.

The infrastructure of our inContact portfolio and VoIP technologies has both system redundancy within the applications as well as geographical redundancy with data centers in Los Angeles and Dallas in the United States and Munich and Frankfurt in Germany. Full backups of all our core customer data are performed weekly and differential backups are performed nightly. Transaction log backups take place every 30 minutes. We use secure sockets layer ("SSL") encryption to protect sensitive areas of our customer information and service-oriented websites. Remote access to our systems is made possible through a 168-bit encrypted Virtual Private Network. System passwords are changed on a periodic basis and stored in a secure folder with restricted access. All local computers are scanned for viruses on a real-time basis and report to a central server. We believe our backup, maintenance and security systems are adequate for preserving the delivery of service to our customers and operation of our business without significant outages or interruptions. However, an unforeseen or catastrophic event is always possible and could have a significant impact on our business.

Research and Development

We incurred research and development expenses of \$12.6 million in 2013, \$9.4 million in 2012 and \$6.4 million in 2011 primarily related to the development of our inContact portfolio of cloud contact center software solutions. We continue to invest a significant portion of our revenue in research and development to leverage our strategic position as a technology provider. Our research and development efforts are focused on improving the features, functionality and security of our existing service offerings as well as developing new proprietary services. In addition, from time to time we supplement our internal research and development activities with outside development resources and acquired technology. Because of our common, multi-tenant application architecture, we are able to provide all of our customers with a service based upon a single version of our applications. We are able to upgrade all of our customers at the same time with each release. As a result, we do not have to maintain multiple versions of our applications and are able to

maintain relatively low research and development expenses as compared to enterprise or premises software vendors. Another contributor to our advantage is the diverse technical and communications expertise in our research and development group as it is composed of numerous professionals with backgrounds in software, hardware and network connectivity. This group is structured as product-centric teams each of which follows formal development processes for enhancements, new feature developments, release management and quality assurance.

Acquiring Intellectual Property

We intend to pursue strategic acquisitions of intellectual property by direct acquisition of the technology or the company that owns the technology. We will rely primarily on our internal technical staff and our executive officers to identify prospective acquisitions, perform due diligence, negotiate contracts, and subsequently integrate the acquired technology or companies. We do not expect to acquire any technology unless the persons responsible for its development will remain, for some period of time, committed on a full-time basis, to further the development and integration of the new technology into our portfolio of services. We intend to use a combination of available cash, debt, long-term earnout arrangements, and equity, as consideration in future acquisitions.

Intellectual Property

We rely on a combination of trademark, copyright, trade secret and patent laws in the United States and other jurisdictions, as well as confidentiality procedures and contractual provisions to protect our proprietary technology and our brand. We also enter into confidentiality and proprietary rights agreements with our employees, consultants and other third parties and control access to software, documentation and other proprietary information.

As of December 31, 2013, we hold twelve United States patents and additional United States patent applications are pending. Our patents expire between 2032 and 2033. We cannot predict whether our pending patent applications will result in issued patents. Our patents and patent applications concern our inContact portfolio platform infrastructure. The following are our registered trademarks in the U.S. and elsewhere:

inContact®

inTouch®

ECHO®

inCloud

Satisfaction as a Service

Personal Connection

We have received in the past, and may receive in the future, communications from third parties claiming that we have infringed on their intellectual property rights. The cost to defend or settle these claims can be significant. Any intellectual property claims, regardless of merit, may also require us to seek licenses to that technology. In addition, we license third-party technologies that are incorporated into some elements of our services. Licenses from third-party technologies may not continue to be available to us at a reasonable cost or on reasonable commercial terms, or at all. Additionally, the steps we have taken to protect our intellectual property rights may not be adequate. Third parties may infringe or misappropriate our proprietary rights. Competitors may also independently develop technologies that are substantially equivalent or superior to the technologies we employ in our services. If we fail to protect our proprietary rights adequately, our competitors could offer similar services, potentially significantly harming our competitive position and decreasing our revenues.

Competition

The majority of market share in the contact center infrastructure market and in the workforce optimization software market is still held by traditional premise-based equipment providers. The premise-based method of selling solutions, via onsite equipment and software, is now being challenged by cloud providers. According to the DMG Hosted Contact Center Infrastructure Market Report, approximately 5% of all contact center seats in North America have transitioned to the cloud, for a total of approximately 871,000 seats¹.

While the cloud contact center market is still highly fragmented, inContact holds a lead position with approximately 85,000 seats of cloud contact center software as of the end of 2013¹. Because of our diligent efforts over the past several years and our experience with more than 1,500 implementations, we believe we are in a position to capitalize on the market fragmentation and become the clear leader in the market for cloud contact center software solutions.

Government Regulation

General

The Telecommunications Act of 1996 (“the Act”) vests the Federal Communications Commission (“FCC”) with jurisdiction over interstate network connectivity services, while preserving state and local jurisdiction over many aspects of these services. As a result, network connectivity services are regulated at both the federal and state levels in

the United States. In addition, a specific form of Internet-based telephony that interconnects with the Public Switched Telephone Network (“PSTN”) called “interconnected Voice over Internet Protocol” (“I-VoIP”) service is also subject to certain analogous regulations at the federal and, increasingly, state level. More recently, pursuant to statutory requirement, the FCC promulgated regulations extending narrow duties to non-interconnected VoIP (“non-I-VoIP”) service providers.

¹ 2013 Hosted Contact Center Infrastructure Market Report, DMG Consulting LLC, September 2013.

The FCC regulates providers of interstate and international long distance services, interstate access, I-VoIP and non-I-VoIP services. Most states exercise jurisdiction over intrastate long distance services and local exchange services. A small, but growing number of states also exercise jurisdiction over I-VoIP services for narrow purposes, such as ensuring collection of state universal service and other state regulatory program contributions. Significant changes to applicable laws or regulations imposed by the FCC or state regulatory agencies could negatively impact our business, operating results and financial condition.

The following summarizes important, but not all, present and proposed federal and state regulations that could impact our operations. Federal and state regulations are subject to judicial proceedings and to legislative and administrative proposals that could materially affect how we and others in this industry operate. The specific impact, however, cannot be predicted at this time.

Federal Regulation of Internet Telephony and other IP-Enabled Voice Services

VoIP telephony and other forms of IP-enabled communications are increasingly becoming subject to regulation. As a result, certain cost benefits of IP-based services, which we currently take advantage of, may erode.

The FCC has not classified all IP-enabled or VoIP communications services as unregulated information services or as regulated network connectivity services. Instead, the FCC has imposed certain legacy network connectivity regulations on I-VoIP services in a piecemeal, ad hoc manner. These regulations include requirements concerning emergency communications (“E911”), network connectivity relay services for hearing-impaired individuals (“TRS”), Customer Propriety Network Information (“CPNI”), and the facilitation of wiretaps and government surveillance under the Communications Assistance for Law Enforcement Act (“CALEA”). In addition, the FCC ruled that I-VoIP providers must contribute to the Universal Service Fund (“USF”) regime.

Network connectivity service providers are required, under the Act to make their services available to all people with disabilities. The FCC extended this obligation to I-VoIP providers in 2007. Signed in October 2010, the Twenty-First Century Communications and Video Accessibility Act of 2010 (“CVAA”) required the FCC to adopt various measures to ensure that people with disabilities have access to emerging communications technologies, and to promulgate rules requiring non-interconnected VoIP providers to contribute to the TRS Fund. To implement the CVAA, the FCC adopted rules requiring non-interconnected VoIP service providers to contribute to the TRS Fund on the basis of their interstate end-user revenues. The FCC also adopted record-keeping requirements and annual certification requirements for network connectivity, I-VoIP and non-I-VoIP providers. The rules do not affirmatively impose any other regulatory responsibilities on non-interconnected VoIP providers. Because the new rules are narrow and focused and because the Company has already taken measures to ensure the accessibility of its products and services to those with disabilities, we expect that they will have a minimal cost impact on the Company. But, the CVAA also signals a trend toward expansion of FCC regulations to a broader variety of enhanced communications services.

In addition, the regulatory treatment of IP-based conferencing services is currently under review. In a 2011 decision, the FCC’s Wireline Competition Bureau (“WCB”) denied MeetingOne.com’s request for review of a decision of the USF administrator, the Universal Service Administrative Company (“USAC”) concluding that MeetingOne.com’s IP conferencing service is regulated network connectivity; MeetingOne appealed the decision. While the outcome of this appeal remains to be seen, it could have an impact on the regulatory treatment of IP conferencing services, and how our business treats these services.

Similarly, the appropriate regulatory treatment of short messaging services (“SMS”)/text messaging for USF purposes remains uncertain. Both industry participants and USAC have sought clarification from the FCC on this issue. To date, however, the FCC has not responded to multiple requests for guidance on this issue.

Based on the nature of our IP-enabled services, we do not believe the FCC decisions to date will have a significant impact on our business, operating results, financial condition or future prospects. Nonetheless, we acknowledge that the regulatory classification of many IP-enabled services remains uncertain, and changes to the regulatory treatment of IP-based communications services could significantly affect our business.

Federal Regulation of Broadband Internet Access Services

In the past, the FCC has maintained a “hands-off” policy with regard to the regulation of Internet access services and adopted a series of decisions that classified broadband Internet access services as unregulated information services. Recently, however, the FCC has relied on its ancillary jurisdiction to regulate broadband Internet access services. In 2010, the FCC adopted the “Open Internet” or “Network Neutrality” rules, which require providers of fixed broadband Internet access services to disclose information regarding their network management practices, performance, and commercial terms. Further, the rules prohibit fixed broadband providers from unreasonably discriminating in their transmission of lawful network traffic and from blocking lawful content, applications, services or non-harmful devices unless such blocking is a part of a provider’s reasonable network management. Recently, the U.S. Court of Appeals for the D.C. Circuit struck down portions of the FCC’s regulations addressing network neutrality. The FCC is now

considering adopting new regulations and/or potentially re-classifying certain broadband Internet access services. We rely on third parties to provide or supply Internet access services and do not operate a broadband network. At this time, we do not believe the Open Internet rules will impact us.

Intercarrier Compensation and Universal Service Reform

As a long distance provider, we remit access fees directly to local exchange carriers or indirectly to our underlying network connectivity carriers for the origination and termination of our long distance network connectivity traffic pursuant to the FCC's "intercarrier compensation" rules. In 2011, the FCC adopted reforms to the existing intercarrier compensation regime. The new rules subject VoIP traffic to the FCC's intercarrier compensation rules. The FCC set the default charge for toll traffic exchanged between a VoIP provider and a local carrier at the interstate access rate. The charge for local traffic exchanged will be the reciprocal compensation rate.

