inContact, Inc.

Third Quarter 2013 Earnings Conference Call

November 4, 2013

Operator: Good day and welcome to today's inContact's Third Quarter 2013 Earnings conference call. At this time, all lines are in a listen-only mode; however, later in the program, you will have the opportunity to register to ask questions. This conference may be recorded.

And now, it is now my pleasure to turn the conference over to Greg Ayers, CFO. Please go ahead, sir.

Greg Ayers: Thank you and good afternoon. This is Greg Ayers, CFO of inContact. Welcome to our Third Quarter 2013 conference call. I will begin by presenting the Safe Harbor statement, and I will then turn the call over to CEO, Paul Jarman, to review our third quarter 2013 results and provide an update on important Q3 Company developments. Finally, I will provide additional detail on our financial results for the quarter before opening it up for Q&A. For access to our news release and other information on inContact, please visit our website at www.incontact.com.

The Private Securities Litigation Reform Act of 1995 provides a Safe Harbor statement for forward-looking statements made on the Company's behalf. All statements, other than statements of historical facts, which address the Company's expectations of sources of capital or which express the Company's expectation for the future with respect to financial performance or operating strategies, can be identified as forward-looking statements. Such statements made by the Company are based on the knowledge of the environment in which it operates, but because of the factors previously stated as well as other factors beyond the control of the Company, actual results may differ materially from the expectations expressed in the forward-looking statements.

And now, I will turn the call over to Paul Jarman.

Paul Jarman: Thanks, Greg. I am pleased to announce that in Q3 we are seeing record achievements across all of our business metrics including sales pipeline, bookings, implementations and revenue. Q3 was another record bookings quarter, up 35% over what was a very strong comparable quarter of Q3 2012. During the quarter, we closed 71 contracts, 52 with new logo customers and 19 expansion deals. These strong bookings are a direct result of our strategy and continued investment in demand generation marketing, sales expansion and the growing power of our distribution channel.

At the end of the quarter, we had 43 quota-bearing sales people in four U.S. geographies and in the UK. I am particularly pleased with our onboarding process that translates into faster time to productivity for our recently hired sales reps. For example, one of the newer reps brought in a large deal with a digital media company that will yield an ACV of more than three quarters of a million dollars once they complete implementation.

In the third quarter, Software revenue grew 23% year-over-year, and software-related telecom revenues grew 21%. The steady growth this quarter and year to date is giving us a record run rate for Software and software-related revenues of over 115 million dollars. In addition, adjusted EBITDA for the quarter was 1.9 million dollars.

Now I would like to share more details about our strategy, our execution on that strategy and our continued growth and momentum in the cloud.

ENTERPRISE MOMENTUM

We continue to make strong inroads into the enterprise market as the cloud contact center model is being increasingly adopted by larger organizations. We added 4 new Fortune 500 companies during the quarter and now have 36 on our growing client roster. As of the quarter end, we had 15 customers with annual recurring billings over $500,000. Three of the new deals signed in Q3 are with customers who will yield over $500,000 annually once they are fully deployed on our system. So we continue to successfully move up market and win large enterprise deals.

An important factor for us, as well as for all other SaaS players, is the ability to manage time to revenue, or in other words, the time it takes to turn up larger contracts. Often, larger organizations have more complex requirements that include integrating or consolidating multiple business systems or connecting multiple divisions and contact center locations. We are aggressively managing the implementation cycles for our larger deals. I am pleased to report that the enterprise customers that we signed earlier this year have now begun implementation and will continue staged roll out over the upcoming quarters.

One example is a large regional bank that we talked about last quarter. The first 2 stages were completed during this quarter with 350 agents. The remainder of the project is scheduled for completion during first quarter 2014, and the full implementation will be 1000 agents.

On the other hand, we do also continue to experience wins where the customers have a great sense of urgency or a pending deadline, and this rapid deployment is a major benefit of our cloud model. One such deal from Q3 was with the Georgia Department of Revenue.

