

inContact, Inc.
Form 10-K
March 09, 2012
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-K

Annual report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934
For the fiscal year ended December 31, 2011

Or

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

Commission File No. 1-33762

inContact, Inc.

(Exact name of registrant as specified in its charter)

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Delaware **87-0528557**
(State or other jurisdiction of **(IRS Employer**
incorporation or organization) **Identification No.)**
7730 S. Union Park Avenue, Suite 500, Salt Lake City, Utah 84047
(Address of principal executive offices and Zip Code)
(801) 320-3200
(Registrant's telephone number, including area code)

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

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

None

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

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

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

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

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

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

Large Accelerated Filer Accelerated Filer
Non-Accelerated Filer Smaller reporting company

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

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of the last business day of the registrant's most recently completed second fiscal quarter: \$160,479,543.

The number of shares outstanding of the registrant's class of \$0.0001 par value common stock as of February 21, 2012 was 43,695,967.

DOCUMENTS INCORPORATED BY REFERENCE: Information required by Items 10 through 14 of Part III of this Form 10-K, to the extent not set forth herein, is incorporated herein by reference to portions of the registrant's definitive proxy statement for the registrant's 2012 Annual Meeting of Stockholders, which will be filed with the Securities and Exchange Commission not later than 120 days after the end of the fiscal year ended December 31, 2011. Except with respect to the information specifically incorporated by reference in this Form 10-K, the registrant's definitive proxy statement is not deemed to be filed as a part of this Form 10-K.

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FORWARD-LOOKING STATEMENTS

In addition to historical information, this annual report on Form 10-K contains forward-looking statements. Forward-looking statements include all statements that do not relate solely to historical or current facts, and can generally be identified by the use of words such as may, believe, will, expect, project, estimate, intend, anticipate, plan, continue or similar expressions. In particular, information appearing under Management's Discussion and Analysis of Financial Condition and Results of Operations and Business includes forward-looking statements. Forward-looking statements inherently involve many risks and uncertainties that could cause actual results to differ materially from those projected in these statements. Where, in any forward-looking statement, we express an expectation or belief as to future results or events, such expectation or belief is based on the current plans and expectations of our management and expressed in good faith and believed to have a reasonable basis, but there can be no assurance that the expectation or belief will result or be achieved or accomplished. The following include some, but not all, of the factors that could cause actual results or events to differ materially from those anticipated:

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

Rapid technological changes;

Failure by us to implement our strategies;

Our ability to keep pace with changing customer needs;

Financial difficulties experienced by any of our top customers;

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

Our ability to attract and retain key personnel;

General economic conditions; and

Possible terrorist attacks and ongoing military action throughout the world.

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

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

WHERE YOU CAN FIND MORE INFORMATION

We are subject to the informational requirements of the Securities Exchange Act of 1934. Accordingly, we file periodic reports and other information with the Securities and Exchange Commission (SEC). We make our annual report on Form 10-K, quarterly reports on Form 10-Q,

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current reports on Form 8-K and amendments to those reports available through our Internet site, www.inContact.com as soon as reasonably practicable after electronically filing such materials with the SEC. They may also be obtained by writing to inContact, Inc., 7730 S. Union Park Avenue, Suite 500, Salt Lake City, Utah 84047. In addition, copies of these reports may be obtained through the Securities and Exchange Commission website at www.sec.gov or by visiting the SEC's Public Reference Room at 100 F Street, NE, Washington, DC 20549 or by calling the SEC at 800-SEC-0330. Our common stock trades on The NASDAQ Capital Market under the symbol SAAS.

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PART I

ITEM 1. BUSINESS

Overview

What We Do

inContact, Inc. (inContact, we, us, our, or the Company) began in 1997 as a reseller of telecommunications services and has evolved to become a leading provider of cloud-based contact center solutions. Cloud-based is a term used to refer to on-demand computing, data storage and delivery of technology services through the Internet (Cloud), which includes software-as-a-service (SaaS). inContact helps contact centers around the world create effective customer experiences through its powerful portfolio of cloud-based contact center call routing, self-service and agent optimization solutions. The Company s services and solutions enable contact centers to operate more efficiently, optimize the cost and quality of every customer interaction, create new pathways to profit and ensure ongoing customer-centric business improvement and growth.