In addition to undertaking intercarrier compensation reform, the FCC is considering comprehensive reforms to its USF regime. The FCC is seeking comment on proposals to expand the scope of USF contributors. For example, the FCC is considering requiring broadband Internet access providers to contribute to the USF. While USF contribution reform is anticipated, no timetable for implementation has been set.

As a regulated service provider, we contribute to the USF. We expect that reform may include an expansion of the range of contributors to include a broader scope of enhanced communications services. Further, as part of its efforts to reform the USF system, the FCC has directed wholesale providers to move from an entity-wide exemption process to a service-by-service exemption process in order to demonstrate compliance with the so-called Carrier's Carrier Rule ("CCR"). In short, the CCR is the mechanism by which wholesale providers must determine what revenues are attributable to non-contribution eligible resale revenue and which revenue is assessable end-user revenue for USF contribution purposes. As a wholesaler of network connectivity, our failure to procure evidence of the contribution status of our resellers may result in revenue reclassification and increased USF costs. As a purchaser of network connectivity inputs, we are also required to provide evidence of our contribution status to suppliers. Our failure to comply with the CCR could result in increased supplier costs. We have implemented policies and procedures necessary to comply with the CCR as both a wholesaler and consumer of interstate network connectivity.

While any material changes to the USF contribution system could impact the Company's business, because the Company passes through USF fees on an equitable and non-discriminatory basis to end users, either as a component part of the rate charged for network connectivity services or as a separately invoiced line item, we do not anticipate any material financial impact.

In addition, some states are expanding the base of service providers required to contribute to state universal service funds. Such expansions could impact our business, but we do not expect a material effect on the Company.

Data Protection Regulations

Each company that collects, processes, shares, stores, or disposes of personal data must protect this data with the appropriate security measures. Numerous federal, state and international laws, regulations, and industry standards create requirements and restrictions that affect our corporate or commercial transactions, marketing and business development activities, and interaction with our workforce. We have procedures in place to ensure that we properly comply with all data protection and privacy regulations. To the extent that new regulations are adopted that significantly impact our business, our costs of providing service could increase.

Other General Regulations

The regulatory scheme associated with the competitive network connectivity market will continue to evolve and can be expected to change the competitive environment for communications in general. It is not possible to predict how such evolution and changes will affect, if at all, our business or the industry in general.

Employees

As of December 31, 2013, we employed a total of 547 employees. Our employees are not represented by a labor union. We have not experienced any work stoppages and believe relations with our employees are good.

Executive Officers of inContact

The executive officers of inContact are elected each year at the organizational meeting of the Board of Directors, which follows the annual meeting of the shareholders, and at other Board of Directors' meetings, as appropriate. We have employed each of the executive officers in the position or positions indicated in the list and pertinent notes below.

At December 31, 2013, the following were executive officers of inContact:

Name	Age	Position	Since
Paul Jarman	44	Director and Chief Executive Officer	1997
Gregory Ayers	52	Executive Vice President and Chief Financial Officer	2009
Scott Welch ⁽¹⁾	49	Executive Vice President and Chief Operating Officer	2004
William Robinson	47	Executive Vice President of Sales	2012
Mariann McDonagh	52	Executive Vice President and Chief Marketing Officer	2010
Sunny Gosain ⁽²⁾	42	Executive Vice President and Chief Product Officer	2011
Bassam Salem	41	Executive Vice President and Chief Business Officer	2011
Julian Critchfield ⁽³⁾	49	Executive Vice President and Chief Technology Officer	2014

Paul Jarman has served as President of inContact since December 2002 and as Chief Executive Officer of inContact since January 2005. Prior to December 2002, he served as an Executive Vice President. Mr. Jarman is one of the original founders of inContact.

Gregory Ayers was elected and has served as an Executive Vice President and Chief Financial Officer of inContact since March 2009. Mr. Ayers was a self-employed financial consultant for a year prior to March 2009. Mr. Ayers served as Chief Financial Officer for two years at ZARS Pharma.

Scott Welch was elected Executive Vice President and Chief Operating Officer of inContact in September 2004 and currently serves as Chief Operating Officer and Chief Security Officer. Mr. Welch began his association with inContact in September 2003 as Chief Information Officer. Before joining inContact, Mr. Welch served as Vice President of Information Technology at Access Long Distance.

William Robinson was elected Executive Vice President of Sales of inContact in July 2012. Prior to joining inContact, Mr. Robinson provided strategy and go to market consulting for various technology companies from June 2011 through June 2012. Prior to that, Mr. Robinson was Vice President of the Americas for software-as-a-service content management provider Alfresco Software from April 2009 through June 2011. Prior to Alfresco, Mr. Robinson was Vice President of Business Intelligence for Hewlett Packard from February 2008 through April 2009.

Mariann McDonagh was elected as Executive Vice President and Chief Marketing Officer of inContact in April 2010. Prior to joining inContact, Ms. McDonagh was Senior Vice President of Corporate Marketing and Investor Relations for Xtralis from June 2008 to April 2010, where she led growth strategy for this global leader in early threat detection. Before Xtralis, she served as Senior Vice President of Corporate Marketing from March 2002 to May 2008 for Verint Systems Inc.

Sunny Gosain was elected as Executive Vice President and Chief Product Officer of inContact in August 2011. Prior to joining inContact, Mr. Gosain was the chief executive responsible for software-as-a-service ERP product line operations for Consona, Inc. from June 2010 to July 2011. Prior to Consona, he was Chief Technology Officer and Chief Information Officer for Compiere, Inc. from March 2007 to June 2010.

Bassam Salem was elected Executive Vice President and Chief Business Officer of inContact in November 2011 and began his association with inContact in March 2010 as Senior Vice President of Professional Services. Prior to joining inContact, Mr. Salem was the Senior Director of Worldwide Client Services at the Omniture business unit of Adobe from March 2005 to March 2010.

In January 2014, Julian Critchfield was elected as Executive Vice President and Chief Technology Officer of inContact. Prior to joining inContact, Mr. Critchfield was the Chief Technology Officer and General Manager for GE Healthcare from October 2011 to January 2014. Prior to GE Healthcare, Mr. Critchfield was the Executive Vice President of Product Development at Micro Focus Inc. from March 2010 to September 2011. Prior to Micro Focus Inc. Mr. Critchfield was the Support Vice President of Engineering in the Oracle Fusion Middleware Division from June 2004 to March 2010.

¹ Mr. Welch separated from inContact in February 2014.

² Mr. Gosain separated from inContact in January 2014.

³ Mr. Critchfield's employment began January 2014.

ITEM 1A. RISK FACTORS

The following is a discussion 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 described below, in addition to the other cautionary statements and risks described elsewhere as well as the other information contained in this report and in our other filings with the SEC, including our reports on Forms 10-Q and 8-K. The risks and uncertainties described below 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 and you may lose all or part of your investment.

Our results of operations have shown significant losses over the past several years, which could impact the resources we have to pursue our business and adversely affect an investment in inContact.

Our net loss was \$9.0 million, \$5.4 million and \$9.9 million for the years ended December 31, 2013, 2012 and 2011, respectively. Continued losses will diminish the working capital we have available to pursue development of our business. Sales within the Software segment continue to improve, but we have not achieved positive annual operating results and whether inContact will ultimately achieve positive results and cash flow should be considered a substantial risk with respect to our business.

The stability and growth of our revenues depends on our ability to attract and retain on-going customers.

The revenue model for companies selling software services under the cloud model, such as inContact, is to attract and retain customers who purchase services under contracts providing for monthly or periodic charges. Our ability to increase and maintain revenue depends substantially on the efficacy of our contact center and call routing solutions and maintaining customer satisfaction. Our failure to deliver services our customers need and want, and to keep our customers satisfied, would adversely affect our results or operations.

Incremental revenue from reseller partners and international sales may not exceed expenditures, which could adversely impact our results of operations.

From 2011 to 2013, we expended a significant amount of money to develop our infrastructure and international delivery systems to be able to serve new customers we expect will come from the reseller sales channel established in 2011 and new sales opportunities we hope to develop in the future. We expect to make additional expenditures for this purpose in 2014. Revenue from our reseller arrangements beyond July 2014 may not be sufficient to cover our investment in infrastructure and facilities or our continuing cost of operating the expanded service capacity, which would have a significant adverse effect on our results of operations.

Failure to effectively develop and expand our sales and marketing capabilities could harm our ability to increase our customer base and achieve broader market acceptance of our solutions.

Increasing our customer base and achieving broader market acceptance of our solutions will depend to a significant extent on our ability to expand our sales and marketing operations. We plan to continue to expand our direct sales force and engage additional third-party channel partners. This expansion will require us to invest significant financial and other resources. Our business will be seriously harmed if our efforts do not generate a corresponding increase in revenue. We may not achieve anticipated revenue growth from expanding our direct sales force if we are unable to hire and develop talented direct sales personnel, if our new direct sales personnel are unable to achieve desired productivity levels in a reasonable period of time, or if we are unable to retain our existing direct sales personnel. We also may not achieve significant revenue growth from our third-party channel partners if we are unable to attract and retain motivated channel partners, if any existing or future channel partners fail to successfully market, resell,

implement or support our solutions for their users, or if they represent multiple providers and devote greater resources to market, resell, implement and support competing products and services.

We have a lengthy product sales cycle, which has contributed and may continue to contribute to the variability of quarterly operating results.

We have experienced a lengthy initial sales and eventual “turn-up” cycle for our inContact portfolio in our Software segment, averaging approximately five to eight months. The lengthy sales cycle is one of the factors that has caused, and may continue to cause, our revenues and operating results to vary significantly from quarter to quarter. As our inContact portfolio is relatively new in the marketplace, we must provide a significant amount of education to prospective customers about the use and benefits of our products and services, which can cause potential customers to take many months to make these decisions. The length of the sales cycle can also be affected by other factors over which we have little or no control, including customer budgetary constraints, timing of customer budget cycles, and concerns by the customer about the introduction of new products by us or by our competitors. As a result, sales

cycles for customer orders vary substantially from customer to customer. Excessive delay in sales could be significant and adversely affect our business, financial condition or results of operations.

Our quarterly results of operations may fluctuate in the future.

