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inContact, Inc.

First Quarter 2016 Earnings Conference Call

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PRESENTATION

Operator:

Good day, everyone, and welcome to today's program. At this time, all participants are in a listen-only mode. Later you will have the opportunity to ask questions during the question-and-answer session. You may register to ask a question at any time by pressing star and one on your touchtone phone and you may withdraw yourself from the queue by pressing the pound key. I will be standing by if you need any assistance.

It's now my pleasure to turn the conference over to Mr. Greg Ayers. Please go ahead.

Gregory Ayers:

Thank you and good afternoon. This is Greg Ayers, CFO of inContact. Welcome to our Q1 2016 conference call. I will begin the call with some prepared remarks and I will then turn the call over to CEO, Paul Jarman, to review our first quarter results. 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 about inContact, please visit our website at www.incontact.com.

The purpose of today's call is to provide you with information regarding our first quarter 2016 results. Some of our discussion and responses to your questions may contain forward-looking statements, which are subject to risks, uncertainties, and assumptions. Should any of these risks or uncertainties materialize or should our assumptions prove to be incorrect, actual Company results could differ materially from these forward-looking statements. These risks, uncertainties and assumptions, as well as other information on potential risk factors that could affect our financial results are included in our filings with the SEC, including our most recent report on Form 10-Q, particularly under the heading Risk Factors.

During the call, we may offer incremental metrics to provide additional insight into our business or quarterly results. Please be advised this detail may be one-time and may or may not be provided in the future.

Now, I'll turn the call over to Paul Jarman. Paul?

Paul Jarman:

Thank you, Greg, and thank you to everyone for joining our call this afternoon. I'm pleased to report solid results in the first quarter of 2016 as we continue to execute our plan for revenue growth, for increasing our operating margin and for market leadership. We are attracting new customers at a rapid pace and we're seeing excellent expansion with existing account. We have a large multi-year opportunity ahead of us and we are well positioned as a leader in terms of growth, profitability and innovation. I'll provide details behind this plan throughout our call today starting with our financial results from the first quarter with revenue and growth in annual recurring revenue or ARR.

First, software revenue for the quarter increased by 28% to $41.5 million year-over-year. Our total revenue increased 22% year-over-year to $62.4 million for Q1. Second, our growth in ARR continued strong this quarter at $156.2 million as of March 31. This represents a 30% increase over ARR as of Q1 of last year. During the quarter, we closed a record 160 contracts, including 106 new customer logos and 54 expansion deals, and with our very strong pipeline, we are well positioned from continued growth in the upcoming quarters.

As I laid out at the beginning of the year, we plan to grow revenue while also improving our operating margin and we achieved both goals this quarter. I am very pleased to report strong results in our bottom line during the quarter. Adjusted EBITDA for Q1 was $5.7 million compared to $2.6 million in Q1 of 2015. This is an improvement of over 117% year-over-year.

As it relates to cash flow for the quarter, after you adjust for you one-time costs for the two acquisitions and our corporate move, we generated over $2.5 million of free cash flow. Our plan to improve operating margins is well underway and we are seeing the initial results of several initiatives designed to increase efficiencies through automation and business process improvements across the Company. We are streamlining everything from sales and marketing processes to provisioning, billing and professional services.

One of our key initiatives is focused on knowledge management and customer communities. We are already seeing success by making incremental investments now for immediate effect and for long-term company-wide efficiencies. Each of these positive results for the quarter gives us confidence to increase our revenue and Adjusted EBITDA guidance for the full year in 2016.

At this point, I'd like to emphasize our leadership as indicated through now five different industry analysts. In March, inContact was identified by International Data Corp. or IDC as the leading provider in the cloud contact center market. In fact, we were the only Company to be placed in IDC's leadership category, shutting out all other competitors. I'd like to emphasize here that we are the only Company to receive recognition as a leader by all five major analyst firms including Gartner, IDC, Frost & Sullivan, Ovum and DMG. While each individual report is important on its own, the cumulative validation is especially powerful. Our customers and partners rely on these reports to compare different companies and to make final purchasing decisions.

Even more evidence is coming in through two new awards. First, inContact was the winner of the 10th Annual Salesforce AppExchange Demo Jam. Second, we received the 2016 Vendor of Excellence Award from PACE, the Professional Association for Customer Engagement, which is a global organization of contact center professionals. These third-party accolades validate our overall market leadership and help us gain further momentum in the very exciting customer experience industry.

Now, I'd like to call out two additional Fortune 500 customers that came in this quarter. The first one came through our carrier channel with one of the largest beverage makers in the world. The company needed to consolidate many aging disparate systems in order to add new locations and gain visibility across the customer journey.

