

inContact, Inc.
Form 10-Q
November 06, 2009
[Table of Contents](#)

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d) of the

Securities Exchange Act of 1934

For the Quarterly Period Ended September 30, 2009

Commission File No. 1-33762

inContact, Inc.

(Exact name of registrant as specified in its charter)

Delaware

87-0528557

Edgar Filing: inContact, Inc. - Form 10-Q

(State or other jurisdiction of

(IRS Employer

incorporation or organization)

Identification No.)

7730 S. Union Park Avenue, Suite 500, Midvale, UT 84047

(Address of principal executive offices and Zip Code)

(801) 320-3200

(Registrant's telephone number, including area code)

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer

Non-accelerated filer Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

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

Class	Outstanding as of November 6, 2009
Common Stock, \$.0001 par value	31,333,806 shares

Table of Contents

TABLE OF CONTENTS

ITEM NUMBER AND CAPTION

PART I FINANCIAL INFORMATION

Item 1. Financial Statements	
<u>Condensed Consolidated Balance Sheets as of September 30, 2009 and December 31, 2008 (unaudited)</u>	3
<u>Condensed Consolidated Statements of Operations for the Three and Nine Months Ended September 30, 2009 and 2008 (unaudited)</u>	4
<u>Condensed Consolidated Statement of Stockholders' Equity for the Nine Months Ended September 30, 2009 (unaudited)</u>	5
<u>Condensed Consolidated Statements of Cash Flows for the Nine Months Ended September 30, 2009 and 2008 (unaudited)</u>	6
<u>Notes to Condensed Consolidated Financial Statements (unaudited)</u>	7
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	17
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	26
<u>Item 4. Controls and Procedures</u>	26

PART II OTHER INFORMATION

<u>Item 1. Legal Proceedings</u>	27
<u>Item 1A. Risk Factors</u>	27
<u>Item 6. Exhibits</u>	27
<u>Signatures</u>	28

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

	September 30, 2009	December 31, 2008
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 4,218	\$ 4,096
Restricted cash	80	
Auction rate preferred securities		50
Accounts and other receivables, net of allowance for uncollectible accounts of \$1,727 and \$1,871, respectively	9,246	8,176
Other current assets	1,475	1,065
Total current assets	15,019	13,387
Restricted cash	166	
Property and equipment, net	9,443	8,369
Intangible assets, net	2,683	3,484
Goodwill	3,397	2,858
Auction rate preferred securities	75	175
Other assets	563	474
Total assets	\$ 31,346	\$ 28,747
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Current portion of long-term debt and capital lease obligations	\$ 1,503	\$ 1,246
Trade accounts payable	6,578	7,039
Accrued liabilities	3,068	2,291
Accrued commissions	1,184	1,158
Deferred revenue	1,448	939
Total current liabilities	13,781	12,673
Long-term debt and capital lease obligations	8,614	5,756
Deferred rent	380	432
Deferred revenue	209	395
Warrants (Note 5)	543	
Total liabilities	23,527	19,256
Stockholders equity:		
Common stock, \$0.0001 par value; 100,000,000 shares authorized; 31,328,251 and 31,065,228 shares issued and outstanding as of September 30, 2009 and December 31, 2008, respectively	3	3
Additional paid-in capital	72,217	70,518
Warrants and options outstanding	700	1,355
Accumulated deficit	(65,051)	(62,335)
Accumulated other comprehensive loss	(50)	(50)

Edgar Filing: inContact, Inc. - Form 10-Q

Total stockholders' equity	7,819	9,491
Total liabilities and stockholders' equity	\$ 31,346	\$ 28,747

See accompanying notes to condensed consolidated financial statements.

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

	Three months ended September 30, 2009		Nine months ended September 30, 2009	
	2008 <i>(as adjusted)</i>		2008 <i>(as adjusted)</i>	
Revenue:				
Software	\$ 7,357	\$ 5,037	\$ 21,189	\$ 13,940
Telecom	13,590	14,766	42,188	45,029
Total revenue	20,947	19,803	63,377	58,969
Costs of revenue:				
Software	2,430	2,243	6,986	6,650
Telecom	9,824	10,584	31,204	32,373
Total costs of revenue	12,254	12,827	38,190	39,023
Gross profit	8,693	6,976	25,187	19,946
Operating expenses:				
Selling and marketing	4,583	4,404	13,108	13,360
Research and development	1,331	1,166	3,480	3,445
General and administrative	3,123	3,297	10,859	10,769
Total operating expenses	9,037	8,867	27,447	27,574
Loss from operations	(344)	(1,891)	(2,260)	(7,628)
Other income (expense):				
Interest income	1	10	2	41
Interest expense	(144)	(155)	(527)	(323)
Change in fair value of warrants (Note 5)	(54)		(430)	
Total other expense	(197)	(145)	(955)	(282)
Loss before income taxes	(541)	(2,036)	(3,215)	(7,910)
Income tax expense	12	3	39	9
Net loss	\$ (553)	\$ (2,039)	\$ (3,254)	\$ (7,919)
Net loss per common share:				
Basic and diluted	\$ (0.02)	\$ (0.07)	\$ (0.10)	\$ (0.26)
Weighted average common shares outstanding:				
Basic and diluted	31,316	31,065	31,184	31,044

See accompanying notes to condensed consolidated financial statements.

Table of Contents**INCONTACT, INC.****CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY - (Unaudited)***(in thousands)*

	Common Stock		Additional Paid-in Capital	Warrants and Options Outstanding	Accumulated Deficit	Accumulated Other Comprehensive Loss		Total
	Shares	Amount						
Balance at January 1, 2009	31,065	\$ 3	\$ 70,518	\$ 1,355	\$ (62,335)	\$ (50)	\$ 9,491	
Cumulative effect of change in accounting principle (Note 5)				(651)	538		(113)	
Common stock issued for options exercised	197		476				476	
Issuance of restricted stock	51		129				129	
Stock-based compensation			879				879	
Vesting of restricted stock units			190				190	
Vesting of warrants				21			21	
Shares issued due to cashless warrant exercise	15		25	(25)				
Net loss					(3,254)		(3,254)	
Balance at September 30, 2009	31,328	\$ 3	\$ 72,217	\$ 700	\$ (65,051)	\$ (50)	\$ 7,819	

See accompanying notes to condensed consolidated financial statements.

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

	Nine months ended September 30,	
	2009	2008
Cash flows from operating activities:		
Net loss	\$ (3,254)	\$ (7,919)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization:		
Depreciation of fixed assets	2,081	1,577
Amortization of intangible assets	801	2,565
Amortization of software development costs	738	359
Amortization of note financing costs	88	23
Stock-based compensation	1,219	1,029
Change in fair value of warrants	430	
Changes in operating assets and liabilities:		
Accounts and other receivables, net	(1,070)	773
Other current assets	(410)	201
Other non-current assets	(29)	(159)
Trade accounts payable	(458)	(978)
Accrued liabilities	777	1,191
Accrued commissions	26	(188)
Deferred rent	(52)	
Deferred revenue	323	751
Net cash provided by (used in) operating activities	1,210	(775)
Cash flows from investing activities:		
Increase in restricted cash	(246)	
Contingent purchase price payments	(544)	(530)
Redemption of auction rate preferred securities	150	1,000
Purchase of intangible asset		(52)
Purchases of property and equipment	(697)	(614)
Capitalized software development costs	(2,588)	(1,096)
Net cash used in investing activities	(3,925)	(1,292)
Cash flows from financing activities:		
Borrowings under revolving credit facility	6,270	4,000
Payments under revolving credit facility	(2,750)	
Principal payments on long-term debt and capital leases	(1,068)	(659)
Debt financing fees	(91)	
Proceeds from exercise of options and warrants	476	105
Net cash provided by financing activities	2,837	3,446
Net increase in cash and cash equivalents	122	1,379
Cash and cash equivalents at beginning of period	4,096	2,760

Edgar Filing: inContact, Inc. - Form 10-Q

Cash and cash equivalents at end of period	\$ 4,218	\$ 4,139
--	----------	----------

Supplemental cash flow information

Cash paid for interest	\$ 448	\$ 324
Cash paid for taxes	\$ 41	\$ 9

Supplemental schedule of non-cash investing and financing activities:

Unrealized loss on change in fair value of auction rate securities	\$	\$ 50
Property and equipment included in trade accounts payable	\$ 29	\$ 118
Property and equipment and other assets financed through capital leases	\$ 606	\$ 1,108
Cashless exercise of warrants	\$ 25	\$

See accompanying notes to condensed consolidated financial statements.

Table of Contents

INCONTACT, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

NOTE 1. ORGANIZATION AND BASIS OF PRESENTATION

Organization

We changed our name from UCN, Inc. to inContact, Inc. (inContact , we , us , our , or the Company) on January 1, 2009. The accompanying consolidated financial statements and related footnotes refer to us as inContact for all periods presented. We are incorporated in the state of Delaware.