Our quarterly revenue and results of operations may fluctuate as a result of a variety of factors, many of which are outside of our control. If our quarterly revenue or results of operations fall below the expectations of investors or securities analysts, the price of our common stock could decline substantially. Fluctuations in our results of operations may be due to a number of factors, including, but not limited to, those listed below and identified throughout this “Risk Factors” section:

Our ability to retain and increase sales to existing customers, attract new customers and satisfy our customers’ requirements;

Changes in the mix of revenue between our segments because the gross margin is significantly higher for the Software segment than for the Network connectivity segment;

The timing and success of new product introductions and enhancements or product initiation by us or our competitors;

Changes in our pricing policies or those of our competitors;

The amount and timing of expenditures related to expanding our operations;

The purchasing and budgeting cycles of our customers; and

General economic, industry and market conditions.

Because the sales cycle for the evaluation and implementation of our solutions is variable based on the specific customer needs, we may experience a delay between increasing operating expenses and the generation of corresponding revenue, if any. As a result, if revenue for a particular quarter is below our budgeted expectations, we may not be able to proportionally reduce operating expenses for that quarter, causing a disproportionate effect on our expected results of operations for that quarter.

Due to the foregoing factors, and the other risks discussed in this report, you should not rely on quarter-to-quarter comparisons of our results of operations as an indication of our future performance.

Our growth and results of operations are unknown, which means an investment in us has greater risk.

It is not possible to predict with any certainty the growth of our business over the next year. Our ability to continue our growth and improve our results of operations will depend on a number of factors, including our ability to promote and gain market acceptance of cloud software solutions, to maintain and expand our independent agent network, to fund maintenance and expansion of infrastructure to service our customers, to meet existing and emerging competition, and to maintain sufficient operating margins despite pricing pressures. Furthermore, the growth and development of our business may be harmed if we are unable to adapt and expand our systems, procedures and controls to support and manage our growth. All of these factors indicate there could be fluctuations in our results of operations and volatility in our stock price that could expose an investor to greater risk.

Our operating results may be negatively impacted by the pricing decisions of our competitors and our providers. We may not be able to mitigate this impact with our other services.

Our costs of revenues in our Network connectivity segment from period to period are affected by the pricing for network connectivity service we can obtain from the wholesale providers of these services. We must price our services at levels that are competitive, so costs of revenues affect the rates we offer to customers and our resulting revenues. This industry has a history of downward pressure on network connectivity service rates as a result of competition among providers. To acquire and retain customers, we offer these services at prices that are competitive in conjunction with the other benefits we provide. Consequently, falling prices will likely result in lowering our rates to users, which

will reduce revenues. On the other hand, higher prices charged by our providers will increase our costs of revenues and cut into operating results, unless we raise prices to our customers, which may be difficult for us to do if our competitors are not subject to the same upward pricing pressures or choose not to increase prices notwithstanding such pressure. From period to period pricing volatility could adversely affect our result of operations and financial condition.

Disruptions in the operation of our technology could adversely affect our operations.

We are dependent on our computer databases, billing and accounting computer programs, network and computer hardware that houses these systems to effectively operate our business and market our services. Our customers may become dissatisfied by any system failures that interrupt our ability to provide our service to them. Substantial or repeated system failures would significantly reduce the

attractiveness of our services. Significant disruption in the operation of these systems would adversely affect our business and results of operations.

Our enhanced services are dependent on leased network connectivity lines, and a significant disruption or change in these services could adversely affect our business.

Our inContact portfolio of cloud software solutions are provided to customers through a dedicated network of equipment we own connected through leased network connectivity lines with capacity dedicated to us that is based on Internet protocol. Communication initiated by the user is converted to data packs that are transmitted through the dedicated network and managed by our software that resides on our equipment attached to the network. We also move a portion of our voice long distance service over this dedicated network because it lowers our cost of providing the service from using traditional transmission methods.

We lease network connectivity lines and space at co-location facilities for our equipment from third-party suppliers, which represents the backbone of our dedicated network. If any of these suppliers is unable or unwilling to provide or expand their current levels of service to us, the services we offer to customers would be adversely affected. We may not be able to obtain substitute services from other providers at reasonable or comparable prices or in a timely fashion. Any resulting disruptions in the services we offer that are provided over our dedicated network would likely result in customer dissatisfaction and adversely affect our operations. Furthermore, pricing increases by any of the suppliers we rely on for the dedicated network could adversely affect our results of operations if we are unable to pass pricing increases through to our customers.

If there are interruptions or delays in our services through third-party error, our own error or the occurrence of unforeseeable events, delivery of our solutions could become impaired, which could harm our relationships with customers and subject us to liability.

We provide our services through computer hardware that we own and that is currently located in third-party web hosting co-location facilities maintained and operated in California, Texas, Utah, Germany, England, Hong Kong and the Philippines. Our hosting providers do not guarantee that our customers' access to our solutions will be uninterrupted, error-free or secure. Our operations depend on our providers' ability to protect their and our systems in their facilities against damage or interruption from natural disasters, power or network connectivity failures, criminal acts and similar events. Our back-up computer hardware and systems have not been tested under actual disaster conditions and may not have sufficient capacity to recover all data and services in the event of an outage occurring simultaneously at all facilities. In the event that our hosting facility arrangements were terminated, or there was a lapse of service or accidental or willful damage to such facilities, we could experience lengthy interruptions in our service as well as delays and/or additional expense in arranging new facilities and services. Any or all of these events could cause our customers to lose access to the services they are purchasing from us. In addition, the failure by our third-party hosting facilities to meet our capacity requirements could result in interruptions in our service or impede our ability to scale our operations.

Design and mechanical errors, spikes in usage volume and failure to follow system protocols and procedures could cause our systems to fail, resulting in interruptions in our customers' service to their customers. Any interruptions or delays in our services, whether as a result of third-party error, our own error, natural disasters or security breaches, whether accidental or willful, could harm our relationships with customers and our reputation. This in turn could reduce our revenue, subject us to liability, and cause us to issue credits or pay penalties or cause customers to fail to continue service, any of which could adversely affect our business, financial condition and results of operations. In the event of damage or interruption, our insurance policies may not adequately compensate us for any losses that we may incur.

If the security of our customers' confidential information contained in our systems or stored by use of our software is breached or otherwise subjected to unauthorized access, our service or our software may be perceived as not being secure and customers may curtail or stop using our service and our solutions.

Our systems and software store and transmit proprietary information and critical data belonging to our customers and their users. Any accidental or willful security breaches or other unauthorized access could expose us to a risk of information loss, litigation and other possible liabilities. If security measures are breached because of third-party action, employee error, malfeasance or otherwise, or if design flaws in our software are exposed and exploited, and, as a result, a third party obtains unauthorized access to any of our clients' data, our relationships with customers and our reputation will be damaged, our business may suffer and we could incur significant liability. Because techniques used to obtain unauthorized access or to sabotage systems change frequently and generally are not recognized until launched against a target, we and our third-party hosting co-location facilities may be unable to anticipate these techniques or to implement adequate preventative measures.

If outside unfriendly parties succeed in penetrating our network security or otherwise misappropriate our customer information, we could be subject to liability. Our liability could include claims for unauthorized purchases with credit card or banking information, impersonation or other similar fraud claims, as well as for other misuses of personal information, including for unauthorized

marketing purposes. These claims could result in litigation and adverse publicity, which could have an adverse effect on our reputation, business and results of operations. As we continue to gain higher profile customers, the risk that unfriendly parties will attempt and succeed in penetrating our network security also increases.

We may not be able to secure additional financing on favorable terms, or at all, to meet our long-term capital needs.

We may determine that additional capital will be necessary in responding to business challenges, including the need to develop new solutions or enhance our existing solutions, enhance our operating infrastructure, fund expansion, respond to competitive pressures, acquire complementary businesses, products and technologies, or for other reasons. We may not be able to secure additional debt or equity financing on favorable terms, or at all, at the time when we need such funding to pursue our business objectives. If we raise additional funds through further issuances of equity or convertible debt securities, our existing stockholders could suffer significant dilution in their percentage ownership of the Company, and any new equity securities we issue could have rights, preferences and privileges senior to those of holders of our common stock. Any debt financing secured by us in the future could involve restrictive covenants relating to our capital raising activities and other financial and operational matters, which may make it more difficult for us to obtain additional capital and to pursue business opportunities, including potential acquisitions. In addition, if we decide to raise funds through debt or convertible debt financings, we may be unable to meet our interest or principal payments.

If we are unable to protect our intellectual property rights, our competitive position could be harmed or we could be required to incur significant expenses to enforce our rights.

Our success depends to a significant degree upon the protection of our software and other proprietary technology rights. We rely on trade secret, copyright, patent, and trademark laws and confidentiality agreements with employees and third parties, all of which offer only limited protection. The steps we have taken to protect our intellectual property may not prevent misappropriation of our proprietary rights or the reverse engineering of our solutions. We may not be able to obtain any further trademarks, and our pending applications may not result in the issuance of patents or trademarks. Furthermore, legal standards relating to the validity, enforceability and scope of protection of intellectual property rights in other countries are uncertain and may afford little or no effective protection of our proprietary technology. Consequently, we may be unable to prevent our proprietary technology from being exploited abroad, which could affect our ability to expand to international markets or require costly efforts to protect our technology. Policing the unauthorized use of our products, trademarks and other proprietary rights is expensive, difficult and, in some cases, impossible. Litigation may be necessary in the future to enforce or defend our intellectual property rights, to protect our trade secrets or to determine the validity and scope of the proprietary rights of others. Such litigation could result in substantial costs and diversion of management resources, either of which could harm our business. Accordingly, despite our efforts, we may not be able to prevent third parties from infringing upon or misappropriating our intellectual property.

Our development of enhanced services could subject us to claims of patent infringement, such as the Microlog lawsuit, that would adversely affect our results of operations.

We offer enhanced telecommunications and related software services through our dedicated network. Certain enhanced services similar to some of the services we offer have been the subject of litigation regarding patents and intellectual property rights. In addition, many companies in intellectual property-dependent industries, including the call center management and telecommunications industry, have employed intellectual property litigation as a means to gain an advantage over their competitors. As a result, we may be required to defend against claims of intellectual property infringement that may be asserted by our competitors against us and, if the outcome of any such litigation is adverse to us, it may affect our ability to compete effectively. We may not be aware of claims that have arisen alleging enhanced services we offer infringe on intellectual property rights of others. Currently, we are defending

against a lawsuit filed by Microlog alleging we have infringed its patent for a contact center system capable of handling multiple media types of contacts and methods for the using the system. This lawsuit began in January 2014, so at this early stage we cannot make any estimate or prediction regarding how this lawsuit may progress in the future. Our involvement in litigation, opposition proceedings, or other intellectual property proceedings may divert management time from focusing on business operations, could cause us to spend significant amounts of money, and may have no guarantee of success. Any current and future intellectual property litigation also could force us to do one or more of the following:

- stop selling, incorporating, manufacturing or using our service offerings that use the subject intellectual property;
- obtain from a third party asserting its intellectual property rights, a license to sell or use the relevant technology, which license may not be available on reasonable terms, or at all;
- redesign those services or processes that use any allegedly infringing or misappropriated technology, which may result in significant cost or delay to us, or which redesign could be technically infeasible; or
- pay damages, including the possibility of treble damages in a patent case if a court finds us to have willfully infringed certain intellectual property rights.