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

Developments in 2011

Our primary financial objective is to generate recurring cloud-based software revenue from sustainable sources by investing in various cloud-based software growth initiatives, as we believe we are in the early stages of a large, long-term market. In the past, we have grown that business through our direct sales initiatives and referral partner arrangements. We added a new sales channel in 2011. In June 2011, we entered into our first reseller agreement for our cloud-based contact center solutions with Siemens Enterprise Communications (Siemens). Siemens is a world-wide distributor/reseller of our portfolio of cloud-based software solutions, which includes the exclusive right to sell our solutions in Europe (including Russia), Middle East, and Africa (EMEA). In November 2011, we entered into a North America reseller agreement with Verizon Business Communications (Verizon). Our new opportunity in 2011 is to leverage the marketing and sales capacity of these large enterprises selling to call center owners and operators to substantially increase our business in North America and establish our business overseas all of which we believe will generate significant growth in our recurring cloud-based software revenue.

This new opportunity means we must invest in the infrastructure required to deliver our cloud-based software to new enterprise and international customers and increase our customer service and support capacity. We began making that investment in 2011, and were able to fund our expenditures in 2011, as well as expected expenditures in 2012, with the \$23.6 million we raised from the sale of 7.2 million shares of common stock to a parent company of Siemens. Even so, the investment we made increased our cost of services and other operating expenses in 2011, which adversely affected our margins and results of operations. Our ability to recoup that investment depends on how successful our reseller strategy is in 2012 and beyond, but we are able to mitigate the risk associated with future realization of sales by obtaining minimum purchase commitments from Siemens to generate \$5.0 million of net software revenue in 2012 and \$10.0 million in 2013.

Products and Services

The inContact Cloud Portfolio

The inContact portfolio consists of the following integrated solutions:

inContact ACD : The goal of an Automatic Call Distributor (ACD) is to get callers to the right agent as quickly as possible. inContact provides advanced contact handling and routing functionality along with the management services required for our customers to monitor and manage the

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process. The inContact ACD includes skills-based routing, universal contact queues, automatic call back, and inbound/outbound call blending. Dynamic connections with the database enhance the call routing even further by leveraging real-time data for routing decisions to improve the caller experience. inContact ACD is also capable of aggregating multiple contact center sites into a single entity for improved management and reporting of large, complex contact center operations.

inContact CTI : Computer Telephony Integration (CTI) leverages the customer database to deliver a caller experience based on data relevant to the caller. inContact CTI integrates with customer data servers to provide agents with pre-populated customer data that reduce contact handling times. The inContact CTI can also link Interactive Voice Response applications with transaction databases, enabling caller self-service and reducing the need for agents where appropriate.

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

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

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

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

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

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

inContact eLearning : inContact eLearning provides targeted, prioritized training, communications and testing directly to the agent's desktop during dips in call volumes. Our customers experience reduced call escalations and minimized cost per call with better trained agents.

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inContact Network Connectivity: inContact runs a national carrier-class telecommunications network providing both TDM and VoIP connectivity as well as toll-free and local-number services. All incoming calls are handled on the inContact network that was designed from the ground up to support a broad range of software applications. Outgoing calls are routed through a portfolio of partners specially selected for call-quality as well as low-cost services to benefit our customers.

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Professional Services: We offer professional support services from contact center experts who help customers establish, set up and optimize their contact centers for user satisfaction and revenue optimization. Our contact center experts assist customers in customizing detailed call routing and call distribution mapping to ensure calls are routed in the most effective and efficient manner possible using the inContact portfolio of services to their maximum potential needed by each unique contact center.

The Power of the Cloud Model

The cloud model enables subscribers to access a wide variety of application services that are developed specifically for delivery over the Internet on an as-needed basis. Purchasing cloud-based applications offers advantages to businesses over traditional software licensing and delivery models, including the following:

Operational expense rather than a capital expense;

Overlay existing infrastructure without additional investment;

Low up-front expenditure reduces risk and is especially appealing in a challenging economic climate;

Remove complexity of day-to-day management;

Ability to use at-home agents or multi-site workforces because the software is delivered over the Internet and can be accessed from any location;

Continued access to state-of-the-art technology and avoidance of technology lock-in with no need to install and manage third-party hardware and software in-house;

Ability to scale as business needs change; and

Instant built-in scalability, redundancy, security, hosting and IT expertise.

This type of lower cost subscription service is particularly attractive for start-up companies and medium-sized businesses. However, the model also is becoming increasingly appealing to larger organizations as they seek to reduce significant hardware and software expenses, while maintaining or improving contact center functionality and capacity.