We provide Software as a Service (SaaS) through our inContact suite, an advanced contact handling and performance management software application. Our services provide a variety of connectivity options for carrying inbound calls to our inContact suite or linking agents to our inContact applications. We provide users the ability to monitor agent effectiveness through our user survey tools and the ability to efficiently monitor their agent needs. We are also an aggregator and provider of telecommunications services. We contract with a number of third party providers for the right to resell the various telecommunication services and products they provide, and then offer all of these services to the users. These services and products allow the user to buy only the telecommunications services they need, combine those services in a customized enhanced contact center package, receive one bill for those services, and call a single point of contact if a service problem or billing issue arises.

Basis of Presentation

These unaudited condensed consolidated financial statements of inContact and its subsidiaries have been prepared in accordance with the rules and regulations of the United States Securities and Exchange Commission (SEC). Such rules and regulations allow the omission of certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States, so long as the statements are not misleading. In the opinion of management, these financial statements and accompanying notes contain all adjustments (consisting of normal recurring adjustments) necessary to present fairly the financial position and results of operations for the periods presented herein. These condensed consolidated financial statements should be read in conjunction with the consolidated audited financial statements and notes thereto contained in Exhibit 99.1 to the Current Report on Form 8-K for the year ended December 31, 2008, filed with the SEC on August 7, 2009. The results of operations for the three and nine month periods ended September 30, 2009 are not necessarily indicative of the results to be expected for the year ended December 31, 2009. Our significant accounting policies are set forth in Note 1 to the consolidated financial statements in the 2008 Annual Report on Form 10-K.

Reclassifications

Beginning in the second quarter of 2009, we added the captions Software revenue , Telecom Revenue , Software costs of revenue , Telecom costs of revenue and Gross profit to our condensed consolidated statements of operations, which previously included single line items for revenue and costs of revenue (excluding depreciation and amortization) and did not include a gross profit subtotal. Also beginning in the second quarter of 2009, we changed our allocation of certain operating costs and expenses within our consolidated statements of operations. Depreciation and amortization expense related to revenue generating assets is included in the captions Software costs of revenue and Telecom costs of revenue. Depreciation and amortization expense not associated with revenue generating assets is allocated to our other operating expense categories. Depreciation and amortization expense was previously reported separately in the caption Depreciation and amortization. In addition, professional service costs and costs associated with providing customer service are included in the caption Software costs of revenue and Telecom costs of revenue and overhead expenses are included in costs of revenue and each operating expense category. These costs were previously included in General and administrative expenses. We believe this change in presentation provides increased transparency and improved comparability of our costs of revenue and operating expenses and that gross profit is a useful, widely accepted measure of profitability and operating performance. These reclassifications had no effect on reported consolidated loss from operations, net loss or per share amounts. Amounts presented for the three and nine months ended September 30, 2008 have been reclassified to conform to the current presentation.

Table of Contents

The following table provides the amounts reclassified for the three and nine months ended September 30, 2008 (*in thousands*):

	Three months ended September 30, 2008	Nine months ended September 30, 2008
Amounts Reclassified		
Costs of revenue:		
Software	\$ 2,093	\$ 6,296
Telecom	492	1,615
Selling and marketing	364	840
General and administrative	(1,460)	(4,613)
Depreciation and amortization	(1,609)	(4,501)
Research and development	120	363
Total costs of revenue and operating expenses		

Additionally, see Note 13 for reclassifications of costs and expenses within our segments.

Recent Accounting Pronouncements

In April 2009, the Financial Accounting Standards Board (FASB) issued the following two FASB Staff Positions intended to provide additional guidance and enhance disclosures regarding fair value measurements and impairment of securities:

Accounting Standards Codification (ASC) 820-10-65-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly*, provides additional guidance for estimating fair value in accordance with ASC 820 (formerly SFAS No. 157) when the volume and level of activity for the asset or liability have decreased significantly. ASC 820-10-65-4 also provides guidance on identifying circumstances that indicate a transaction is not orderly. The provisions of ASC 820-10-65-4 were adopted by us on January 1, 2009 and did not have a significant effect on our financial position or results of operations.

ASC 825-10-65-1, *Interim Disclosures about Fair Value of Financial Instruments*, requires disclosures about fair value of financial instruments in interim reporting periods of publicly traded companies that were previously only required to be disclosed in annual financial statements. The provisions of ASC 825-10-65-1 were effective beginning in our interim period ending on June 30, 2009. As ASC 825-10-65-1 amends only the disclosure requirements about fair value of financial instruments in interim periods, the adoption of ASC 825-10-65-1 is not expected to affect the Company's condensed consolidated financial statements. This disclosure is presented in Note 5.

In May 2009, the FASB issued ASC 855-10, *Subsequent Events*, to establish general standards of accounting for and disclosure of subsequent events. ASC 855-10 renames the two types of subsequent events as *recognized* subsequent events or *non-recognized* subsequent events and also modifies the definition of the evaluation period for subsequent events as events or transactions that occur after the balance sheet date, but before the financial statements are issued. This will require entities to disclose the date, through which an entity has evaluated subsequent events and the basis for that date (the issued date for public companies). ASC 855-10 is effective for interim or annual financial periods ending after June 15, 2009, and will be applied prospectively. This disclosure is presented in Note 14.

In June 2009, the FASB issued Statement of Financial Accounting Standards No. 168, the *FASB Accounting Standards Codification*. The Accounting Standards Codification will become the source of authoritative U.S. General Accepted Accounting Principles (GAAP) recognized by the FASB to be applied by nongovernmental entities. Once the Accounting Standards Codification is in effect, all of its content will carry the same level of authority. The Accounting Standards Codification became effective for interim and annual periods ending after September 15, 2009. We have applied the Accounting Standards Codification in the third quarter of fiscal 2009. The adoption of the Accounting Standards Codification does not have an effect on our financial position and results of operations. However, because the Accounting Standards Codification completely replaces existing standards, it affects the way U.S. GAAP is referenced within the consolidated financial statements and accounting policies.

In August 2009, the FASB issued Accounting Standards Update (ASU) 2009-05 (previously exposed for comments as proposed FSP FAS 157-f) to provide guidance on measuring the fair value of liabilities under ASC 820. ASU 2009-05 clarifies that the quoted price for the identical liability, when traded as an asset in an active market, is also a Level 1 measurement for that liability when no adjustment to the quoted price is

Edgar Filing: inContact, Inc. - Form 10-Q

required. In the absence of a Level 1 measurement, an entity must use a valuation technique in a manner consistent with the principles in ASC 820. ASU 2009-05 is effective for the first interim or annual reporting period beginning after its issuance. We do not expect the adoption of ASU 2009-05 to have a significant impact on our consolidated financial statements and footnote disclosures.

Table of Contents

In September 2009, the FASB issued ASU 2009-13, *Revenue Recognition (Topic 605): Multiple-Deliverable Revenue Arrangements a consensus of the FASB Emerging Issues Task Force* (formerly EITF 08-1, *Revenue Arrangements with Multiple Deliverables*). ASU 2009-13, which supersedes Accounting Standards Codification (ASC) 605-25, applies to all deliverables in contractual arrangements in which a vendor will perform multiple revenue-generating activities. Specifically, ASU 2009-13 addresses the unit of accounting for arrangements involving multiple deliverables. It also addresses how arrangement consideration should be allocated to the separate units of accounting, when applicable. Although ASU 2009-13 retains the criteria from ASC 605-25 for when delivered items in a multiple-deliverable arrangement should be considered separate units of accounting, it removes the previous separation criterion under ASC 605-25 that objective and reliable evidence of fair value of any undelivered items must exist for the delivered items to be considered a separate unit or separate units of accounting. ASU 2009-13 is effective for fiscal years beginning on or after June 15, 2010. We are still evaluating the impact that the adoption of ASU 2009-13 will have on our consolidated financial statements.

NOTE 2. REVENUE RECOGNITION

Revenue is recognized in accordance with ASC 605-10-S99, *Revenue Recognition* (formerly SEC Staff Accounting Bulletin Topic 13, *Revenue Recognition*), 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.

inContact Suite of Services

Revenue is derived from the use of any of our inContact suite of services that are provided on a monthly recurring basis. Our all-in-one inContact software solution is delivered over our telecommunications and data network. The all-in-one inContact solution includes features such as: skills-based routing; automated call distribution; self-service menus; speech recognition based automated interactive voice response; database integration with the contact handling technology; multimedia contact management (voice, fax, email, chat); management reporting features; workforce management features; performance optimization benchmarking; custom call routing and call flow design; and new hire screening and on-line training tools. Monthly recurring charges are billed in arrears and recognized for the period in which they are earned. In addition to the monthly recurring revenue, revenue is also received on a non-recurring basis for professional services included in implementing or improving a user's inContact suite experience. For sales contracts with multiple elements (hosted software, training, installation, long distance services), we follow the guidance provided in ASC 605-25, *Revenue Recognition for Multiple-Element Arrangements* (formerly the Emerging Issues Task Force Issue No. 00-21, *Revenue Arrangements with Multiple Deliverables*). ASC 605-25 allows companies to recognize revenues upfront for delivered elements of a contract when it has objective and reliable evidence of fair value for the undelivered elements of the contract. However, because we have not yet established objective and reliable evidence of fair value for our inContact suite of services (the undelivered element), we defer revenue for upfront fees received for professional services, such as training and installation (the delivered elements), and recognize such fees as revenue over the term of the contract, which is generally 12 to 36 months. Accordingly, we have recorded \$1.7 million of deferred revenue at September 30, 2009 and \$1.3 million of deferred revenue at December 31, 2008. Fees for long distance services in multiple element arrangements with the inContact suite of services are based on usage and are recognized as revenue in the same manner as fees for traditional long distance services discussed in the following paragraph.