The Georgia Department of Revenue selected inContact to help improve the customer service experience for state residents while reducing operational costs.

They will finish deploying the inContact solution by year end. As the principal tax collecting agency for the State of Georgia, the organization must scale to meet dramatic fluctuations in call volume. That ranges from 500 calls a day during slower months to up to 5,000 calls a day during tax season. With the previous system, the agency had to hire temporary workers in times of peak demand. With inContact's advanced routing, the Department of Revenue can route calls across its eleven locations, thus maximizing existing personnel resources and reducing costs related to temporary staff.

During the quarter, we also saw continued momentum among enterprise healthcare providers, who are faced with growing contact volumes, needing to add more services and addressing the changes mandated by the Affordable Care Act. These organizations are turning to the cloud for flexibility and scalability that they cannot get with premise solutions. In Q3, we added 10 new healthcare customers, 3 of which had over a 6 figure annual contract value. We expect this to continue to be a promising vertical for inContact.

Enterprises select inContact for a wide variety of reasons including

- our 100% focus on the cloud,
- our redundancy and reliability,
- our connectivity options, and
- our high touch service model.

The good news is that there is ample room for market growth. In a recent report, industry analyst firm—Ovum—predicted that the number of cloud agent seats will more than double within 5 years.

In this same report, Ovum recognized inContact as a market leader and named us in the coveted shortlist category. According to the report, inContact led all other vendors in 4 out of 6 categories. This market leadership gives us a powerful advantage as the cloud contact center market continues to expand.

INNOVATION / 13.2 RELEASE

inContact is setting the pace for rapid and ongoing innovation. In September, we announced the second major release of our cloud contact center platform this year. This release included a number of unique applications that will only enhance our enterprise attractiveness and extend our competitive advantage.

For example, our patented Personal Connection outbound solution connects agents at the first "Hello". It eliminates the awkward pause common to standard predictive dialers in the industry. A recent study by Harris Interactive found that nearly 50% of the consumers it surveyed hang up before the agent has a chance to speak because of that annoying pause. Our customers are enthusiastically embracing this new application as a "game changer." We believe that Personal Connection opens up additional addressable market for inContact—as, according to Frost & Sullivan—more than 20% of contact center spend in 2012 was related to outbound solutions.

Additionally, this release features Supervisor on the Go—which is a new mobile app for the iPad. This app empowers call center managers with information that includes real time control as they walk the floor. The inContact mobile app offers significantly more functionality than what is available from competitors.

And finally, we introduced the new inContact Agent Console for Salesforce. Native to the Force platform, Agent Console sits right in the Salesforce desktop giving agents the power to visualize their call queues, manage interactions and disposition post call work. Seamless screen pops of relevant customer data are delivered automatically so that the agent can increase up sell and cross sell, improving both first call resolution and customer satisfaction.

Earlier this year, we put more emphasis on our cloud workforce optimization business, which includes a combination of our own organic solutions in addition to the OEM Verint suite. WFO is becoming key to the enterprise deals, helping us to improve our competitive advantage. In Q3, we saw significant growth in our WFO business which increased the overall value of new bookings as well as expanded contract values with current customers.

In October, we held our 5th annual user conference, ICUC 2013, which was the most successful user event in our history, with customer attendance up almost 40% over last year. The sold out conference featured more than 25 customer speakers, industry analysts and media attendees, including a record number of partners as paying sponsors. We also had 50 prospects attending this year's conference. Last year, ICUC directly influenced more than $4 million in annual contract values from either new or existing customers. This year, we expect that ICUC will contribute even more meaningfully to new bookings and existing customer expansion contracts.

CHANNEL

inContact has the broadest distribution channel of any other cloud contact center player. We continue to experience good momentum in our reseller channel and, in Q3, approximately 25% of our closed deals were a direct result of these relationships. The Verizon channel continues to perform very well each quarter. For example in this quarter, one large state government customer added 9 new contracts. The Verizon pipeline is the largest that it has ever been to date and we are extremely encouraged by this progress.