For companies selling software application services under the cloud-based model, such as inContact, sales generally result in lower initial revenues than traditional software licensing and delivery models. However, because customers generally subscribe to this kind of product for a period of time, future revenues are more predictable than traditional software sales models where license revenue may be recognized in the quarter when signed. As a result of our use of the cloud model, we depend on monthly recurring revenues from our customers, which provide us with a much more predictable and stable revenue stream than if we sold our inContact platform as a premise-based product.

Telecom Products and Services

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

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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. Our primary providers are Qwest, Verizon and Global Crossing. 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 our all-in-one, contact center solution,

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(3) receive one bill for those services, (4) call us at a single point of contact 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 customers can focus on their business operations.

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

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

We maintain a contact center in Salt Lake City, Utah for receiving customer service and billing inquiries. Our customer service personnel are available during extended business hours and also provide emergency service 24 hours a day, seven days a week. We place a high priority on customer service since we believe it is a primary factor in acquiring and retaining customers.

Market Opportunity

Many businesses need to manage a large volume of telephone traffic with users and business contacts. With the traditional premise-based hardware and software solutions, the business: (1) purchases a system from an equipment provider, (2) installs the system on site, (3) purchases long distance service from a provider and (4) attaches one to the other. This separation between call management and call delivery has resulted in a fragmented market served by multiple vendors that offer either:

High-end, onsite, hardware and software solutions, designed to improve worker productivity, for which the return on investment is lengthy and often hard to justify, except for contact center operations that are large enough to afford the significant investment needed to purchase the costly equipment, software and technical expertise; or

Less expensive hardware and software solutions that are more affordable to the small and mid-sized contact center market, which have few features, little flexibility and limit the business's ability to improve worker productivity.

Our strategy is to deploy an all-in-one contact management solution that is scalable to the business's call traffic, enables a distributed workforce, improves worker productivity, offers the features found in the high-end hardware and software solutions, and is affordable to contact centers of all sizes.

In today's challenging economy, the preferred practice of our prospective customers is to use outsourced services paid for as used over standard periods, rather than incurring large upfront capital expenditures that use working capital that is recovered over long periods of use.

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

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Sales and Marketing

Marketing continues to be a strategic growth engine for inContact. In 2011, we continued our targeted marketing activities to accelerate sales growth. We are driving demand for our services through the following key strategies:

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

Develop customer references to support the story;

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

Leverage social media;

Increase scale and impact of demand generation programs; and

Nurture leads for more effective conversion to qualified opportunities.

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

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

In 2011 and prior years, inContact's cloud-based software solutions have been sold predominately through our direct sales organization. In June 2011, we established a new sales channel by entering into a reseller agreement with Siemens, whereby Siemens became a world-wide distributor/reseller of our portfolio of hosted solutions. Siemens was granted a non-exclusive right to resell inContact's cloud-based software solutions and other services globally with an exclusive right to sell the inContact services in EMEA. The initial term of the agreement is between June 14, 2011 and December 31, 2013. Siemens agreed to the following minimum purchase commitments during the term of the Agreement:

\$5.0 million in net software revenue for calendar year 2012 with quarterly milestones of 15% for Quarter 1, 20% for Quarter 2, 25% for Quarter 3 and 40% for Quarter 4; and

\$10.0 million in net software revenue for calendar year 2013 with quarterly milestones of 15% for Quarter 1, 20% for Quarter 2, 25% for Quarter 3 and 40% for Quarter 4.

If Siemens produces \$4.0 million in net software revenue for the fourth quarter of 2013, the agreement can be extended at Siemens' option for calendar year 2014 with a minimum purchase commitment of \$4.0 million per quarter for a total commitment of \$16.0 million for 2014.

Siemens has the right to brand or co-brand the portfolio of cloud-based software solutions with Siemens' trade name or service mark. The relationship will begin with a co-branding solution and we agreed to pursue a full branding solution per a mutually agreeable timeline. inContact agreed to provide sales and marketing material, fund and manage the platform for the portfolio of software solutions in Europe, manage all operational functions of delivering the software solutions, and to support Siemens' customer and internal support training programs. We believe this reseller agreement will provide additional opportunities, especially in EMEA, for inContact by leveraging Siemens' sales force to sell our portfolio of hosted solutions.

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In October 2011, we entered into another reseller agreement with Verizon. The Verizon reseller agreement has no minimum purchase commitments, but we believe it will allow us to increase market share in North America by leveraging their sales and distribution force to sell our portfolio of cloud-based software solutions.