Traditional Long Distance Services

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

NOTE 3. BASIC AND DILUTED NET LOSS PER COMMON SHARE

Basic earnings per share is computed by dividing the net income or loss applicable to common shares by the weighted average number of common shares outstanding. Diluted earnings per share is computed by dividing the net income or loss by the sum of the weighted average number of common shares plus the weighted average common stock equivalents, which would arise from the exercise of outstanding stock options and warrants, using the treasury stock method and the average market price per share during the period.

As a result of incurring a net loss for the three and nine months ended September 30, 2009 and 2008, no outstanding common stock equivalents are included in the calculation of diluted earnings per share because such effect would be anti-dilutive. We had outstanding options, restricted stock units, and warrants to purchase a total of 6,072,000 shares of common stock at September 30, 2009 and 5,817,000 shares of common stock at September 30, 2008.

Table of Contents**NOTE 4. RESTRICTED CASH**

Beginning January 1, 2009, we were required by an equipment financing company (Lessor) to provide a letter of credit equal to 30% of our \$550,000 of borrowings made subsequent to that date under the equipment leasing facility with the Lessor. Accordingly, we have classified the associated letter of credit balance of \$166,000 as long-term restricted cash in the accompanying balance sheet at September 30, 2009. The remaining \$80,000 of current restricted cash is held on deposit for credit card processing.

NOTE 5. FAIR VALUE OF FINANCIAL INSTRUMENTS

The fair value of a financial instrument is the amount that could be received upon the sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Financial assets are marked to bid prices and financial liabilities are marked to offer prices. Fair value measurements do not include transaction costs. We adopted ASC 820-10, *Fair Value Measurements and Disclosures* (formerly Statement of Financial Accounting Standards No. 157, *Fair Value Measurement*), on January 1, 2008. This standard defines fair value, establishes a framework to measure fair value, and expands disclosures about fair value measurements. ASC 820-10 establishes a fair value hierarchy used to prioritize the quality and reliability of the information used to determine fair values. Categorization within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement. The fair value hierarchy is defined into the following three categories:

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

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

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

Auction Rate Preferred Securities

Auction rate preferred securities (ARPS) were our only assets measured at fair value on a recurring basis subject to the disclosure requirements of ASC 820-10 at September 30, 2009. We classified the investment in ARPS as a Level 3 investment as these securities have significant unobservable inputs. The fair value of the investment in ARPS as of September 30, 2009 was \$75,000. We have determined the estimated fair values of these securities utilizing a discounted cash flow analysis as of September 30, 2009. This analysis considers, among other items, the collateralization of the underlying securities, the expected future cash flows and the expectation of the next time the security is expected to have a successful auction. These securities were also compared, when possible, to other observable market data with similar characteristics to the securities held by us.

The following were inputs used in our discounted cash flow analysis to value the ARPS:

Interest rate earned on ARPS. The fund pays interest at LIBOR plus 1.25%.

Bond yield. The bond yield was determined using the AAA bond yield curve.

Liquidity discount rate. The liquidity discount represents the amount of additional return management estimates an investor would require in order to purchase preferred shares in this fund over a AAA rated bond.

Discount rate. The discount rate was determined using the bond yield plus the liquidity discount rate.

Warrants

We adopted ASC 815-40, *Contracts in an Entity's Own Equity* (formerly Emerging Issues Task Force Issue No. 07-5, *Determining Whether an Instrument (or Embedded Feature) is Indexed to an Entity's Own Stock*) effective January 1, 2009. The adoption of the requirements of ASC 815-40 can affect the accounting for warrants and many convertible instruments with provisions that protect holders from a decline in the stock

Edgar Filing: inContact, Inc. - Form 10-Q

price (or down-round provisions). Down-round provisions reduce the exercise price of a warrant or convertible instrument if a company either issues equity shares for a price that is lower than the exercise price of those instruments or issues new warrants or convertible instruments that have a lower exercise price. We evaluated whether warrants to acquire our stock contain provisions that protect holders from declines in the stock price or otherwise could result in modification of the exercise price and/or shares to be issued under the respective warrant agreements based on a variable that is not an input to the fair value of a fixed-for-fixed option. We determined that the following warrants contained such provisions, thereby concluding they were not indexed to our own stock:

Warrants issued to ComVest Capital, LLC (ComVest) in conjunction with the Revolving Credit Note and Term Loan Agreement, exercisable for 330,000 shares of our common stock that expire May 23, 2011.

Warrants issued to ComVest in conjunction with the an amendment to the Revolving Credit Note and Term Loan Agreement, exercisable for 55,000 shares of our common stock that expire May 23, 2011.

Table of Contents

In accordance with ASC 815-40, on January 1, 2009 we began recognizing these warrants issued to ComVest (the ComVest Warrants) as liabilities at their respective fair values on each reporting date. The cumulative effect of the change in accounting for these warrants of \$538,000 was recognized as an adjustment to the opening balance of accumulated deficit at January 1, 2009. The cumulative effect adjustment was the difference between the amounts recognized in the condensed consolidated balance sheet before initial adoption of ASC 815-40 and the amounts recognized in the condensed consolidated balance sheet upon the initial application of ASC 815-40. The amounts recognized in the condensed consolidated balance sheet as a result of the initial application of ASC 815-40 on January 1, 2009 were determined based on the amounts that would have been recognized if ASC 815-40 had been applied from the issuance date of the warrants. We measured the estimated fair value of these warrants as of September 30, 2009, and recorded a \$430,000 charge during the nine months ended September 30, 2009 to record the liabilities associated with these warrants at their estimated fair values totaling \$543,000 as of that date. We estimated the fair values of these securities using a Black-Scholes valuation model.

Recurring Level 3 Activity

The table below provides a reconciliation of the beginning and ending balances for the major classes of assets and liabilities measured at fair value using significant unobservable inputs (Level 3). The table reflects gains and losses for the quarter for all financial assets and liabilities categorized as Level 3 as of September 30, 2009 and 2008 (*in thousands*):

Auction rate preferred securities:	
Balance at January 1, 2009	\$ 225
Total redemptions	(150)
Total realized and unrealized gains (losses)	
Balance at September 30, 2009	\$ 75
Balance at January 1, 2008	\$ 2,000
Total redemptions	(1,000)
Total realized and unrealized gains (losses)	(50)
Balance at September 30, 2008	\$ 950
Warrants:	
Balance at January 1, 2009	113
Total change in fair value	430
Balance at September 30, 2009	\$ 543

Fair Value Estimates

Our fair value estimates at September 30, 2009 were as follows (*in thousands*):

	Fair value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Gains (losses) during the nine months ended September 30, 2009
Assets:					
Auction rate preferred securities	\$ 75	\$	\$	\$ 75	\$

Edgar Filing: inContact, Inc. - Form 10-Q

Total	\$ 75	\$	\$	\$ 75	\$
Liabilities:					
ComVest warrants	\$ 543	\$	\$	\$ 543	\$ (430)
Total	\$ 543	\$	\$	\$ 543	\$ (430)

Our fair value estimates at December 31, 2008 were as follows (*in thousands*):

	Fair value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Gains (losses) during the year ended December 31, 2008
Assets:					
Auction rate preferred securities	\$ 225	\$	\$	\$ 225	\$ (50)
Total	\$ 225	\$	\$	\$ 225	\$ (50)

Table of Contents*Basis for Valuation*

The carrying amounts reported in the accompanying consolidated balance sheets for cash and cash equivalents, accounts and other receivables, and trade accounts payable approximate fair value because of the immediate or short-term maturities of these financial instruments. The estimated fair value of the auction rate preferred securities was computed as described above. The fair values of the revolving credit note and promissory notes payable were computed using a discounted cash flow model using estimated market rates adjusted for our credit risk as of September 30, 2009. The fair value of the ComVest warrants were computed using a Black-Scholes option pricing model. The carrying value and estimated fair value of our auction rate preferred securities, revolving credit note, promissory notes payable, and ComVest warrants are as follows (*in thousands*):

	September 30, 2009		December 31, 2008	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
Auction rate preferred securities	\$ 75	\$ 75	\$ 225	\$ 225
Revolving credit note	\$ 7,570	\$ 6,942	\$ 4,050	\$ 4,008
Promissory notes	\$ 119	\$ 119	\$ 177	\$ 176
ComVest warrants	\$ 543	\$ 543	\$	\$

Our disclosure of the estimated fair value of our financial instruments is made in accordance with the requirements of ASC 825-10, *Financial Instruments*, (formerly Statement of Financial Accounting Standards No. 107, *Disclosures about Fair Value of Financial Instruments*). The estimated fair value amounts have been determined by us using available market information and appropriate valuation methodologies. However, considerable judgment is required to interpret market data in order to develop the estimates of fair value. Accordingly, the estimates presented herein are not necessarily indicative of the amounts we could realize in a current market exchange. The use of different market assumptions and estimation methodologies may have a material effect on the estimated fair value amounts. The fair value estimates presented herein are based on pertinent information available to management as of September 30, 2009 and December 31, 2008.