We continue to work with Siemens, now known as Unify, to ramp their cloud business in both North America and in Europe. This relationship began slowly, but we are now seeing far better progress than previously. Even with this progress, we do not believe that Unify's actual sell through revenue will reach the targeted minimum revenue commitment by Q3 2014. However, you may recall that Siemens hired a new cloud sales team in North America in Q1, and in Q3, they closed a deal with a Fortune 100 company that has one of the world's biggest brands. In addition, more than a dozen Unify associates attended our recent user conference. Their pipeline is getting stronger every quarter.

We are also gaining traction with additional partners and our own sales efforts in Europe. For example, we implemented 100 seats for a wireless carrier just last week in Europe with one of these partners.

As discussed over the past several quarters, we have begun to diversify and expand our partner relationships. The new VAR that signed last quarter has completed sales training in several regions, and we are currently working on opportunities with them that total over 1500 seats.
The value of our combined pipeline of reseller contracts continues to climb each quarter. Entering Q4, reseller deals are approximately 18% of our total pipeline value, which is up 45% from just four quarters ago.

In summary, the cloud contact center market has <u>clear and powerful momentum</u>, as evidenced by both the growth forecasts of industry analysts as well as the continued acceleration of our enterprise business. <u>These dynamics are great news for inContact</u>.   We are a leader in a market that is expected to more than double within the next five years.

2013 has been our most significant year for innovative new products, which are in demand with companies of all sizes as they adapt to rapidly changing customer expectations. We have a strong and growing distribution channel that will help us reach the broadest possible audience. We are winning in many large vertical markets, and we are converting enterprise bookings into successful implementations and revenue. In fact, we are seeing record achievements across all of our business metrics including sales pipeline, bookings, implementations and revenue.

We are off to a strong start in bookings for the 4th quarter. We strongly believe that all of this adds up to a record year for inContact and great momentum heading into next year.

Now, I'd like to turn the call over to Greg to provide additional details on our Q3 financial results.

Greg Ayers: Thank you, Paul. First, I will recap the definitions of our two operating segments, Software and Telecom. I will then cover our Q3 operating segment and consolidated results, as well as other financial highlights.

Our first segment is the Software segment, which includes all monthly recurring revenue related to the delivery of our software applications, associated professional services and setup fees, as well as minimum purchase commitment revenue.

For Q3 2013, I am pleased to report that our Software segment revenue increased to $17.1 million, which represents a 23% increase ~~or 3.2 million~~ over the $14 million in Q3 2012. This increase was the result of the following three key drivers of our Software revenue: The first driver of quarterly Software revenue growth is existing customer retention. Our Software revenue retention for the quarter remained very strong and was consistent with previous quarters, at a rate above 92%.

The second driver of quarterly Software revenue growth is the variable utilization of software services by existing customers. This metric fluctuates due to the seasonality, customer service activities and macroeconomic conditions, as well as the revenue generated from the sale of additional services to existing customers. The measurement of this revenue growth is similar in concept to the retail industry's use of the same-store sales metric; in other words, it excludes attrition and new customer contract revenue. With these existing customers, we experienced a 2.2% increase during the quarter, primarily driven by higher utilization by customers.

The third and final driver of our Q3 Software revenue growth is revenue from new contracts that are not yet included in the same-store sales metric. We closed 71 new contracts in the third quarter, 52 of which came from new customers and 19 which were upsells to existing accounts, where we expanded our footprint in agent seats, new locations or additional software application offerings. We estimate the expected future value of these contracts will be approximately 35% higher than the total estimated annual contract value of our Q3 2012 bookings.

I would like to take a moment to remind you how inContact calculates bookings. Bookings is an estimate of the annual contract value and not the full value of a multi-year contract, nor does it include the estimated associated connectivity revenue. We believe that this bookings calculation is a better reflection of the true Software revenue run rate that will be added to the business.