International

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

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

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

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

Technology and Research and Development

Technology

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

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

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

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

Research and Development

We incurred research and development expenses of \$6.4 million in 2011, \$5.3 million in 2010 and \$4.8 million in 2009 primarily related to the development of our inContact portfolio of cloud-based software solutions. We continue to invest a significant portion of our revenue in research and development to leverage our strategic position as a technology provider. Our research and development efforts are focused on improving the features, functionality and security of our existing service offerings as well as developing new proprietary services. In addition, from time to time, we supplement our internal research and development activities with outside development resources and acquired technology. Because of our common, multi-tenant application architecture, we are able to provide all of our customers with a service based upon a single version of our applications. We are able to upgrade all of our customers at the same time with each release. As a result, we do not have to maintain multiple versions of our applications and are able to maintain relatively low research and development expenses as compared to enterprise or premises software vendors. Another contributor to our advantage is the diverse technical and communications expertise in our research and development group as it is composed of numerous professionals with backgrounds in software, hardware and telecommunications. This group is structured as product-centric teams each of which follows formal development processes for enhancements, new feature developments, release management and quality assurance.

Intellectual Property

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

We have no issued patents and the majority of our patent applications concern our inContact portfolio platform infrastructure. The following are our registered trademarks in the U.S. and elsewhere:

inContact®

inTouch®

ECHO®

inCloud

Satisfaction as a Service

We have received in the past, and may receive in the future, communications from third parties claiming that we have infringed on the intellectual property rights of others. The cost to defend or settle these claims can be significant. Any intellectual property claims, regardless of merit, may also require us to seek licenses to that

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technology. At present, we are not aware of any claims being pursued against us. In addition, we license third-party technologies that are incorporated into some elements of our services. Licenses from third-party technologies may not continue to be available to us at a reasonable cost or on reasonable commercial terms, or at all. Additionally, the steps we have taken to protect our intellectual property rights may not be adequate. Third parties may infringe or misappropriate our proprietary rights. Competitors may also independently develop technologies that are substantially equivalent or superior to the technologies we employ in our services. If we fail to protect our proprietary rights adequately, our competitors could offer similar services, potentially significantly harming our competitive position and decreasing our revenues.

Competition

The majority of market share in the contact center infrastructure market and in the workforce optimization software market is still held by traditional premise-based equipment providers. The premise-based method of selling solutions, via onsite equipment and software, is now being challenged by cloud-based providers. However, market share among the group of cloud-based providers is fragmented and remains small.

We believe that today there is no clear cloud-based contact center market leader. However, according to the DMG Hosted Contact Center Infrastructure Market Report, inContact is the market share leader, based on agent seats¹. Because of our diligent efforts over the past several years and our experience with more than 1,000 implementations, we believe we are in a position to capitalize on the market fragmentation and become the clear leader in the cloud-based market for contact center software.

Government Regulation

General

The Telecommunications Act of 1996 vests the Federal Communications Commission (FCC) with jurisdiction over interstate telecommunications services, while preserving state and local jurisdiction over many aspects of these services. As a result, telecommunications services are regulated at both the federal and state levels in the United States. In addition, a specific form of Internet-based telephony that interconnects with the Public Switched Telephone Network (PSTN) called interconnected Voice over Internet Protocol (I-VoIP) service is also subject to certain analogous regulations at the federal and, increasingly, state level. More recently, pursuant to statutory requirement, the FCC promulgated regulations extending narrow duties to non-interconnected VoIP service. We believe we are in compliance with the laws and regulations applicable to our business.

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

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

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

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

¹ 2011/2012 Hosted Contact Center Infrastructure Market Report, DMG Consulting LLC, December 2011.

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

In October 2010, legislation was signed into law that for the first time subjects providers of non-interconnected VoIP services to government regulation. Specifically, the Twenty-First Century Communications and Video Accessibility Act of 2010 (CVAA) required the FCC to adopt various measures to ensure that people with disabilities have access to emerging communications technologies, and to promulgate rules requiring non-interconnected VoIP providers to contribute to the TRS Fund. To implement the CVAA, the FCC adopted rules requiring non-interconnected VoIP service providers to contribute to the TRS Fund on the basis of their interstate end-user revenues. The contribution obligation is limited, and the rules do not affirmatively impose any other regulatory responsibilities on non-interconnected VoIP providers. Because the new rules are narrow and focused, we expect that they will have a minimal cost impact on the Company. But, the CVAA also signals a trend toward expansion of FCC regulations to a broader variety of enhanced communications services.