NOTE 6. GOODWILL AND INTANGIBLE ASSETS

The changes in the carrying amount of goodwill for the nine months ended September 30, 2009 consisted of the following (*in thousands*):

Balance as of January 1, 2009	\$ 2,858
Goodwill adjustment	539
Balance as of September 30, 2009	\$ 3,397

The goodwill adjustment of \$539,000 in the first three quarters of 2009 was a result of contingent purchase price payments related to acquisitions in previous years. Goodwill from acquisitions is attributable to the Software segment.

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

	September 30, 2009			December 31, 2008		
	Gross Assets	Accumulated Amortization	Intangible assets, net	Gross Assets	Accumulated Amortization	Intangible assets, net
Customer lists acquired	\$ 16,495	\$ 16,040	\$ 455	\$ 16,495	\$ 15,647	\$ 848
Technology and patents	10,231	9,058	1,173	10,231	8,755	1,476
Trade names and trade marks	1,194	213	981	1,194	152	1,042
Non-compete agreement	333	313	20	333	269	64
Domain name	54		54	54		54
Total	\$ 28,307	\$ 25,624	\$ 2,683	\$ 28,307	\$ 24,823	\$ 3,484

Edgar Filing: inContact, Inc. - Form 10-Q

Amortization expense was \$161,000 for the three months ended September 30, 2009 and \$931,000 for the three months ended September 30, 2008. Amortization expense was \$801,000 for the nine months ended September 30, 2009 and \$2.6 million for the nine months ended September 30, 2008. Based on the recorded intangibles at September 30, 2009, estimated amortization expense is expected to be \$133,000 during the remainder of 2009, \$574,000 in 2010, \$555,000 in 2011, \$239,000 in 2012, \$210,000 in 2013 and \$210,000 in 2014.

Table of Contents**NOTE 7. ACCRUED LIABILITIES**

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

	September 30, 2009	December 31, 2008
Accrued payroll and other compensation	\$ 2,231	\$ 1,554
Accrued payphone and carrier charges	251	301
Current portion of operating lease obligations	44	45
Accrued professional fees	268	238
Current portion of deferred rent	67	40
Other	207	113
Total	\$ 3,068	\$ 2,291

NOTE 8. LONG-TERM DEBT AND CAPITAL LEASE OBLIGATIONS

On July 16, 2009, we entered into a revolving credit loan agreement (Revolving Credit Agreement) with Zions First National Bank (Zions). Under the terms of the Revolving Credit Agreement, Zions agreed to loan up to \$8.5 million under a revolving credit note. The Revolving Credit Agreement is secured by substantially all the assets of inContact. We used a portion of the borrowings from the Revolving Credit Agreement with Zions to pay-off the existing ComVest revolving credit loan, totaling approximately \$6.5 million.

The interest rate under the Zions Revolving Credit Agreement is four and five-tenths percent (4.5%) per annum above the ninety day LIBOR rate, from time to time in effect, adjusted as of the date of any change in the ninety day LIBOR rate. Interest under the Revolving Credit Agreement is paid monthly in arrears, and all principal is due in July 2011. The balance outstanding under the Revolving Credit Agreement cannot exceed the lesser of (a) \$8.5 million or (b) the sum of 85 percent (85%) of eligible billed receivables, and 65 percent (65%) of eligible earned but unbilled receivables.

The Revolving Credit Agreement contains certain covenants. Financial covenants include requirements to maintain a minimum adjusted EBITDA (defined as earnings before interest expense, income tax expense, depreciation, amortization, and other non cash charges, minus capitalized research and development costs) and minimum working capital.

The Revolving Credit Agreement imposes certain restrictions on inContact's ability, without the approval of Zions, to incur additional debt, make distributions to stockholders, or acquire other businesses or assets. The facility provides for the usual and customary events of default for transactions of this type.

We drew \$3.2 million from our Revolving Credit Note with ComVest Capital, LLC (ComVest) and paid back \$750,000 on the ComVest Revolving Credit Note during the nine months ended September 30, 2009. We also drew \$3.0 million from our Revolving Credit Agreement with Zions and paid down \$2.0 million on the Zions Revolving Credit Agreement during the nine months ended September 30, 2009. As noted above, we paid off the ComVest revolving credit loan on July 16, 2009.

In addition to the Zions revolving credit loan agreement, inContact entered into a commitment agreement with Zions Credit Corporation for an equipment leasing facility of up to \$1 million.

We entered into an equipment leasing facility with an equipment financing company (Lessor) in 2008. Under the terms of the leasing facility, the Lessor has agreed to provide us financing of \$2.8 million to lease computer related equipment and software for our business operations, which the Lessor will lease to us in the form of a capital lease. The term of the facility is 30 months upon our acceptance of the leased property. The calculated interest rate is subject to change based on changes in the Treasury yield, installation period of the lease and the residual value. We have utilized the full \$2.8 million of the leasing facility at September 30, 2009 to acquire computer related equipment and software. We have \$1.9 million of capital lease obligations at September 30, 2009 related to this equipment leasing facility. Beginning January 1, 2009, we were required by the Lessor to provide a letter of credit equal to 30% of the \$550,000 of additional borrowings made subsequent to that date under the equipment leasing facility. Accordingly, we have classified the associated letter of credit balance of \$166,000 as long-term restricted cash on the accompanying balance sheet at September 30, 2009.

Edgar Filing: inContact, Inc. - Form 10-Q

We also have \$439,000 of capital lease obligations at September 30, 2009 related to equipment leasing facilities entered into during 2007 and 2006.

Table of Contents**NOTE 9. CAPITAL TRANSACTIONS**

In December 2008, we entered into a consulting agreement with a third party to provide investor relations services. Under the agreement, we agreed to issue as partial consideration for services a total of 100,000 shares of our common stock, earned monthly in arrears in equal monthly installments during the 18-month period commencing January 1, 2009. We issued 51,000 shares of common stock to this third party during the nine months ended September 30, 2009 pursuant to the consulting agreement.

NOTE 10. STOCK-BASED COMPENSATION

We account for stock-based compensation in accordance with ASC 718-10, Stock Compensation (formerly Statement of Financial Accounting Standards No. 123(R), *Share-Based Payment*). ASC 718-10 requires companies to estimate the fair value of stock-based awards on the date of grant using an option pricing model. The value of the portion of the award that is ultimately expected to vest is recognized as expense over the requisite service periods in our Consolidated Statements of Operations. As stock-based compensation expense recognized in each period is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures. ASC 718-10 requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

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

	Three months ended September 30,		Nine months ended September 30,	
	2009	2008	2009	2008
Costs of revenue	\$ 16	\$ 2	\$ 21	\$ 6
Selling and marketing	79	176	236	450
Research and development	78	57	214	144
General and administrative	236	109	748	429
Total	\$ 409	\$ 344	\$ 1,219	\$ 1,029

We selected the Black-Scholes model as the most appropriate method for determining the estimated fair value for stock-based awards. The Black-Scholes model requires the use of highly subjective and complex assumptions which determine the fair value of stock-based awards, including the option's expected term and the price volatility of the underlying stock. Volatility is based on historical stock prices over the expected life of the option.

During the nine months ended September 30, 2009, we granted 919,538 stock options, principally to our executive officers, with exercise prices ranging from \$1.32 to \$3.80 and a weighted-average fair value of \$1.00. During the nine months ended September 30, 2008, we granted 903,250 stock options with exercise prices ranging from \$2.00 to \$4.50 and a weighted-average fair value of \$1.21.

As of September 30, 2009, there was \$911,000 of total unrecognized compensation cost related to non-vested stock-based compensation awards granted under our stock option plans. The compensation cost is expected to be recognized over a weighted average period of 1.49 years.

NOTE 11. COMPREHENSIVE LOSS

Comprehensive loss includes unrealized losses on auction rate preferred securities. The difference between net loss and comprehensive loss is as follows (*in thousands*):

	Nine months ended September 30,	
	2009	2008
Net loss	\$ (3,254)	\$ (7,919)
Unrealized loss on available-for-sale securities		(50)
Comprehensive loss	\$ (3,254)	\$ (7,969)

NOTE 12. RELATED PARTY TRANSACTIONS

We paid the Chairman of the Board of Directors (the Chairman) \$6,000 per month during the nine months ended September 30, 2009 and 2008 for consulting, marketing, and capital raising activities. We owed the Chairman \$6,000 at September 30, 2009 and December 31, 2008. The Chairman has also provided his personal guaranty in the amount of up to \$250,000 to certain long distance carriers, for which we have agreed to indemnify him for any losses for which he may become liable.