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We are aware of a significant number of patents and patent applications relating to aspects of our technologies filed by, and issued to, third parties. We cannot assure you that we will ultimately prevail if any of this third-party intellectual property is asserted against us or that we will ultimately prevail in the patent infringement litigation with Microlog.

If our solutions fail to perform properly or if they contain technical defects, our reputation could be harmed, our market share may decline and we could be subject to product liability claims.

Our software products and services may contain undetected errors or defects that may result in product failures, slow response times, or otherwise cause our products to fail to perform in accordance with customer expectations. Because our customers use our products and services for important aspects of their business, any errors or defects in, or other performance problems with, our products and services could hurt our reputation and may damage our customers' businesses. If that occurs, we could lose future sales, or our existing customers could elect to not renew or to delay or withhold payment to us, which could result in an increase in our provision for uncollectible accounts and an increase in collection cycles for accounts receivable. Clients also may make account adjustment claims against us, which could result in the expense and risk of litigation. Product performance problems could result in loss of market share, failure to achieve market acceptance and the diversion of development resources. If one or more of our products fails to perform or contains a technical defect, a customer may assert a claim against us for substantial damages, whether or not we are responsible for the product failure or defect.

Product liability claims could require us to spend significant time and money in litigation or to pay significant settlements or damages. Although we maintain general liability insurance, including coverage for errors and omissions, this coverage may not be sufficient to cover liabilities resulting from such product liability claims. Also, our insurer may disclaim coverage. Our liability insurance also may not continue to be available to us on reasonable terms, in sufficient amounts, or at all. Any product liability claims successfully brought against us would cause our business to suffer.

We provide service level commitments to our customers, which could cause us to provide credits for future services if the stated service levels are not met for a given period and could significantly harm our revenue.

Our customer agreements provide service level commitments. If we are unable to meet the stated service level commitments or suffer extended periods of unavailability for our service, we may be contractually obligated to provide these customers with credits for future services. Our revenue could be significantly impacted if we suffer unscheduled downtime that exceeds the allowed downtimes under our agreements with our customers. In light of our historical experience with meeting our service level commitments, we do not currently have any reserves on our balance sheet for these commitments. The failure to meet this level of service availability may require us to credit qualifying customers for the value of an entire month of their subscription fees, not just the value of the subscription fee for the period of the downtime. As a result, a failure to deliver services for a relatively short duration could cause us to issue these credits to all qualifying customers. Any extended service outages could harm our reputation, revenue and operating results.

We may become subject to state regulation for certain service offerings, which could increase our cost of doing business.

Certain states take the position that offerings by VoIP companies are intrastate and therefore subject to state regulation. These states argue that if the beginning and end points of communications are known, and if some of these communications occur entirely within the boundaries of a state, the state can regulate that offering. We believe that the FCC has pre-empted states from regulating VoIP offerings in the same manner as providers of traditional network connectivity services. We cannot predict how this issue will be resolved or its impact on our business at this time.

We rely on third party network service providers to originate and terminate substantially all of our public switched telephone network calls, so significant failures in these networks could be detrimental to our operations.

We leverage the infrastructure of third party network service providers to provide telephone numbers, PSTN call termination and origination services, and local number portability for our customers rather than deploying our own network throughout the United States. If any of these network service providers cease operations or otherwise terminate the services that we depend on, the delay in switching our technology to another network service provider, if available, and qualifying this new service could have a material adverse effect on our business, financial condition or operating results.

New regulation of the Internet by governmental agencies could adversely affect the way we operate or increase our cost of doing business.

In addition to regulations addressing Internet telephony and broadband services, other regulatory issues relating to the Internet, in general, could affect our ability to provide our services. Congress has adopted legislation that regulates certain aspects of the Internet

including online content, user privacy, taxation, liability for third-party activities and jurisdiction. In addition, a number of initiatives pending in Congress and state legislatures would prohibit or restrict advertising or sale of certain products and services on the Internet, which may have the effect of raising the cost of doing business on the Internet generally.

Federal, state, local and foreign governmental organizations are considering other legislative and regulatory proposals that would regulate and/or tax applications running over the Internet. We cannot predict whether new taxes will be imposed on our services, and depending on the type of taxes imposed, whether and how our services would be affected thereafter. Increased regulation of the Internet may decrease its growth and hinder technological development, which may negatively impact the cost of doing business via the Internet or otherwise materially adversely affect our business, financial condition and results of operations.

We are expanding the sales of our services to customers located outside of the United States so our business will be susceptible to risks associated with international operations.

We currently have offices outside of the United States and have operations, sales personnel or independent consultants in several foreign countries. We have limited experience operating in foreign jurisdictions. Our inexperience in operating our business outside of the United States increases the risk that our services and any future international expansion efforts will not be successful, which could result in us not meeting our revenue goals. Operating in international markets also requires management attention and financial resources. We cannot be certain that the investment and additional resources required in establishing, acquiring or integrating operations in other countries will produce desired levels of revenues or profitability. In addition, conducting international operations subjects us to new risks that we have not generally faced in the United States. These may include:

- Fluctuations in currency exchange rates;
- Unexpected changes in foreign regulatory requirements;
- Longer accounts receivable payment cycles and difficulties in collecting accounts receivable;
- Difficulties in managing and staffing international operations;
- Potentially adverse tax consequences, including the complexities of foreign value added tax systems and restrictions on the repatriation of earnings;
- General economic conditions in international markets, including ongoing uncertainty in global economic conditions global financial markets, which may cause a decline in customer or consumer activity;
- Localization of our services, including translation into foreign languages and associated expenses;
- Dependence on certain third parties to increase customer sales;
- The burdens of complying with a wide variety of foreign laws and different legal standards, including laws and regulations related to privacy and network connectivity;
- Compliance with bribery and corruption commercial practices law that prohibit certain commercial conduct worldwide;
- Increased financial accounting and reporting burdens and complexities;
- Increased risk for international network connectivity fraud;
- Political instability abroad, terrorist attacks and security concerns in general; and
- Reduced or varied protection for intellectual property rights in some countries.

The occurrence of any one of these risks could negatively affect our international business and, consequently, our results of operations generally.

Regulation of IP telephony services is unclear, so the imposition of significant regulation in the future could adversely affect our operations.

We deliver our inContact portfolio of cloud contact center solutions and move other network connectivity service through our VoIP Network. We view government regulation as one of the conditions of the environment within which we conduct business that does impact, and will continue to impact, our business as we endeavor to comply with existing regulations and what may come in the future. At both the federal and state level there are initiatives, proposals, proceedings and investigations pending with respect to network connectivity and the Internet that we describe in some detail above in the “Government Regulation” section of ITEM 1. BUSINESS. This section describes areas where the regulatory landscape could change and significantly impact our business, and you should review that section carefully. Our failure to anticipate, plan for, and comply with new regulation as it comes along on a cost

effective basis is a continuing risk of our business that could have a significant adverse effect on our business activity and results of operations.

Our ability to offer services outside the U.S. is subject to different local regulatory environments, which may be unknown, complicated and uncertain.

Regulatory treatment of enhanced communications services outside the United States varies from country to country and often the laws are unclear. We currently distribute our products and services directly to consumers and through resellers and channel partners that may be subject to network connectivity regulations in their home countries. The failure by us or our customers, resellers and channel partners to comply with these laws and regulations could reduce our revenue and profitability. Because of our relationship with the resellers and channel partners, some countries may assert that we are required to register as a network connectivity provider in that country. In such case, our failure to do so could subject us to fines or penalties. In addition, some countries are considering subjecting enhanced communication services to the regulations applied to traditional telephone companies. Regulatory developments such as these could have an adverse effect on the use of our services in international locations and as a result, our growth and results of operations.

Increased taxes or fees on our service will increase our customers' cost of using our service and/or reduce our profit margins (to the extent the costs are not passed through to our customers) and we may be subject to liabilities for past sales and additional taxes, surcharges and fees.

The tax and fee structure relative to enhanced communications services is complex, ambiguous and subject to interpretation. Based on its interpretation of applicable law, the Company believes that it has either remitted or accrued for all taxes and regulatory fees owed as a result of its operations. If, however, taxing and regulatory authorities arrive at different interpretations of applicable law, our ultimate liability could exceed the amount the Company has remitted and accrued. In addition, the collection of additional taxes, fees or surcharges in the future could have the effect of increasing our prices or reduce our profit margins. Compliance with these regulations may also make us less competitive with those competitors who choose not to comply with the regulations.

Our emergency and E-911 calling services are different from those offered by traditional wireline telephone companies and may expose us to significant liability. There may be risks associated with limitations associated with E-911 emergency dialing with our service.

To the extent we are obligated to provide E-911 and emergency calling services for specific offerings, both services are different, in significant respects, from the emergency calling services offered by traditional wireline telephone companies. In each case, the differences may cause significant delays, or even failures, in callers' receipt of the emergency assistance they need.

On June 1, 2007, the FCC released a Notice of Proposed Rulemaking in which it tentatively concluded that all interconnected VoIP service providers that allow customers to use their service in more than one location (nomadic VoIP service providers such as us) must utilize an automatic location technology that meets the same accuracy standards that apply to providers of commercial mobile radio services (mobile phone service providers). This was followed by a series of inquiries and FCC NPRMs concerning the applicability and implementation of E-911 requirements to VoIP services.

In some instances, our nomadic emergency calling solution requires that we route an emergency call to a national emergency call center instead of connecting our customers directly to a local Public Safety Answering Point ("PSAP") through a dedicated connection and through the appropriate selective router. The FCC may issue further guidance on compliance requirements in the future that might require us to reevaluate the method in which our E-911 access

service is provisioned. Any changes in the method in which E-911 access service could have an adverse effect on our business, financial condition or operating results. In late July 2008, the President signed into law the “New and Emerging Technologies 911 Improvement Act of 2008.” The law provides public safety, interconnected VoIP providers and others involved in handling 911 calls the same liability protections when handling 911 calls from interconnected VoIP users as from mobile or wired telephone service users. The applicability of these laws and regulations to an enhanced call center offering remains unclear.