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

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

Federal Regulation of Broadband Internet Access Services

In the past, the FCC has maintained a hands-off policy with regard to the regulation of Internet access services and adopted a series of decisions that classified broadband Internet access services as unregulated information services. Recently, however, the FCC has relied on its ancillary jurisdiction to regulate broadband Internet access services. In 2010, the FCC adopted the Open Internet or Network Neutrality rules, which require providers of fixed broadband Internet access services to disclose information regarding their network management practices, performance, and commercial terms. Further, the rules prohibit fixed broadband providers from unreasonably discriminating in their transmission of lawful network traffic and from blocking lawful content, applications, services or non-harmful devices unless such blocking is a part of a provider's reasonable network management. The Open Internet rules are currently under appeal. We rely on third parties to provide or supply Internet access services and do not operate a broadband network. At this time, we do not believe the Open Internet rules will impact us.

Intercarrier Compensation and Universal Service Reform

As a long distance provider, we remit access fees directly to local exchange carriers or indirectly to our underlying long distance carriers for the origination and termination of our long distance telecommunications traffic pursuant to the FCC's intercarrier compensation rules. In 2011, the FCC adopted reforms to the existing intercarrier compensation regime. The new rules subject VoIP traffic to the FCC's intercarrier compensation

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rules. The FCC set the default charge for toll traffic exchanged between a VoIP provider and a local carrier at the interstate access rate. The charge for local traffic exchanged will be the reciprocal compensation rate. We are in the process of undertaking an internal review and implementing measures to comply with the new intercarrier compensation rules. We cannot predict exactly how the new regime will impact our business but expect that it will affect the cost of services provided to our customers, particularly long distance services.

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

As a regulated service provider, we contribute to the USF. We believe that we are currently in compliance with the FCC's USF rules. We expect that reform may include an expansion of the range of contributors to include a broader scope of enhanced communications services. While any material changes to the USF contribution system could impact the company's business, because the Company passes through USF fees on an equitable and non-discriminatory basis to end users, either as a component part of the rate charged for telecommunications services or as a separately invoiced line item, we do not anticipate any material financial impact.

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

Data Protection Regulations

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

Other General Regulations

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

Employees

As of December 31, 2011, we employed a total of 412 employees. Our employees are not represented by a labor union. We have not experienced any work stoppages and believe relations with our employees are good.

Executive Officers of inContact

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

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At December 31, 2011, the following were executive officers of inContact:

| Name | Age | Position | Since |
|------------------|------------|--|--------------|
| Paul Jarman | 42 | Director and Chief Executive Officer | 1997 |
| Gregory S. Ayers | 50 | Executive Vice President and Chief Financial Officer | 2009 |
| Scott Welch | 47 | Executive Vice President and Chief Operating Officer | 2004 |
| Frank Maylett | 49 | Executive Vice President of Sales | 2008 |
| Mariann McDonagh | 50 | Executive Vice President and Chief Marketing Officer | 2010 |
| Sunny Gosain | 40 | Executive Vice President and Chief Product Officer | 2011 |
| Bassam Salem | 39 | Executive Vice President and Chief Business Officer | 2011 |

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

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

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

Frank Maylett was elected Executive Vice President of Sales of inContact in May 2008. Prior to joining inContact, Mr. Maylett spent two years at Brocade Communications Systems, Inc. as the global sales manager.

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

Sunny Gosain was elected as Executive Vice President and Chief Product Officer of inContact in August 2011. Prior to joining inContact, Mr. Gosain was the chief executive responsible for SAAS ERP product line operations for Consana, Inc. from June 2010 to June 2012. Prior to Consona, he was Chief Technology Officer and Chief Information Officer for Compiere, Inc. from March 2007 to June 2010.

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

Business Segments

We report financial information for our operating segments based on the way that management organizes the segments within the business for making operating decisions and assessing performance. We operate under two business segments: Software and Telecom. The Software segment includes all monthly recurring revenue related to the delivery of our inContact portfolio of 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. Software revenue was 45% of total revenue in 2011, 41% in 2010, and 35% in 2009, and telecommunications revenue was 55% of total revenue in 2011, 59% in 2010, and 65% in 2009. Please see the financial information on our segments presented under Note 15 of the Notes to Consolidated Financial Statements.

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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 in