Table of Contents**NOTE 13. SEGMENTS**

We operate under two business segments: Software and Telecom. The Software segment includes all monthly recurring revenue related to the delivery of our software applications plus the associated professional services and setup fees related to the software services product features. The Telecom segment includes all voice and data long distance services provided to customers. During the first three quarters of 2008, we referred to our Software segment as the SaaS segment. We subsequently determined in the fourth quarter of 2008 that referring to this segment as the Software segment is clearer to our customers, investors and other stakeholders of our business.

We report financial information for our operating segments under the provisions of ASC 280-10, *Segment Reporting* (formerly Statement of Financial Accounting Standards No. 131, *Disclosures about Segments of an Enterprise and Related Information*). The method described in ASC 280-10 for determining what segment information to report is referred to as the management approach. The management approach is based on the way that management organizes the segments within the business for making operating decisions and assessing performance. Beginning in the second quarter of 2009, in conjunction with the change in our consolidated statements of operations as described above under the heading

Reclassifications, we reevaluated our approach to how we compile segment financial information for purposes of making operating decisions and assessing performance. As a result, we made changes to the manner in which certain indirect expenses are allocated to our two operating segments: Software and Telecom. Due primarily to this change, beginning in the second quarter of 2009, a larger portion of total indirect expenses are allocated to the Software segment than has historically been allocated to the Software segment since we began disclosing segment financial information. To improve comparability, segment information reported in this Note 13 is reclassified to reflect the impact of changes made in our segmentation on the reporting periods included herein. These reclassifications have no effect on reported consolidated revenue, loss from operations, net loss or per share amounts. These reclassifications also have no effect on reported segment revenues.

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

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

The following table provides the amounts reclassified for the Software and Telecom segments for the three and nine months ended September 30, 2008 (*in thousands*):

	Three months ended September 30, 2008		
	Software	Telecom	Consolidated
Amounts Reclassified			
Costs of revenue	\$ 2,093	\$ 492	\$ 2,585
Direct selling and marketing	(244)	244	
Direct research and development			
Depreciation and amortization	(869)	(740)	(1,609)
Indirect	609	(1,585)	(976)
Total costs of revenue and operating expenses	\$ 1,589	\$ (1,589)	\$

	Nine months ended September 30, 2008		
	Software	Telecom	Consolidated
Amounts Reclassified			
Costs of revenue	6,296	1,615	\$ 7,911
Direct selling and marketing	(568)	568	
Direct research and development			
Depreciation and amortization	(2,324)	(2,177)	(4,501)
Indirect	1,544	(4,954)	(3,410)

Total costs of revenue and operating expenses	\$ 4,948	\$ (4,948)	\$
---	----------	------------	----

Table of Contents

Operating segment revenues and profitability for the three and nine months ended September 30, 2009 and 2008 (as adjusted) are as follows (*in thousands*):

	Three months ended September 30, 2009			Three months ended September 30, 2008		
	Software	Telecom	Consolidated	Software	Telecom	Consolidated
Revenue	\$ 7,357	\$ 13,590	\$ 20,947	\$ 5,037	\$ 14,766	\$ 19,803
Costs of revenue	2,430	9,824	12,254	2,243	10,584	12,827
Gross profit	4,927	3,766	8,693	2,794	4,182	6,976
Gross margin	67%	28%	41%	55%	28%	35%
Operating expenses:						
Direct selling and marketing	3,116	1,220	4,336	2,489	1,551	4,040
Direct research and development	1,155		1,155	1,046		1,046
Indirect	2,465	1,081	3,546	2,356	1,425	3,781
Income (loss) from operations	\$ (1,809)	\$ 1,465	\$ (344)	\$ (3,097)	\$ 1,206	\$ (1,891)

	Nine months ended September 30, 2009			Nine months ended September 30, 2008		
	Software	Telecom	Consolidated	Software	Telecom	Consolidated
Revenue	\$ 21,189	\$ 42,188	\$ 63,377	\$ 13,940	\$ 45,029	\$ 58,969
Costs of revenue	6,986	31,204	38,190	6,650	32,373	39,023
Gross profit	14,203	10,984	25,187	7,290	12,656	19,946
Gross margin	67%	26%	40%	52%	28%	34%
Operating expenses:						
Direct selling and marketing	8,346	4,094	12,440	7,925	4,595	12,520
Direct research and development	3,027		3,027	3,082		3,082
Indirect	7,770	4,210	11,980	7,374	4,598	11,972
Income (loss) from operations	\$ (4,940)	\$ 2,680	\$ (2,260)	\$ (11,091)	\$ 3,463	\$ (7,628)

NOTE 14. SUBSEQUENT EVENTS

Pursuant to ASC 855-10, Subsequent Events (formerly Statement of Financial Accounting Standards No. 165, *Subsequent Events*), we have reviewed all subsequent events and transactions that occurred after our September 30, 2009 unaudited condensed consolidated balance sheets date as of November 6, 2009, our issuance date.

Table of Contents

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

The following discussion and analysis of financial condition and results of operations should be read in conjunction with the December 31, 2008 consolidated financial statements and notes thereto, along with the Management's Discussion and Analysis of Financial Condition and Results of Operations included in Exhibit 99.1 to the Current Report on Form 8-K, filed separately with the U.S. Securities and Exchange Commission on August 7, 2009.

OVERVIEW

We are principally focused on selling software solutions and telecommunication services to the contact center industry. In 2005, we began the process of transitioning from operating as a telecommunications services provider to operating primarily as a Software-as-a-Service provider focused on the contact center market.

We began as a reseller of telecommunication services. After a series of strategic acquisitions, we emerged with a new product approach combining a national voice over IP (VoIP) network with innovative, on-demand contact handling and agent optimization software technology called inContact®. We use the SaaS model to sell our inContact product suite to the contact center industry. Our inContact product suite is a set of software applications hosted and delivered by us to our customers on a per-seat basis with the ability to scale capacity up or down as business fluctuates.

We continue to derive the majority of our revenue from long distance telecommunication and related services. As a domestic and international long distance reseller and aggregator, we contract with a number of third party long distance service providers for the right to resell telecommunication services to our customers. The variety of traditional telecommunication services we offer enables our customers to: (1) buy most of the telecommunications services they need from one source, (2) combine those services into a customized package including inContact's all-in-one, contact center solution, (3) receive one bill for those services, (4) make one call to inContact if service problems or billing issues arise, and (5) depend on our professional team of employees to manage their network and contact center solution, end-to-end, so our users can focus on their business operations.

We offer our users a set of traditional connectivity products, which include the dedicated voice T1 product, the Intelligent-T , VoIP connectivity services and our switched 1+ services. In addition to long distance, toll-free, and other traditional telephone services, these connectivity options enable our users to connect to our VoIP Network and the complete set of inContact suite of services we have available. Our users publish toll free and local inbound numbers to their customers enabling inbound calls to be handled directly or through the inContact suite embedded in the VoIP Network.

SOURCES OF REVENUE

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

Software

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

Telecom

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

Table of Contents

COSTS OF REVENUE AND OPERATING EXPENSES

Costs of Revenue

Costs of revenue consist primarily of payments to third party long distance service providers for resold telecommunication services to our customers. Costs of revenue also include salaries (including stock-based compensation) and related expenses for our hosting, support and professional services organizations, equipment depreciation relating to our hosting services, and amortization of acquired intangible assets, amortization of capitalized software development costs, and allocated overhead, such as rent, utilities and depreciation on property and equipment. As a result, overhead expenses are included in costs of revenue and each operating expense category. The cost associated with providing professional services is significantly higher as a percentage of revenue than the cost associated with delivering our software services due to the labor costs associated with providing professional services.

Sales and Marketing

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

Research and Development

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

General and Administrative

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

RESULTS OF OPERATIONS

Reclassifications

Beginning in the second quarter of 2009, we made a number of reclassifications to our historical consolidated statements of operations. We added the captions Software revenue, Telecom Revenue, Software costs of revenue, Telecom costs of revenue and Gross profit to our consolidated statements of operations, which previously included single line items for revenue and costs of revenue (excluding depreciation and amortization) and did not include a gross profit subtotal. Also, we changed our allocation of certain operating expenses within our consolidated statements of operations. Depreciation and amortization expense related to revenue generating assets is included in the captions Software costs of revenue and Telecom costs of revenue. Depreciation and amortization expense not associated with revenue generating assets is allocated to our other operating expense categories. Depreciation and amortization expense was previously reported separately in the caption Depreciation and amortization. In addition, professional service costs, costs associated with providing customer service, and overhead expenses have been allocated to Software costs of revenue and Telecom costs of revenue. These costs were previously included in General and administrative expenses. We believe this presentation provides increased transparency and improved comparability of our costs of revenue and operating expenses and that gross profit is a useful, widely accepted measure of profitability and operating performance. These reclassifications had no effect on any reported measures of profit or loss, including our consolidated loss from operations, net loss or per share amounts.