Because of limitations inherent in E-911 access service for interconnected VoIP and the potential for user error customers may, in the future, attempt to hold us responsible for any loss, damage, personal injury or death suffered as a result of any failure of our E-911 services.

The FCC adopted orders reforming the system of payments between regulated carriers that we partner with to interface with the public switch telephone network. The rates we pay for the services performed by these carriers may increase as a result of the FCC's reform order. As a result, we may increase rates for service, making our offerings less competitive with others in the marketplace, or reduce our profitability.

The FCC reformed the system under which providers of network connectivity services compensate each other for transporting and/or terminating various types of traffic, including VoIP traffic that terminates on the PSTN and applied new call signaling requirements to VoIP and other service providers. The FCC's rules concerning charges for transmission or termination of VoIP traffic could result in an increased cost to terminate the traffic absent specific agreements that include a rate for VoIP-PSTN traffic when exchanged between us and other carriers. For VoIP traffic that terminates on the PSTN, the Order establishes a transitional framework that establishes default intercarrier compensation rates for VoIP-PSTN traffic that are equal to the rates applicable to non-VoIP traffic and allows regulated providers of network connectivity services to tariff these default charges in the relevant federal and state tariffs that apply in the absence of an agreement. The rules also establish a multiyear transition to a national "bill-and-keep" framework as the ultimate end state for traffic exchanged with a local exchange carrier. Under bill-and-keep, providers do not charge one another for terminating traffic and instead recover the costs of termination from their own customers. To the extent that the company transmits VoIP traffic that is not subject to an existing intercarrier compensation arrangement and another provider imposes higher intercarrier compensation charges than we, or the third parties terminating our traffic to the PSTN, pay today, our termination costs could initially increase. In the near term, this change could result in us either increasing our retail charges for services to our customers or, reducing our profitability. However, over the longer term, we expect our costs to terminate traffic to the PSTN to decline.

ITEM 1B. UNRESOLVED STAFF COMMENTS

We have not received any comments from the Securities and Exchange Commission that remain unresolved.

ITEM 2. PROPERTIES

We lease our principal office space in Salt Lake City, Utah, which is our corporate headquarters, including our principal administrative, marketing, technical support and research and development facilities. At December 31, 2013, the space consists of approximately 59,000 square feet and the lease for this office space expires in June 2015, but we have an option to renew the lease for an additional five years at the end of the lease period. We also lease smaller office spaces in California, England and the Philippines. We believe that our current facilities are suitable and adequate to meet our current needs, and that suitable additional or substitute space will be available as needed to accommodate expansion of our operations.

The hosting of our equipment and software at co-located third-party facilities is significant to our business and we have entered into agreements with third-party facilities in California, Texas, England, Germany, Hong Kong and the Philippines under multiple agreements that either continue month-to-month or expire between February 2014 and July 2018. We believe that our contracted space for our hardware and software at these facilities is both suitable and adequate for our current development plans and that suitable additional facilities will be available as needed.

ITEM 3. LEGAL PROCEEDINGS

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. Pursuant to a motion filed by Insidesales.com, 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 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 and no liability has been recorded.

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. We are at the very early stages of this lawsuit and presently intend to defend the claims vigorously.

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.

ITEM 4. MINE SAFETY DISCLOSURES

This item does not apply to our business.

PART II

ITEM MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS, AND
5. ISSUER PURCHASES OF EQUITY SECURITIES

Market Price, Stockholder Matters, and Unregistered Sales

Our common stock trades on The NASDAQ Capital Market under the symbol "SAAS." The following table presents the high and low closing sales prices per share of our common stock as reported on The NASDAQ Capital Market for the four calendar quarters of 2013 and 2012:

Calendar Quarter Ended:	High	Low
March 31, 2013	\$8.09	\$4.81
June 30, 2013	\$8.92	\$7.18
September 30, 2013	\$9.62	\$8.00
December 31, 2013	\$8.28	\$6.96

Calendar Quarter Ended:	High	Low
March 31, 2012	\$5.93	\$4.41
June 30, 2012	\$5.87	\$4.55
September 30, 2012	\$6.66	\$4.76
December 31, 2012	\$6.99	\$5.17

As of February 20, 2014, we had approximately 2,959 holders of record of our common stock. Since inception, no dividends have been paid on the common stock. We intend to retain any earnings for use in our business activities, so it is not expected that any dividends on the common stock will be declared and paid in the foreseeable future.

Stock Performance Graph

Notwithstanding any statement to the contrary in any of our filings with the SEC, the following information shall not be deemed "filed" with the SEC or "soliciting material" under the Securities Exchange Act of 1934 and shall not be incorporated by reference into any such filings irrespective of any general incorporation language contained in such filing.

The line graph below compares the cumulative stockholder return on our common stock with the cumulative total return of the Russell 2000 Index and the NASDAQ Computer and Data Processing Index for the five fiscal years ended December 31, 2013. The stock price information shown on the graph below is not necessarily indicative of future price performance.

Equity Compensation Plan Information

The following table provides information on our compensation plans at December 31, 2013 under which equity securities are authorized for issuance.

Plan category	(a) Number of securities to be issued upon exercise of outstanding options, warrants, and rights	(b) Weighted-average exercise price of outstanding options, warrants and rights	(c) Number of securities remaining available for future issuances under equity compensation plans (excluding securities reflected in column (a))
Equity compensation plans approved by security holders	3,095,841	\$ 4.32	1,797,440
Equity compensation plans not approved by security holders	366,500 ⁽¹⁾	\$ 4.59	N/A
Total	3,462,341	\$ 4.35	1,797,440

(1) This figure includes options issued to officers and employees under individual compensation arrangements.

Repurchases of Securities

Stock repurchases for the year ended December 31, 2013, were as follows (in thousands, except per share data):

Calendar Quarter Ended:	Total number of shares purchased	Average price per share	Total number of shares purchased as part of a publically announced plan or program	Maximum number of shares that may yet be purchased under the plan or program
March 31, 2013 ⁽¹⁾	492	\$ 5.55	—	—
June 30, 2013	—	—	—	—
September 30, 2013 ⁽²⁾	24	8.43	—	—
December 31, 2013 ⁽³⁾	14	7.13	—	—
Total shares repurchased	530	\$ 5.72	—	—

- (1) In February 2013, we amended certain terms of our reseller agreement with Unify. Under the amended agreement, Unify has the right to pay in shares of inContact Common Stock, discounted from the market price by nine percent, the following: i) outstanding amounts totaling \$2.7 million as of December 31, 2012, ii) minimum purchase commitments in 2013, and iii) the difference between actual sold through revenue and minimum purchase commitments in 2014. In February 2013, we received 492,000 shares of our common stock from Unify to pay the \$2.7 million of outstanding receivables at December 31, 2012.
- (2) In July 2013, we received 24,000 shares of our common stock from an employee for the settlement of the employee's payroll tax obligation of \$206,000 associated with the lapsing of the selling restriction of a restricted stock award.
- (3) In November 2013, we received 14,000 shares of our common stock from employees for the settlement of the employees' payroll tax obligation of \$100,000 associated with the lapsing of the selling restriction of a restricted stock award.

ITEM 6. SELECTED FINANCIAL DATA

The following tables set forth selected financial data for each of the years in the five-year period ended December 31, 2013. The consolidated statements of operations data and balance sheet data are derived from the audited Consolidated Financial Statements of inContact. The following selected financial data should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations and the Consolidated Financial Statements, including the Notes thereto, appearing elsewhere in this report.

Consolidated Statement of Operations Data (in thousands, except per share data):

	Year Ended December 31,				
	2013	2012	2011	2010	2009
Net revenue	\$ 130,037	\$ 110,280	\$ 88,472	\$ 81,704	\$ 84,036
Net loss	\$(9,018)	\$(5,384)	\$(9,941)	\$(1,507)	\$(3,069)

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Net loss applicable to common stockholders	\$(9,018)	\$(5,384)	\$(9,941)	\$(1,507)	\$(3,069)
Net loss per share:					
Basic and diluted	\$(0.16)	\$(0.11)	\$(0.24)	\$(0.04)	\$(0.10)
Cash dividends per common share	\$—	\$—	\$—	\$—	\$—

Consolidated Balance Sheet Data (in thousands):

	As of December 31,				
	2013	2012	2011	2010	2009
Total assets	\$107,918	\$96,347	\$58,414	\$40,585	\$38,929
Long-term obligations	\$9,048	\$5,200	\$7,071	\$8,973	\$9,475

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Introduction

Management's discussion and analysis of financial condition and results of operations ("MD&A") is provided as a supplement to the accompanying consolidated financial statements and notes to help provide an understanding of inContact's financial condition, cash flows and results of operations. MD&A is organized as follows:

Overview. This section provides a general description of our business, as well as developments we believe are important in understanding the results of operations and financial condition or in understanding anticipated future trends.

Consolidated Results of Operations. This section provides an analysis of our consolidated results of operations for the three years ended December 31, 2013.

Segment Results of Operations. This section provides an analysis of our segment results of operations for the three years ended December 31, 2013.

Liquidity and Capital Resources. This section provides an analysis of our cash flows for the three years ended December 31, 2013, as well as a discussion of our outstanding debt and commitments that existed as of December 31, 2013. Included in the analysis of outstanding debt is a discussion of the amount of financial capacity available to fund our future commitments, as well as a discussion of other financing arrangements.

Contractual Obligations and Off-Balance Sheet Arrangements. This section provides a tabular presentation of our outstanding contractual obligations that existed as of December 31, 2013.

Critical Accounting Estimates. This section discusses accounting estimates that are considered important to our results of operations and financial condition, require significant judgment and require estimates on the part of management in application. Our significant accounting policies, including those considered to be critical accounting policies, are summarized in Part IV, Item 15 "Financial Statements"—Note 1—"Accounting Policies."

Overview

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

We began offering cloud 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.

We provide software which includes the following:

Automatic call distributing

Computer telephony integration
Interactive voice response with speech recognition
Outbound dialing
PBX and CRM integration
Echo agent service surveys and reports
Workforce optimization
Quality monitoring
Screen recording

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Interactive reporting tool

Taken together, the inContact cloud portfolio creates an integrated solution for contact centers, including those with distributed workforces—either at-home or multi-site.

Business Developments

In 2011, we entered into reseller agreements for our cloud contact center software solutions with Unify, Inc. (“Unify”) (formerly Siemens Enterprise Communications) and Verizon. The Unify agreement included minimum revenue purchase commitments. During 2013, Unify resold substantially fewer software services than they had originally anticipated. In February 2013, we amended certain provisions of our reseller agreement with Unify, allowing Unify more time to implement a revised go to market sales plan, with the objective of increasing contract revenue progressively to a level commensurate with the amount of the quarterly minimum purchase commitments. The revised minimum purchase commitments total \$4.5 million of net software revenue in 2012, \$7.0 million in 2013 and up to \$5.0 million in 2014, which may be credited up to \$1.0 million in 2014, in consideration for up to \$1.0 million investment by Unify in sales and marketing of our cloud contact center software solutions.