In Q3 2013, Software segment gross margin was 59% on a GAAP basis and 71% with non-cash charges added back compared to Q3 2012's 60% and 72%, respectively. This slight decrease in GAAP gross margin is principally attributable to higher levels of amortization associated with previously capitalized software development costs, as well as acquisitions of technology. Q3's $10 million of Software segment gross profit represents a new Company record.

Our second segment is the Telecom segment, which includes all voice and long distance services provided to both our telecom-only legacy customers, as well as to our Software segment customers. Telecom segment revenue for Q3 2013 was $15.1 million, an 8% increase over the $14 million in Q3 2012. As 80% of the Telecom segment revenue is generated by our Software segment customers, we expect Telecom segment revenue to continue to move in parallel to Software segment revenue.

The Q3 Telecom segment gross margin increased to a record 36%, up from 34% in Q3 2012. This increase in gross margin is principally attributable to continued leverage from our telecom equipment investments. Q3's 25% Telecom segment operating margin is the highest in the Company's history.

Our consolidated results for Q3 are as follows: Consolidated revenue increased to $32.2 million, a $4.3 million increase or 15% from Q3 2012's $27.9 million. This revenue increase was driven by the growth in our Software segment and software-related Telecom. Now that the software-related Telecom revenue has grown to 80% of total Telecom revenue, 91% of our consolidated revenue is derived from SaaS contract billings and for Q3, totaled $29.2 million.

Consolidated gross margin percentage was 48% in the third quarter compared to 47% for the same period in 2012. This increase in gross margin is principally attributable to improvement in the Telecom segment through leveraging fixed costs. Adding back non-cash charges, consolidated gross margin percentage on a non-GAAP basis was 55% for the third quarter compared to 54% for the same period in 2012.

Operating expenses were $17.9 million, up $4.1 million from Q3 2012's $13.8 million. Approximately 60% of the increase came from higher levels of investment in Software segment sales and marketing. As Paul mentioned previously, the investment in sales and marketing has paid off over the past 13 quarters, as we continue to achieve year-over-year strong bookings.

GAAP net loss for the quarter was $2.5 million or 5 cents per share as compared to a net loss of $882 thousand or 2 cents per share for Q3 2012. The increase in the net loss is primarily attributable to an increase in non-cash charges. Adjusted EBITDA, which is a non-GAAP measure, is an important metric of our operating results due to the significant amount of depreciation and amortization, resulting primarily from previous acquisitions of software products, customer bases, network technology, amortization of capitalized software development cost and stock-based comp. Q3 2013 adjusted EBITDA was $1.9 million versus $2.2 million during the same period in 2012. Year to date adjusted Ebitda is approximately 6 million, which is ahead of our expectations of managing the business to approximately $4 million in adjusted EBITDA for the full year.

Q3 marks the seventh sequential quarter that we've generated positive adjusted EBITDA. As of September 30th, 2013, we had 47.6 million in cash and had access to an additional 18.5 million under our line of credit and term note facility.

In summary, we're pleased with the Company's continued success and look forward to continuing our strong momentum over the remainder of the year.

Paul and I will now turn the call over to the Operator for Q&A.

Operator: Thank you. At this time, if you would like to register to ask a question, please do so by pressing the star, and one on your touchtone phone. If you've found that your question has already been answered, you may remove yourself from the queue by pressing the pound key. Once again, it is star, and one to register to ask a question and we'll pause just a moment to allow those questions to queue.

Operator: And thank you, ladies and gentlemen, that is all the time we have for questions at this time.

Paul Jarman: Well, thank you. We appreciate everyone's time today and look forward to our success and everyone's success in the future. Thank you and have a great day.

Operator: And this does conclude today's program. We appreciate your participation. Please enjoy the rest of your day. You may disconnect at any time.