Table of Contents**Three Months Ended September 30, 2009 and 2008**

The following is a tabular presentation of our condensed consolidated operating results for the three months ended September 30, 2009 compared to our condensed consolidated operating results for the three months ended September 30, 2008, as adjusted (*in thousands*):

	2009	2008	\$ Change	% Change
Revenue	\$ 20,947	\$ 19,803	\$ 1,144	6%
Costs of revenue	12,254	12,827	(573)	-4%
Gross profit	8,693	6,976	1,717	
Gross margin	41%	35%		
Operating expenses:				
Selling and marketing	4,583	4,404	179	4%
Research and development	1,331	1,166	165	14%
General and administrative	3,123	3,297	(174)	-5%
Total operating expenses	9,037	8,867	170	
Loss from operations	(344)	(1,891)	1,547	
Other expense	(197)	(145)	(52)	36%
Loss before income taxes	(541)	(2,036)	1,495	
Income tax expense	12	3	9	
Net loss	\$ (553)	\$ (2,039)	\$ 1,486	

Revenue

Total revenues increased \$1.1 million or 6% to \$20.9 million during the three months ended September 30, 2009 compared to revenues of \$19.8 million during the same period in 2008. The increase relates to an increase of \$2.3 million in Software segment revenue due to our focus on sales and marketing efforts on our all-in-one hosted inContact suite. This increase is offset by a decrease of \$1.2 million in Telecom segment revenue due to expected attrition and a change in the pricing structure for short-duration calls related to certain of our customers.

Costs of revenue

Costs of revenue decreased \$573,000 or 4% to \$12.2 million during the three months ended September 30, 2009 compared to costs of revenue of \$12.8 million during the same period in 2008. Cost of revenue as a percentage of revenue decreased six percentage points to 59% during the three months ended September 30, 2009 compared to 65% during the same period in 2008. This decrease is primarily driven by our transition in sales mix from our lower margin Telecom segment to our higher margin Software segment as a result of increased sales of our hosted inContact suite.

Selling and marketing

Selling and marketing expense increased \$179,000 or 4% to \$4.6 million during the three months ended September 30, 2009 from \$4.4 million during the same period in 2008. This increase is due to increased efforts to create lead generation opportunities for our Software segment.

Research and development

Research and development expense increased \$165,000 or 14% to \$1.3 million during the three months ended September 30, 2009 from \$1.2 million during the same period in 2008. This increase primarily relates to increased headcount to accelerate the development and delivery of new products in our Software segment. During the three months ended September 30, 2009, we capitalized an additional \$861,000 of costs related to our internally developed software compared to \$258,000 during the same period in 2008 as a result of our increased efforts in research and development activities on behalf of personnel that qualify for capitalization under GAAP.

Edgar Filing: inContact, Inc. - Form 10-Q

General and administrative

General and administrative expense decreased \$174,000 or 5% to \$3.1 million during the three months ended September 30, 2009 from \$3.3 million during the same period in 2008. This decrease primarily relates to a decrease of \$152,000 in bad debt expense due to less than expected write-offs of uncollectible accounts.

Table of Contents*Other expense*

Other income (expense) increased \$52,000 or 36% to \$197,000 during the three months ended September 30, 2009 from \$145,000 during the same period in 2008. This increase is primarily due to the adoption of a new accounting pronouncement on January 1, 2009. We recorded a non-cash charge of \$54,000 in the third quarter of 2009 representing the change in fair value of warrants during the period. See Note 5 to the accompanying Notes to the Unaudited Condensed Consolidated Financial Statements for a more detailed explanation of the accounting for this new accounting pronouncement.

Nine Months Ended September 30, 2009 and 2008

The following is a tabular presentation of our condensed consolidated operating results for the nine months ended September 30, 2009 compared to our condensed consolidated operating results for the nine months ended September 30, 2008, as adjusted (*in thousands*):

	2009	2008	\$ Change	% Change
Revenue	\$ 63,377	\$ 58,969	\$ 4,408	7%
Costs of revenue	38,190	39,023	(833)	-2%
Gross profit	25,187	19,946	5,241	
Gross margin	40%	34%		
Operating expenses:				
Selling and marketing	13,108	13,360	(252)	-2%
Research and development	3,480	3,445	35	1%
General and administrative	10,859	10,769	90	1%
Total operating expenses	27,447	27,574	(127)	
Loss from operations	(2,260)	(7,628)	5,368	
Other expense	(955)	(282)	(673)	239%
Loss before income taxes	(3,215)	(7,910)	4,695	
Income tax expense	39	9	30	
Net loss	\$ (3,254)	\$ (7,919)	\$ 4,665	

Revenue

Total revenues increased \$4.4 million or 7% to \$63.4 million during the nine months ended September 30, 2009 compared to revenues of \$59.0 million during the same period in 2008. The increase relates to an increase of \$7.2 million in Software segment revenue due to our focus on sales and marketing efforts on our all-in-one hosted inContact suite. This increase is offset by a decrease of \$2.8 million in Telecom segment revenue due to expected attrition.

Costs of revenue

Costs of revenue decreased \$833,000 or 2% to \$38.2 million during the nine months ended September 30, 2009 compared to \$39.0 million during the same period in 2008. Costs of revenue as a percentage of revenue decreased six percentage points to 60% during the nine months ended September 30, 2009 compared to 66% during the same period in 2008. This decrease is primarily driven by our transition in sales mix from our lower margin Telecom segment to our higher margin Software segment as a result of increased sales of our hosted inContact suite.

Selling and marketing

Selling and marketing expense decreased \$252,000 or 2% to \$13.1 million during the nine months ended September 30, 2009 from \$13.4 million during the same period in 2008. This decrease is due to reduced commissions expense related to legacy Telecom customers.

Research and development

Research and development expense remained relatively flat at \$3.5 million during the nine months ended September 30, 2009 and 2008. During the nine months ended September 30, 2009, we capitalized an additional \$2.4 million of costs related to our internally developed software compared to \$877,000 during the same period in 2008 as a result of our increased efforts in research and development activities on behalf of personnel that qualify for capitalization under GAAP.

Table of Contents

General and administrative

General and administrative remained relatively flat at approximately \$10.8 million during the nine months ended September 30, 2009 and 2008.

Other expense

Other expense increased \$673,000 to \$955,000 during the nine months ended September 30, 2009 from \$282,000 during the same period in 2008. Of this increase, net interest expense increased \$243,000 due to a higher outstanding balance on our revolving credit facility in the first three quarters of 2009 as compared to the first three quarters of 2008. The remaining \$430,000 of the increase is due to the adoption of a new accounting pronouncement on January 1, 2009. This non-cash charge taken in 2009 represents the change in fair value of warrants during the period. See Note 5 to the accompanying Notes to the Unaudited Condensed Consolidated Financial Statements for a more detailed explanation of the accounting for this new accounting pronouncement.

SEGMENT REPORTING

We operate under two business segments: Software and Telecom. The Software segment includes all monthly recurring revenue related to the delivery of our software applications plus the associated professional services and setup fees related to the software services product features (referred to as SaaS). The Telecom segment includes all voice and data long distance services provided to customers. During the first three quarters of 2008, we referred to our Software segment as the SaaS segment. We subsequently determined in the fourth quarter of 2008 that referring to this segment as the Software segment is clearer to our customers, investors and other stakeholders of our business.

We report financial information for our operating segments under the provisions of ASC 280-10, *Segment Reporting* (formerly Statement of Financial Accounting Standards No. 131, *Disclosures about Segments of an Enterprise and Related Information*). The method described in ASC 280-10 for determining what segment information to report is referred to as the management approach. The management approach is based on the way that management organizes the segments within the business for making operating decisions and assessing performance. Beginning in the second quarter of 2009, in conjunction with the change in our consolidated statements of operations as described above under the heading *Reclassifications*, we reevaluated our approach to how we compile segment financial information for purposes of making operating decisions and assessing performance. As a result, we made changes to the manner in which certain indirect expenses are allocated to our two operating segments: Software and Telecom. Due primarily to this change, beginning in the second quarter of 2009, a larger portion of total indirect expenses are allocated to the Software segment than has historically been allocated to the Software segment since we began disclosing segment financial information. To improve comparability, segment information reported for the three and nine months ended September 30, 2008 is reclassified to reflect the impact of changes made in our segmentation on the reporting periods included herein. These reclassifications have no effect on reported consolidated revenue, loss from operations, net loss or per share amounts. These reclassifications also have no effect on reported segment revenues.

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.

Table of Contents**Software Segment Results**

The following is a tabular presentation and comparison of our Software segment unaudited condensed consolidated operating results for the three and nine months ended September 30, 2009 and 2008, as adjusted for 2008 (*in thousands*):

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2009	2008	\$ Change	% Change	2009	2008	\$ Change	% Change
Revenue	\$ 7,357	\$ 5,037	\$ 2,320	46%	\$ 21,189	\$ 13,940	\$ 7,249	52%
Costs of revenue	2,430	2,243	187	8%	6,986	6,650	336	5%
Gross profit	4,927	2,794			14,203	7,290		
Gross margin	67%	55%			67%	52%		
Operating expenses:								
Direct selling and marketing	3,116	2,489	627	25%	8,346	7,925	421	5%
Direct research and development	1,155	1,046	109	10%	3,027	3,082	(55)	-2%
Indirect	2,465	2,356	109	5%	7,770	7,374	396	5%
Loss from operations	\$ (1,809)	\$ (3,097)			\$ (4,940)	\$ (11,091)		

Three Months Ended September 30, 2009 and 2008

The Software segment revenue increased \$2.4 million or 46% to \$7.4 million during the three months ended September 30, 2009 from \$5.0 million during the same period in 2008. The increase is a result of the selling and marketing efforts we have undertaken to expand the inContact suite of services in the market. Software segment revenue includes revenue from professional services of \$412,000 for the third quarter of 2009 compared to \$243,000 for the third quarter of 2008.