To provide additional funding for our cloud software growth initiatives and infrastructure investment, we raised \$37.3 million in a Common Stock offering in September 2012, and drew \$4.0 million in April 2013 and \$3.0 million in December 2013 from term loans with Zions.

Trends in Our Business

We continue to experience increases in Software segment revenue principally due to our continued focus and investment in sales and marketing through our initiatives in direct sales and through resellers and referral partner arrangements. We expect Software and Network connectivity segment revenue to continue to increase during 2014 . The Network connectivity segment net growth increase is attributable to the increase in Network connectivity revenue from our inContact portfolio customers, exceeding lost revenue from attrition of our Network connectivity only customers. We expect the Network connectivity revenue from our inContact portfolio customers to continue to exceed the attrition of our Network connectivity only customers in 2014.

There has been an increase in costs of revenue during 2013 due to greater professional service and customer service personnel costs as we employ more personnel, including higher-paid employees with more developed skill sets to service larger mid-market and enterprise customers, greater direct costs attributable to establishing our international infrastructure and international call traffic, and an increase in amortization of previously capitalized internal use software costs. However, the costs of revenue as a percentage of sales has decreased in 2013 as compared to 2012 due to the increase in Software segment revenue in general, and an increase in Software segment revenue from the reseller sales channels added during 2011. We expect costs of revenue in absolute dollars to continue to increase, but we expect the costs of revenue as a percentage of sales to remain the same or to continue to decrease slightly as we anticipate increases in revenue for the reasons noted previously.

Sources of Revenue

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

Software

Software delivery and support of our inContact portfolio is provided on a monthly recurring subscription basis. Monthly recurring charges are billed in arrears and recognized for the period in which they are earned. In addition to the monthly recurring revenue, revenue is also received on a non-recurring basis for professional services or on a recurring basis related to improving a customer's contact center efficiency and effectiveness, as it relates to utilization of the inContact portfolio. Customers access cloud software and data through a secure Internet connection. Support services include technical assistance for our software products and product upgrades and enhancements on a when and if available basis. Our network connectivity and data network is fundamental to our inContact portfolio and allows us to provide the all-in-one inContact solution. Software service revenue also includes revenue related to minimum purchase commitments through July 2014, from a related party reseller referred to in Part IV. Item 13 "Financial Statements" – Note 13 – Related Party Transactions."

Network Connectivity

We derive revenue from network connectivity services such as dedicated transport, VoIP connectivity, switched long distance and data services. These services are provided over our network or through third party network connectivity providers. Revenue for transactional 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 billed monthly charges in arrears and revenue is recognized for such charges over the billing period. If the billing period spans more than one month, earned but unbilled revenues are recognized as revenue for incurred usage to date.

Costs of Revenue and Operating Expenses

Costs of Revenue

Costs of revenue consist primarily of payments to third party 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 in absolute dollars as we continue to support growth initiatives.

Research and Development

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

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.

Results of Operations

Results of 2013 versus 2012

The following is a tabular presentation of our condensed operating results for the year ended December 31, 2013 compared to our condensed operating results for the year ended December 31, 2012 (in thousands):

	2013	2012	\$ Change	% Change	
Net revenue	\$130,037	\$110,280	\$19,757	18	%
Costs of revenue	67,377	59,776	7,601	13	%
Gross profit	62,660	50,504	12,156		
Gross margin	48	% 46			%
Operating expenses:					
Selling and marketing	37,220	28,591	8,629	30	%
Research and development	12,605	9,401	3,204	34	%
General and administrative	21,219	17,140	4,079	24	%
Total operating expenses	71,044	55,132	15,912		
Loss from operations	(8,384)	(4,628)	(3,756)		
Other expense	(351)	(636)	285	45	%
Loss before income taxes	(8,735)	(5,264)	(3,471)		
Income tax expense	(283)	(120)	(163)		
Net loss	\$(9,018)	\$(5,384)	\$(3,634)		

Revenue: Total revenues increased \$19.8 million or 18% to \$130.0 million during 2013 compared to revenues of \$110.3 million during 2012. The increase relates to an increase of \$14.2 million in Software segment revenue due to our continued focus and investment in sales 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 \$5.6 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 \$6.8 million of software revenue during 2013 under our reseller agreement with Unify, which principally represents revenue from Unify's 2013 minimum purchase commitments. Under the arrangement, revenue from resold software services reduces Unify's obligation up to the amount of the quarterly minimum purchase commitments. These minimum purchase commitments were negotiated, in part to mitigate the risks associated with the investment in infrastructure to support our expanded reseller sales and marketing efforts initiated in 2011 and expire at the end of July 2014. We expect that revenue from resold software services will be less than the minimum purchase commitment at the end of July 2014 and there will be a reduction in software revenue from that reseller beginning in August 2014 to the extent the revenue from resold software services is less than the minimum purchase commitment at the end of July 2014.

During 2013, the amount of software services resold by Unify was substantially less than its 2013 minimum purchase commitment. In February 2013, we amended certain provisions of our reseller agreement with Unify, allowing Unify more time to implement a revised go to market sales plan, with the objective of increasing contract revenue progressively to a level commensurate with the amount of the quarterly minimum purchase commitments. The revised minimum purchase commitments total \$4.5 million of net software revenue in 2012, \$7.0 million in 2013 and up to \$5.0 million in 2014, which may be credited up to \$1.0 million in 2014, in consideration for up to \$1.0 million investment by Unify in sales and marketing of our cloud contact center software solutions.

Costs of revenue and gross margin: Costs of revenue increased \$7.6 million or 13% to \$67.4 million during 2013 compared to \$59.8 million during 2012. Our gross margin increased two percentage points to 48% during 2013 from 46% during 2012. The increase in revenue from our inContact portfolio and the minimum purchase commitment offset increased costs attributable to greater professional service and customer service personnel costs incurred to service larger mid-market and enterprise customers and to support resellers, international infrastructure investments initiated in 2011 and increased amortization of previously capitalized software development costs. In addition, lower network connectivity costs due to increased efficiencies in call routing related to a continued investment in technology and lower negotiated direct costs contributed to the gross margin increase.

Selling and marketing: Selling and marketing expense increased \$8.6 million or 30% to \$37.2 million during 2013 from \$28.6 million during 2012. This increase is primarily a result of headcount additions for direct and channel sales employees and higher levels of investment in marketing efforts to create increased awareness of our inContact portfolio of cloud contact center solutions as well as increased lead generation efforts for our Software segment.

Research and development: Research and development expense increased \$3.2 million or 34% to \$12.6 million during 2013 compared to \$9.4 million during 2012. The increase relates to our efforts to expand our content offerings, upgrade and extend our service offerings and develop new technologies.

General and administrative: General and administrative expense increased \$4.1 million or 24% to \$21.2 million during 2013 compared to \$17.1 million during 2012. The increase is primarily due to increased personnel costs and costs incurred to support our business expansion, both domestically and internationally.

Other expense: Other expense decreased \$285,000 to \$351,000 during 2013 compared to \$636,000 during 2012.

Income taxes: Income taxes consist of foreign taxes and various state income taxes and increased \$163,000 in 2013 as compared to 2012 due to increased foreign and state income taxes. We have a full valuation allowance on all deferred tax assets.

Results of 2012 versus 2011

The following is a tabular presentation of our condensed operating results for the year ended December 31, 2012 compared to our condensed operating results for the year ended December 31, 2011 (in thousands):

	2012	2011	\$ Change	% Change	
Net revenue	\$110,280	\$88,472	\$21,808	25	%
Costs of revenue	59,776	52,577	7,199	14	%
Gross profit	50,504	35,895	14,609		
Gross margin	46	% 41	%		
Operating expenses:					
Selling and marketing	28,591	24,563	4,028	16	%
Research and development	9,401	6,354	3,047	48	%
General and administrative	17,140	14,090	3,050	22	%
Total operating expenses	55,132	45,007	10,125		
Loss from operations	(4,628)	(9,112)	4,484		
Other expense	(636)	(755)	(119)	(16	%)
Loss before income taxes	(5,264)	(9,867)	4,603		
Income tax expense	(120)	(74)	46		
Net loss	\$(5,384)	\$(9,941)	\$4,557		

Revenue: Total revenues increased \$21.8 million to \$110.3 million during 2012 compared to revenues of \$88.5 million during 2011. The increase relates to an increase of \$14.8 million in Software segment revenue due to our continued focus and investment in sales 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 \$7.0 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 \$4.5 million of software revenue during 2012, under our reseller agreement with Unify, which principally represents revenue from Unify's 2012 minimum purchase commitments. Under the arrangement, revenue from resold software services reduces Unify's obligation up to the amount of the quarterly minimum purchase commitments. These minimum purchase commitments were negotiated, in part to mitigate the risks associated with the investment in infrastructure to support our expanded reseller sales and marketing efforts initiated in 2011 and

expire at the end of July 2014. If revenue from resold software services does not meet the minimum purchase commitment at the end of July 2014, there will be a reduction in software revenue from that reseller beginning in August 2014 to the extent the revenue from resold software services is less than the minimum purchase commitment at the end of July 2014.

During 2012, the amount of software services resold by Unify was substantially less than its 2012 minimum purchase commitment. In February 2013, we amended certain provisions of our reseller agreement with Unify, allowing Unify more time to implement a revised go to market sales plan, with the objective of increasing contract revenue progressively to a level commensurate with the amount of the quarterly minimum purchase commitments. The revised minimum purchase commitments total \$4.5 million of net software revenue in 2012, \$7.0 million in 2013 and up to \$5.0 million in 2014, which may be credited up to \$1.0 million in 2014, in consideration for up to \$1.0 million investment by Unify in sales and marketing of our cloud contact center software solutions.

Costs of revenue and gross margin: Costs of revenue increased \$7.2 million or 14% to \$59.8 million during 2012 compared to \$52.6 million during 2011. Our gross margin increased five percentage points to 46% during 2012 from 41% during 2011. The increase in revenue from our inContact portfolio and the minimum purchase commitment offset increased costs attributable to greater

professional service and customer service personnel costs incurred to service larger mid-market and enterprise customers and to support resellers, international infrastructure investments initiated in 2011 and increased amortization of previously capitalized software development costs. In addition, lower Network connectivity costs due to increased efficiencies in call routing related to a 2011 investment in technology and lower negotiated direct costs contributed to the gross margin increase.