Gross margin increased 12 percentage points to 67% during the three months ended September 30, 2009 compared to 55% during the same period in 2008. At the end of fiscal 2008, certain intangible assets related to previously acquired technology became fully amortized. As a result, we recorded approximately \$549,000 less in intangible asset amortization during the three months ended September 30, 2009 than the same period in the previous year. The increase in gross margin is also due to increased Software segment revenues in 2009 resulting from the buildup of our sales and marketing infrastructure in previous periods.

Direct selling and marketing expenses in the Software segment increased \$627,000 or 25% to \$3.1 million during the three months ended September 30, 2009 compared to \$2.5 million during the same period in 2008. This increase is a result of headcount additions for employees focused on managing and enhancing our partner relationships. We also continue to develop the services provided in the Software segment by investing in research and development. During the three months ended September 30, 2009, we incurred \$1.2 million in direct research and development costs compared to \$1.1 million during the same period in 2008 and have capitalized an additional \$861,000 of costs incurred during the three months ended September 30, 2009 related to our internally developed software compared to \$258,000 during the same period in 2008. Indirect expenses, which consist of overhead, such as rent, utilities and depreciation on property and equipment, increased \$109,000 or 5% to \$2.5 million during the three months ended September 30, 2009 compared to \$2.4 million during the same period in 2008. This increase is a result of additional expenses resulting from an increase in capital lease obligations and an increase in compensation costs as a result of increased headcount.

Nine Months Ended September 30, 2009 and 2008

The Software segment revenue increased by \$7.2 million or 52% to \$21.2 million during the nine months ended September 30, 2009 from \$13.9 million during the same period in 2008. The increase is a result of the selling and marketing efforts we have undertaken to expand the inContact suite of services in the market. Software segment revenue includes revenue from professional services of \$1.1 million for the first three quarters of 2009 compared to \$717,000 for the first three quarters of 2008.

Gross margin increased 15 percentage points to 67% during the nine months ended September 30, 2009 compared to 52% during the same period in 2008. At the end of fiscal 2008, certain intangible assets related to previously acquired technology became fully amortized. As a result, we recorded approximately \$1.4 million less in intangible asset amortization during the nine months ended September 30, 2009 than the same

Edgar Filing: inContact, Inc. - Form 10-Q

period in the previous year. The increase in gross margin is also due to increased Software segment revenues in 2009 resulting from the buildup of our sales and marketing infrastructure in previous periods.

Direct selling and marketing expenses in the Software segment increased \$421,000 or 5% to \$8.3 million during the nine months ended September 30, 2009 compared to \$7.9 million during the same period in 2008. This increase is a result of headcount additions for employees focused on managing and enhancing our partner relationships. We also continue to develop the services provided in the Software segment by investing in research and development. During the nine months ended September 30, 2009, we incurred \$3.0 million in direct research and development costs compared to \$3.1 million during the same period in 2008 and have capitalized an additional \$2.4 million of costs incurred during the nine months ended September 30, 2009 related to our internally developed software compared to \$877,000 during the same period in 2008. Indirect expenses, which consist of overhead, such as rent, utilities

Table of Contents

and depreciation on property and equipment, increased \$396,000 or 5% to \$7.8 million during the nine months ended September 30, 2009 compared to \$7.4 million during the same period in 2008. This increase is a result of additional expenses resulting from an increase in capital lease obligations and an increase in compensation costs as a result of increased headcount.

Telecom Segment Results

The following is a tabular presentation and comparison of our Telecom segment condensed consolidated operating results for the three and nine months ended September 30, 2009 and 2008, as adjusted for 2008 (*in thousands*):

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2009	2008	\$ Change	% Change	2009	2008	\$ Change	% Change
Revenue	\$ 13,590	\$ 14,766	\$ (1,176)	-8%	\$ 42,188	\$ 45,029	\$ (2,841)	-6%
Costs of revenue	9,824	10,584	(760)	-7%	31,204	32,373	(1,169)	-4%
Gross profit	3,766	4,182			10,984	12,656		
Gross margin	28%	28%			26%	28%		
Operating expenses:								
Direct selling and marketing	1,220	1,551	(331)	-21%	4,094	4,595	(501)	-11%
Direct research and development								
Indirect	1,081	1,425	(344)	-24%	4,210	4,598	(388)	-8%
Income from operations	\$ 1,465	\$ 1,206			\$ 2,680	\$ 3,463		

Three Months Ended September 30, 2009 and 2008

We continue to see decreases in Telecom segment revenue; however, attrition rates are in line with our expectations. Overall Telecom segment revenue decreased \$1.2 million or 8% to \$13.6 million during the three months ended September 30, 2009 compared to \$14.8 million during the same period in 2008. This decrease is due to the expected attrition and a change in the pricing structure for short-duration calls related to certain of our customers. With the decline in revenues from the Telecom segment, we reduced operating costs in the segment as well. Direct selling and marketing expenses decreased 21% during the three months ended September 30, 2009 compared to the same period in 2008 and Indirect expenses, which consist of overhead, such as rent, utilities and depreciation on property and equipment, decreased 24% during the three months ended September 30, 2009 compared to the same period in 2008. As a result, we increased our income from operations in the Telecom segment by \$259,000 for the three months ended September 30, 2009 over the same period in 2008.

Nine Months Ended September 30, 2009 and 2008

We continue to see decreases in Telecom segment revenue; however, attrition rates are in line with our expectations. Overall Telecom segment revenue decreased \$2.8 million or 6% to \$42.2 million during the nine months ended September 30, 2009 compared to \$45.0 million during the same period in 2008. This decrease is due to the expected attrition of our Telecom customers as we focus our selling and marketing efforts on our inContact suite of services. With the decline in revenues from the Telecom segment, we reduced operating costs in the segment as well. Direct selling and marketing expenses decreased 11% during the nine months ended September 30, 2009 compared to the same period in 2008 and Indirect expenses, which consist of overhead, such as rent, utilities and depreciation on property and equipment, decreased 8% during the nine months ended September 30, 2009 compared to the same period in 2008.

LIQUIDITY AND CAPITAL RESOURCES

Our principal sources of liquidity are cash and cash equivalents and available borrowings under our revolving credit facility. On July 16, 2009, we entered into a revolving credit loan agreement (the Revolving Credit Agreement) with Zions First National Bank (Zions). Under the terms of the Revolving Credit Agreement, Zions has agreed to loan up to \$8.5 million under a revolving credit note. The loan is secured by substantially all the assets of inContact. We used a portion of the borrowings from the new loan arrangement with Zions to pay-off the existing ComVest revolving credit loan, totaling approximately \$6.5 million. All outstanding principal under the Zions agreement is due in July 2011.

Edgar Filing: inContact, Inc. - Form 10-Q

The Zions Revolving Credit Agreement contains certain covenants. Financial covenants include requirements to maintain a minimum adjusted EBITDA (defined as earnings before interest expense, income tax expense, depreciation, amortization, and other non-cash charges, minus capitalized research and development costs) of \$250,000 for the quarter ended September 30, 2009 and \$750,000 for each quarter thereafter and minimum working capital of \$1.0 million as of December 31, 2009 and the end of each quarter thereafter. For the three months ended September 30, 2009, our minimum adjusted EBITDA was \$318,000.

The interest rate under the Zions revolving credit note is four and five-tenths percent (4.5%) per annum above the ninety day LIBOR rate, from time to time in effect, adjusted as of the date of any change in the ninety day LIBOR rate. Interest under the

Table of Contents

revolving credit note is paid monthly in arrears, and all principal is due in July 2011. The balance outstanding under the revolving credit note cannot exceed the lesser of (a) \$8.5 million or (b) the sum of 85 percent (85%) of eligible billed receivables, and 65 percent (65%) of eligible earned but unbilled receivables. In addition, inContact is required to maintain minimum cash balances ranging from \$2.75 million to \$3.5 million during the term of the note. In the event our cash balance is less than this range, the advance rate on eligible receivables decreases to 75% of eligible billed accounts receivable.

At September 30, 2009, we had \$4.2 million of cash and cash equivalents. Cash equivalents are comprised of highly liquid assets with an original maturity at date of purchase of three months or less. In addition to cash and cash equivalents, we had access to additional available borrowings under our Zions revolving credit facility. The revolving credit facility is secured by essentially all our assets. The additional available borrowings under the Zions revolving credit facility were \$930,000, resulting in total cash and additional availability under the Zions revolving credit facility of \$5.1 million at September 30, 2009.