Selling and marketing: Selling and marketing expense increased \$4.0 million or 16% to \$28.6 million during 2012 from \$24.6 million during 2011. This increase is primarily a result of headcount additions for channel sales employees and higher levels of investment in marketing efforts to create increased awareness of our inContact portfolio of cloud contact center solutions as well as increased lead generation efforts for our Software segment.

Research and development: Research and development expense increased \$3.0 million or 48% to \$9.4 million during 2012 compared to \$6.4 million during 2011. The increase relates to our efforts to expand our content offerings, upgrade and extend our service offerings and develop new technologies.

General and administrative: General and administrative expense increased \$3.0 million or 22% to \$17.1 million during 2012 compared to \$14.1 million during 2011. The increase is primarily due to increased personnel costs and costs incurred to support our international business expansion.

Other expense: Other expense decreased \$119,000 to \$636,000 during 2012 compared to \$755,000 during 2011. Net interest expense decreased \$145,000 during 2012 compared to 2011 due to a lower average outstanding balance on our Revolving Credit Agreement (“Revolving Credit Agreement”) with Zions in 2012 as compared to 2011. Additionally, there was no change in fair value of warrants in 2012 as compared to a \$158,000 increase in fair value of the warrants during 2011 as the associated warrants were exercised in 2011.

Income taxes: Income taxes consist of foreign taxes and various state income taxes and increased \$46,000 in 2012 as compared to 2011 due to increased foreign and state income taxes. We have a full valuation allowance on all deferred tax assets.

Segment Reporting

We operate under two business segments: Software and Network connectivity. The Software segment (referred to as cloud or SaaS) includes all monthly recurring subscription revenue related to the delivery of our software solutions plus the associated professional services and setup fees, and revenue related to 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. Management evaluates expenditures for both selling and marketing and research and development efforts at the segment level without the allocation of overhead expenses, such as rent, utilities and depreciation on property and equipment.

Software Segment Results

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The following is a tabular presentation and comparison of our Software segment condensed operating results for the years ended December 31, 2013, 2012 and 2011 (in thousands):

	Year ended December 31,			2013 vs. 2012		2012 vs. 2011		
	2013	2012	2011	\$ Change	% Change	\$ Change	% Change	
Net revenue	\$68,897	\$54,705	\$39,870	14,192	26 %	14,835	37 %	
Costs of revenue	28,012	22,134	16,940	5,878	27 %	5,194	31 %	
Gross profit	40,885	32,571	22,930					
Gross margin	59 %	60 %	58 %					
Operating expenses:								
Direct selling and marketing	31,722	23,758	19,810	7,964	34 %	3,948	20 %	
Direct research and development	11,601	8,502	5,706	3,099	36 %	2,796	49 %	
Indirect	20,540	16,688	12,734	3,852	23 %	3,954	31 %	
Loss from operations	\$(22,978)	\$(16,377)	\$(15,320)					

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Results of 2013 versus 2012

The Software segment revenue increased \$14.2 million or 26% to \$68.9 million during 2013 from \$54.7 million during 2012. 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. We recognized \$6.8 million of software revenue during 2013 under our reseller agreement with Unify, which principally represents revenue from Unify's 2013 minimum purchase commitments. Under the arrangement, revenue from resold software services reduces Unify's obligation up to the amount of the minimum purchase commitments. These minimum purchase commitments were negotiated, in part to mitigate the risks associated with the investment in infrastructure to support our expanded reseller sales and marketing efforts initiated in 2011 and expire at the end of July 2014. We expect that revenue from resold software services will be less than the minimum purchase commitment at the end of July 2014 and there will be a reduction in software revenue from Unify beginning in August 2014 to the extent the revenue from resold software services is less than the minimum purchase commitment at the end of July 2014.

During 2013, the amount of software services resold by Unify was substantially less than its 2013 minimum purchase commitment. In February 2013, we amended certain provisions of our reseller agreement with Unify, allowing Unify more time to implement a revised go to market sales plan, with the objective of increasing contract revenue progressively to a level commensurate with the amount of the quarterly minimum purchase commitments. The revised minimum purchase commitments total \$4.5 million of net software revenue in 2012, \$7.0 million in 2013 and up to \$5.0 million in 2014, which may be credited up to \$1.0 million in 2014, in consideration for up to \$1.0 million investment by Unify in sales and marketing of our cloud contact center software solutions.

Software segment revenue also includes revenue from professional and customer support services of \$5.7 million for 2013 compared to \$3.1 million for 2012.

Gross margin decreased one percentage point to 59% in 2013 compared to 60% in 2012. The decrease in gross margin is principally attributable to slightly higher levels of professional service and customer service costs incurred to service larger mid-market and enterprise customers and to support resellers.

Direct selling and marketing expenses in the Software segment increased \$8.0 million or 34% to \$31.7 million in 2013 compared to \$23.8 million during 2012. This increase is a result of headcount additions for direct and channel sales employees and employees focused on managing and enhancing our referral and reseller partner relationships and higher levels of investment in marketing efforts to create increased awareness of our inContact portfolio of cloud contact center solutions. Sales commission expense also increased with the increase in revenue.

We also continue to develop the portfolio of cloud contact center solutions by investing in research and development. During 2013 we incurred \$11.6 million in direct research and development costs compared to \$8.5 million during 2012 and have capitalized an additional \$6.2 million of costs incurred during 2013 related to our internally developed software compared to \$5.5 million during 2012.

Indirect expenses, which consists of overhead, such as allocated general and administrative expenses, rent, utilities and depreciation on property and equipment, increased \$3.9 million in 2013 compared to 2012 as a result of more indirect costs being allocated to the Software segment with the continued shift in revenue and direct expense mix from the Network connectivity segment to the Software segment and the overall increase in indirect expenses.

Results of 2012 versus 2011

The Software segment revenue increased \$14.8 million or 37% to \$54.7 million during 2012 from \$39.9 million during 2011. The increase relates primarily to revenue generated from our inContact portfolio of cloud contact center solutions and is due to our continued focus and investment in sales and marketing through our direct sales and referral and reseller partner arrangements. We recognized \$4.5 million of software revenue during 2012 under our reseller agreement with Unify, which principally represents revenue from Unify's 2012 minimum purchase commitments. Under the arrangement, revenue from resold software services reduces Unify's obligation up to the amount of the minimum purchase commitments. These minimum purchase commitments were negotiated, in part to mitigate the risks associated with the investment in infrastructure to support our expanded reseller sales and marketing efforts initiated in 2011 and expire at the end of July 2014. If revenue from resold software services does not meet the minimum purchase commitment at the end of July 2014, there will be a reduction in software revenue from Unify beginning in August 2014 to the extent the revenue from resold software services is less than the minimum purchase commitment at the end of July 2014.

During 2012, the amount of software services resold by Unify was substantially less than its 2012 minimum purchase commitment. In February 2013, we amended certain provisions of our reseller agreement with Unify, allowing Unify more time to implement a revised go to market sales plan, with the objective of increasing contract revenue progressively to a level commensurate with the amount of

the quarterly minimum purchase commitments. The revised minimum purchase commitments total \$4.5 million of net software revenue in 2012, \$7.0 million in 2013 and up to \$5.0 million in 2014, which may be credited up to \$1.0 million in 2014, in consideration for up to \$1.0 million investment by Unify in sales and marketing of our cloud contact center software solutions.

Software segment revenue also includes revenue from customer and professional services of \$3.1 million for 2012 compared to \$2.5 million for 2011.

Gross margin increased two percentage points to 60% in 2012 compared to 58% in 2011. The increase in revenue from our inContact portfolio and the minimum purchase commitment offset increased costs attributable to greater professional service and customer service personnel costs incurred to service larger mid-market and enterprise customers and to support resellers, international infrastructure investments initiated in 2011 and increased amortization of previously capitalized software development costs.

Direct selling and marketing expenses in the Software segment increased \$3.9 million or 20% to \$23.7 million in 2012 compared to \$19.8 million during 2011. This increase is a result of headcount additions for channel sales employees and employees focused on managing and enhancing our referral and reseller partner relationships and higher levels of investment in marketing efforts to create increased awareness of our inContact portfolio of cloud contact center solutions. Sales commission expense also increased with the increase in revenue.

We also continue to develop the portfolio of cloud contact center solutions by investing in research and development. During 2012, we incurred \$8.5 million in direct research and development costs compared to \$5.7 million during 2011 and have capitalized an additional \$5.5 million of costs incurred during 2012 related to our internally developed software compared to \$4.8 million during 2011.

Indirect expenses, which consist of overhead, such as rent, utilities and depreciation on property and equipment, increased \$4.0 million in 2012 compared to 2011 as a result of more indirect costs being allocated to the Software segment with the continued shift in revenue and direct expense mix from the Network connectivity segment to the Software segment and the overall increase in indirect expenses.

Network Connectivity Segment Results

The following is a tabular presentation and comparison of our Network connectivity segment condensed operating results for the years ended December 31, 2013, 2012 and 2011 (in thousands):

	Year ended December 31,			2013 vs. 2012		2012 vs. 2011			
	2013	2012	2011	\$ Change	% Change	\$ Change	% Change	%	
Net revenue	\$61,140	\$55,575	\$48,602	5,565	10	% 6,973	14	%	
Costs of revenue	39,365	37,642	35,637	1,723	5	% 2,005	6	%	
Gross profit	21,775	17,933	12,965						
Gross margin	36	% 32	% 27						
Operating expenses:									
Direct selling and marketing	3,511	3,207	3,421	(304)	9	% (214)	(6	%)	
Indirect	3,670	2,977	3,336	(693)	23	% (359)	(11	%)	
Income from operations	\$14,594	\$11,749	\$6,208						

Results of 2013 versus 2012

Network connectivity segment revenue increased \$5.6 million or 10% to \$61.1 million during 2013 from \$55.6 million in 2012. This increase is attributable to the Network connectivity revenue from our inContact portfolio customers exceeding the attrition of our network connectivity only customers. Our costs of revenue increased 5% due to the increase in revenue, but Network connectivity gross margin increased 4% due to increased efficiencies in call routing related to continued investment in technology and lower negotiated direct costs, which resulted in lower per-minute network connectivity costs. Selling and marketing expenses increased 9% due to increased personnel costs related to Network connectivity sales support associated with our inContact portfolio customers, partially offset by lower third-party commissions. Indirect expenses, which consist of overhead, such as allocated general and administrative expenses, rent, utilities and depreciation on property and equipment, increased 23% during 2013 compared to 2012 primarily due to an increase in bad debt allocated to the Network connectivity segment.