We experienced a net loss of \$3.3 million during the nine months ended September 30, 2009. Significant expenses affecting operations during this period were non-cash charges related to \$3.6 million of depreciation and amortization, \$1.2 million of stock-based compensation and \$430,000 for the change in the fair value of certain warrants.

Our working capital of \$1.2 million at September 30, 2009 represents a \$524,000 increase from our working capital of \$714,000 at December 31, 2008. The change in working capital was caused by a \$1.5 million increase in accounts receivable and other current assets, a \$461,000 decrease in accounts payable, and a \$152,000 increase in cash, restricted cash and short-term investments. These changes are offset by a \$257,000 increase in the current portion of long-term debt, an \$803,000 increase in accrued liabilities and accrued commissions, and a \$509,000 increase in current deferred revenue.

During the nine months ended September 30, 2009, we generated \$2.8 million of cash from financing activities. We obtained cash from financing activities primarily by borrowing a net \$3.5 million from our revolving credit facility. During the nine months ended September 30, 2009, we generated \$1.2 million of cash from operations and used \$3.9 million of cash in investing activities. Cash used in investing activities was used to pay for capitalized software costs, acquire property and equipment and obtain letters of credit as described in Note 4 to the accompanying Notes to the Unaudited Condensed Consolidated Financial Statements. We had an overall net increase in cash of \$122,000 during the nine months ended September 30, 2009. The amount that we have invested in our expansion has provided additional network capacity and additional resources to help grow our inContact sales.

We believe we can rely on internally generated cash, our revolving credit facility and our equipment leasing facility to finance operations and capital requirements. We believe that existing cash and cash equivalents, cash from operations, and available borrowings under our revolving credit facility will be sufficient to meet our cash requirements during the next twelve months.

We continue to take a proactive approach in managing our operating expenditures and cash flow from operations. In October of 2009, we took measures to reduce operating expenses, including headcount reductions. We believe the savings generated by these measures will accelerate the growth in cash generated from operations.

FAIR VALUE MEASUREMENTS

The fair value of a financial instrument is the amount that could be received upon the sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Financial assets are marked to bid prices and financial liabilities are marked to offer prices. Fair value measurements do not include transaction costs. We adopted ASC 820-10, *Fair Value Measurements and Disclosures* (formerly Statement of Financial Accounting Standards No. 157, *Fair Value Measurement*), on January 1, 2008. This standard defines fair value, establishes a framework to measure fair value, and expands disclosures about fair value measurements. ASC 820-10 establishes a fair value hierarchy used to prioritize the quality and reliability of the information used to determine fair values. Categorization within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement. The fair value hierarchy is defined into the following three categories:

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

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

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

Auction Rate Preferred Securities

Edgar Filing: inContact, Inc. - Form 10-Q

We utilized unobservable (Level 3) inputs in determining the fair value of our auction rate preferred securities, which totaled \$75,000 at September 30, 2009. In prior periods, due to the auction process which took place every 7-30 days for most securities, quoted market prices were readily available, which would qualify as Level 1 under ASC 820-10. However, due to events in credit markets during the first quarter of 2008, the auction events for most of these instruments failed and, therefore, we have determined the estimated fair values of these securities utilizing a discounted cash flow analysis as of September 30, 2009. This analysis considers, among other items, the collateralization of the underlying securities, the expected future cash flows and the expectation of the next

Table of Contents

time the security is expected to have a successful auction. These securities were also compared, when possible, to other observable market data with similar characteristics to the securities held by us. Due to these events, we recorded a temporary unrealized decline in fair value of \$50,000 for the year ended December 31, 2008, with an offsetting entry to accumulated other comprehensive loss. We currently believe that this temporary decline in fair value is due entirely to liquidity issues and not credit issues, because the auction rate preferred securities are in AAA closed-end bond mutual funds that are over-collateralized by at least 200% and are backed by these underlying marketable securities. In addition, our holdings of auction rate preferred securities represented only 3% of our total cash, cash equivalent, and investment balance at September 30, 2009, which we believe allows us sufficient time for the securities to return to original full value. We will re-evaluate each of these factors as market conditions change in subsequent periods.

Warrants

We adopted ASC 815-40, *Contracts in an Entity's Own Equity* (formerly Emerging Issues Task Force Issue No. 07-5, *Determining Whether an Instrument (or Embedded Feature) is Indexed to an Entity's Own Stock*) effective January 1, 2009. The adoption of the requirements of ASC 815-40 can affect the accounting for warrants and many convertible instruments with provisions that protect holders from a decline in the stock price (or down-round provisions). Down-round provisions reduce the exercise price of a warrant or convertible instrument if a company either issues equity shares for a price that is lower than the exercise price of those instruments or issues new warrants or convertible instruments that have a lower exercise price. We evaluated whether warrants to acquire our stock contain provisions that protect holders from declines in the stock price or otherwise could result in modification of the exercise price and/or shares to be issued under the respective warrant agreements based on a variable that is not an input to the fair value of a fixed-for-fixed option. We determined that the following warrants contained such provisions, thereby concluding they were not indexed to our own stock:

Warrants issued to ComVest Capital, LLC (ComVest) in conjunction with the Revolving Credit Note and Term Loan Agreement, exercisable for 330,000 shares of our common stock that expire May 23, 2011.

Warrants issued to ComVest in conjunction with the an amendment to the Revolving Credit Note and Term Loan Agreement, exercisable for 55,000 shares of our common stock that expire May 23, 2011.

In accordance with ASC 815-40, on January 1, 2009 we began recognizing these warrants issued to ComVest (the ComVest Warrants) as liabilities at their respective fair values on each reporting date. We measured the fair value of these warrants as of September 30, 2009, and recorded a \$430,000 charge to record the liabilities associated with these warrants at their estimated fair values totaling \$543,000 as of September 30, 2009. We estimated the fair values of these securities using a Black-Scholes valuation model.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

A summary of our significant accounting policies and estimates is discussed in Management's Discussion and Analysis of Financial Condition and Results of Operations and in Note 1 of Exhibit 99.1 to the Current Report on Form 8-K, filed separately with the U.S. Securities and Exchange Commission on August 7, 2009. The preparation of the financial statements in accordance with U.S. generally accepted accounting principles requires us to make judgments, estimates and assumptions regarding uncertainties that affect the reported amounts of assets and liabilities. Significant areas of uncertainty that require judgments, estimates and assumptions include the accounting for income taxes and other contingencies as well as asset impairment and collectability of accounts receivable. We use historical and other information that we consider to be relevant to make these judgments and estimates. However, actual results may differ from those estimates and assumptions that are used to prepare our financial statements.

Table of Contents

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our cash and cash equivalent are invested with high quality issuers and limit the amount of credit exposure to any one issuer. Due to the short-term nature of the cash equivalents, we believe that we are not subject to any material interest rate risk as it relates to interest income. Interest rates on outstanding lease and long-term debt obligations are fixed and therefore do not vary with market fluctuations.

Our short-term investments of \$75,000 in preferred auction rate securities are rated AAA. While the recent auction failures may limit our ability to liquidate these investments for some period of time, we do not believe the auction failures will materially impact our ability to fund our working capital needs, capital expenditures, or other business requirements.

ITEM 4. CONTROLS AND PROCEDURES

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

Evaluation of Disclosure Controls and Procedures

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

In connection with the preparation of this report, our management, under the supervision and with the participation of the Chief Executive Officer and Chief Financial Officer, reassessed the effectiveness of the design and operation of our disclosure controls and procedures. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures were effective as of September 30, 2009.

Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting that occurred during the third quarter of 2009 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

PART II

ITEM 1. LEGAL PROCEEDINGS

During the quarter ended September 30, 2009, there were no material developments in any pending legal proceedings previously reported. Please see the discussion of legal proceedings under Part II, Item 1, of our report on Form 10-Q for the period ended June 30, 2009, filed with the Securities and Exchange Commission on August 7, 2009.

ITEM 1A. RISK FACTORS

The Private Securities Litigation Reform Act of 1995 provides a safe harbor for forward-looking statements made by us, except where such statements are made in connection with an initial public offering. All statements, other than statements of historical fact, which address activities, actions, goals, prospects, or new developments that we expect or anticipate will or may occur in the future, including such things as expansion and growth of our operations and other such matters are forward-looking statements. Any one or a combination of factors could materially affect our operations and financial condition. These factors include competitive pressures, success or failure of marketing programs, changes in pricing and availability of services and products offered to customers, legal and regulatory initiatives affecting software or long distance service, and conditions in the capital markets. Forward-looking statements made by us are based on knowledge of our business and the environment in which we operate as of the date of this report. Because of the factors discussed in the 2008 Annual Report on Form 10-K under Item 1A Risk Factors, actual results may differ from those in the forward-looking statements.

ITEM 6. EXHIBITS

Exhibit No.	Title of Document
31.1	Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certifications of the Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

Table of Contents

SIGNATURES

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

Date: November 6, 2009

inContact, INC.

By: */s/* PAUL JARMAN
Paul Jarman
Chief Executive Officer

Date: November 6, 2009

By: */s/* GREGORY AYERS
Gregory Ayers
Principal Financial and Accounting Officer