Results of 2012 versus 2011

Network connectivity segment revenue increased \$7.0 million or 14% to \$55.6 million during 2012 from \$48.6 million in 2011. This increase is attributable to the Network connectivity revenue from our inContact portfolio customers exceeding the attrition of our network connectivity only customers. Our costs of revenue increased 6% due to the increase in revenue, but Network connectivity gross margin increased 5% due to increased efficiencies in call routing related to a 2011 investment in technology and lower negotiated direct costs, which resulted in lower per-minute network connectivity costs. Selling and marketing expenses decreased 6% due to lower third-party commissions associated with the attrition of our network connectivity only customers offset partially by increased commissions for Network connectivity revenue associated with our inContact portfolio customers. Indirect expenses, which consist of overhead, such as allocated general and administrative expenses, rent, utilities and depreciation on property and equipment decreased 11% during 2012 compared to 2011 as a result of more indirect costs being allocated to the Software segment with the continued shift in revenue and direct expense mix from the Network connectivity segment to the Software segment.

Liquidity and Capital Resources

Current Financial Condition

Our principal sources of liquidity are cash and cash equivalents, cash available to draw under a term loan agreement (“2013 Term Loan”) and available borrowings under our Revolving Credit Agreement, which expires in July 2015. At December 31, 2013, we had \$49.1 million of cash and cash equivalents. In addition to our \$49.1 million of cash and cash equivalents, we have access to additional available borrowings under our Revolving Credit Agreement with Zions, subject to meeting our covenant requirements, and our 2013 Term Loan with Zions. The available borrowings under the Revolving Credit Agreement at December 31, 2013 were \$14.9 million, based on the maximum available advance amount calculated on the December 20, 2013 borrowing base certificate. The available borrowings under the 2013 Term Loan at December 31, 2013 was \$1.0 million. Total cash and additional availability under the Revolving Credit Agreement and 2013 Term Loan was \$65.0 million at December 31, 2013. The Revolving Credit Agreement is collateralized by substantially all our assets.

We experienced a net loss of \$9.0 million during the year ended December 31, 2013. Significant non-cash expenses affecting operations during 2013 were \$11.5 million of depreciation and amortization and \$4.3 million of stock-based compensation. The non-cash expenses were offset by increases in accounts receivable, other assets, trade accounts payable and deferred revenue resulting in \$7.6 million of cash from operating activities during 2013.

Our working capital of \$48.0 million at December 31, 2013 decreased from \$51.1 million at December 31, 2012. The decrease is primarily due to a \$2.4 million increase in trade accounts payable as a result of the timing of vendor payments.

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 our 2013 Term Loan to finance operations and capital requirements. We believe that existing cash and cash equivalents, cash from operations, available borrowings under our Revolving Credit Agreement and available borrowings under our 2013 Term Loan will be sufficient to meet our cash requirements during the next twelve months.

Revolving Credit Agreement

On July 16, 2009, we entered into a Revolving Credit Agreement with Zions. Under the terms of the Revolving Credit Agreement, Zions agreed to loan up to \$8.5 million under a Revolving Credit Agreement. 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) \$8.5 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.

In June 2013, we amended certain terms of the Revolving Credit Agreement with Zions (“Amendment”). The Amendment increased the allowable balance outstanding from \$8.5 million to \$15.0 million, decreased the interest rate from 4.5% to 4.0% per annum above the ninety day London InterBank Offered Rate (“LIBOR”), extended the term from July 2014 to July 2015 and the financial covenant of minimum quarterly EBITDA was changed from \$1.8 million to \$2.5 million. This financial covenant is only applicable if net cash is less than the outstanding balance on the Revolving Credit Agreement plus \$2.5 million. There was \$14.9 million of unused commitment at December 31, 2013, based on the maximum available advance amount calculated on the December 20, 2013 borrowing base certificate.

The balance of our Revolving Credit Agreement was \$1.0 million at December 31, 2012, which was paid in January 2013 and we had no outstanding balance on our Revolving Credit Agreement at December 31, 2013.

The Zions Revolving Credit Agreement contains certain covenants, which were established by amendment to the Revolving Credit Agreement in April 2012. As of December 31, 2013, the most significant covenants require that the aggregate value of cash, cash equivalents and marketable securities shall not be less than the outstanding balance on the Revolving Credit Agreement plus \$2.5 million, and if at any time the aggregate value is less than the minimum liquidity position, a minimum quarterly EBITDA of \$2.5 million, calculated as of the last day of each calendar quarter, is required. We are in compliance with the covenants at December 31, 2013.

Promissory Note

In October 2011, we entered into a promissory note (“Promissory Note”) with Zions for \$2.5 million to finance the acquisition and development of our infrastructure in Europe to support sales made by us and our resellers in Europe, Middle East and Africa (“EMEA”). The amount outstanding at December 31, 2013 was \$694,000. The interest rate under the Promissory Note is 4.5% per annum above the ninety day LIBOR rate or the LIBOR rate for a specified interest period as elected by us, adjusted as of the date of any change in the ninety day LIBOR or LIBOR. Interest under the Promissory Note is paid monthly in arrears, and principal is paid in 36 equal monthly installments ending in October 2014. The financial covenants are the same as the Revolving Credit Agreement, except that if at any time the aggregate value of cash, cash equivalents and marketable securities is less than the minimum liquidity position, a minimum quarterly EBITDA of \$1.1 million, calculated as of the last day of each calendar quarter, is required. The Promissory Note is guaranteed by Unify and provides that in the event of default by the Company the title will transfer to Unify thereby ensuring continuation of services to their resold customers.

Term Loans

In April 2012, we entered into a term loan agreement (“2012 Term Loan”) with Zions for \$4.0 million, which matures in May 2016. We drew \$4.0 million on the 2012 Term Loan in April 2013. Interest will be paid monthly in arrears and the principal will be paid in 36 equal monthly installments and commenced in September 2013. The interest rate under the Term Loan is 4.5% per annum above the ninety day LIBOR rate, adjusted as of the date of any change in the ninety day LIBOR. The financial covenants are the same as the Revolving Credit Agreement.

In June 2013, we entered into another the 2013 Term Loan with Zions for \$4.0 million, which matures in June 2017. We are allowed to draw on the 2013 Term Loan through June 2014 and the interest rate is 4.25% per annum above the ninety day LIBOR. We drew \$3.0 million on the 2013 Term Loan in December 2013. The principal will be paid in 36 equal monthly installments commencing in August 2014. The 2013 Term Loan is collateralized by the same assets as the Revolving Credit Agreement.

Cash Flows

In summary, our cash flows for the years ended December 31, 2013, 2012 and 2011 were as follows (in thousands):

	Year Ended December 31,		
	2013	2012	2011
Net cash from (used in) operating activities	\$7,566	\$4,433	\$(3,232)
Net cash used in investing activities	\$(17,027)	\$(9,232)	\$(10,022)
Net cash from financing activities	\$9,773	\$35,911	\$20,657

During the year ended December 31, 2013, operating activities provided \$7.6 million of cash, which was primarily due to \$16.5 million of non-cash expenses affecting operations and an increase in liabilities of \$5.0 million, offset by our net loss of \$9.0 million and decrease in assets of \$4.8 million.

During 2013, we used \$17.0 million of cash in investing activities primarily used for development of internal use software and purchases of property and equipment.

Cash received from financing activities was \$9.8 million in 2013 and was primarily due to proceeds of \$7.1 million from the exercise of options and borrowing of \$7.0 million from the 2012 and 2013 Term Loans. These inflows were offset by payments on long-term debt and capital leases of \$3.5 million and net payments of \$1.0 million on our Revolving Credit Agreement.

We had an overall net increase in cash of \$312,000 during the year ended December 31, 2013 and we expect to continue to invest in our sales and marketing activities to grow revenue related to our inContact portfolio and additional network capacity and resources to support our expanding operations.

Contractual Obligations and Off-Balance Sheet Arrangements

We have no off-balance sheet arrangements. However, we have purchase commitments with national network connectivity providers, long term debt, capital leases, operating leases and hosting services. The following table discloses aggregate information about our material contractual obligations and the periods in which payments are due as of December 31, 2013 (in thousands):

	Total	Less Than 1 Year	1-3 Years	4-5 Years	After 5 Years
Promissory note and term loans	\$6,917	\$ 2,444	\$ 4,473	\$ —	\$ —
Interest obligation on promissory note and term loans ⁽¹⁾	508	278	230	—	—
Capital leases	1,224	1,041	183	—	—
Operating leases	3,197	1,821	1,376	—	—
Purchase obligations—hosting services	5,216	2,112	2,933	171	—
Purchase commitments ⁽²⁾	50	50	—	—	—
Total contractual obligations	\$17,112	\$ 7,746	\$ 9,195	\$ 171	\$ —

(1) The interest obligation will fluctuate based on fluctuation of the LIBOR rate. This obligation is based on the rate at December 31, 2013 of 4.74%.

(2) We have a purchase commitment with a national network connectivity provider. The purchase commitment provides for a monthly minimum of \$50,000, which can be terminated with a thirty day written notice. We exceeded our monthly minimums with this carrier in 2013.

Critical Accounting Estimates

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

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

inContact portfolio of services. Revenue is derived from the delivery of any of our software services within the inContact portfolio which are provided on a monthly recurring subscription basis. Because customers do not have the right to take possession of the software, these arrangements are considered service contracts and are not within the scope of Industry Topic 985, Software. Monthly recurring subscription charges are generally billed in arrears and recognized for the period in which they are earned. For subscription contracts with multiple elements (software, training, installation and network connectivity services), we follow the guidance provided in Accounting Standards Codification (“ASC”) 605-25, Revenue Recognition for Multiple-Element Arrangement. In addition to the monthly recurring subscription revenue, revenue is also derived on a non-recurring basis for professional services included in implementing or improving a customer’s inContact portfolio experience. Because our professional services, such as training and installation, are not considered to have standalone value, we defer revenue for upfront fees received for professional services in multiple element arrangements and recognize such fees as revenue over the estimated life of the customer. Professional services sold separately (i.e. not sold contemporaneously with the negotiation of a subscription contract) are recognized as revenue over the period that services are provided. Fees for network connectivity services in multiple element arrangements within the inContact portfolio are based on usage and are recognized as revenue in the same manner as fees for network connectivity services discussed in the following paragraph. Also included is revenue related to the quarterly minimum purchase commitments from a related party reseller.

Network connectivity services. Revenue is derived from network connectivity services, such as dedicated transport, VoIP connectivity, switched long distance and data services. These service