The second new Fortune 500 account came in through the efforts of our direct sales team. The new account, one of the top 10 largest companies in the world, looking to avoid costly upgrades to its outdated premise software, the company is moving initial 170 agents in four global locations for one of their divisions to inContact's more efficient and flexible cloud solutions.

We are excited to get these new marque accounts that reinforce our leadership position and accelerate our growth. We are making big strides in growing the number and size of enterprise accounts. We now have over 90 customers billing over $500,000 annually. We are consistently winning these customers because we are able to show how our solution is the easiest and most reliable way for our customers to achieve their goal. At a recent industry conference, one of our large date (phon) customers reported how inContact helped them dramatically improve quality measures by more than 60%.

We had an exceptional quarter with our growing go-to-market channel. We now have productive partnerships with leading players in major channels including carriers, unified communications and PBX Companies, VARs, referral and implementation partners. Our channel partners are bringing us into many new deals that we would not have seen a year ago. I'd like to give you an idea of how well each channel is performing starting with the carrier channel. Through our carriers, we added several enterprise customers and we are seeing great success in the government sector. We now have state, city, or local government customers in seven of the top 10 largest states.

Our next channel segment is with a leading cloud unified communications, or PBX partners. I am happy to report that this newer channel had the strongest quarter to-date, coming in well over a 100% of goal. A notable example this quarter was a deal brought in by one of our newer partners for over 175 agents at an outdoor retailer. We added over 25 new customers in this channel across the broad range of industries including retail, technology, finance and healthcare and the size of new deals is increasing. We are moving rapidly with these partners for expansion to their customers in Europe. This week, we are training a couple dozen sales people in Europe with one of our PBX partners.

Our third channel is through VARs. We saw many strong deals this quarter. One of our primary VARs brought us in a major expansion deal to a new division of a large retail and e-commerce company. I would like to highlight three expansion deals through one of our European VARs. This Canadian-based partner sells across Europe with excellent reach in to technology, media and public service industries.

Our efforts to recruit and train and support a broad set of channel partners is paying off now in terms of new customers and revenues, and also has a significant wedge against competitors. We have a highly productive go-to-market engine with a dedicated sales team working with our partners. I fully expect this channel to continue to expand faster through the next 18 months and beyond.

In addition to leadership in the channel, we are rapidly innovating in the most important technologies required for contact centers to be cost-efficient and effective in driving greater revenues and higher customer satisfaction. With the inContact customer interaction cloud, we are leading our industry in five key areas with significant new achievements in each. First, in omni-channel routing, we connect customers to the right agent in every interaction regardless of channel. In our first two releases of the year, we have new capabilities in e-mail, chat, SMS, text and proactive voice channels. We continuously innovate and win awards for inContact MAX, My Agent eXperience, with Personal Connection Outbound and with our integrated Salesforce experience.

Second, our Voice as a Service offering leads the market with the only guaranteed service level agreement for voice quality based on our publicly reported voice quality scores.

Third, we are the only contact center provider with our own complete workforce optimization suite. So customers get both omni-channel routing and WFO, all from one vendor. We are now further unifying the tools within the WFO suite, including ours as well as our partner solutions.

Forth, analytics is critical to companies to achieve their business goals. This summer, we are extending our analytics suite to include Natural Language Processing or NLP. NLP can be used for all types of contact center interactions. Based on our recent acquisition of Attensity, we will one of the first to have NLP as part of a complete contact center solution in the cloud from one provider. Our patented NLP technology will fit vast amounts of unstructured data and automatically uncover trends in customer sentiment, intent to purchase and more. With these capabilities, we are adding more robust tools to improve quality of service and efficiency while reducing cost.

Our fifth component is our enterprise-class open cloud platform with over 250 APIs that fuel innovation with over 70 ecosystem partners for our customers. We continually invest in our global multi-tenant cloud infrastructure with the most up to date security, reliability and scalability, supporting our industry-leading uptime guarantees.

These five areas combine for the most complete solution in the market. Our innovation is a significant differentiator for inContact and it is why we are recognized as the leading cloud provider by industry analysts. Innovation opens up new addressable markets for us, helps us add additional partners and creates even more differentiation from our competitors.

In summary, we've had an excellent quarter with growing revenues, ARR and Adjusted EBITDA. This quarter we added customers of all sizes in all verticals, operating in all global regions through direct sales and our partner channels. Our sales pipeline is very strong as we continue to sign new customers and expand to new divisions and business units with enterprise customers. With our financial strength and available resources, we are driving innovation in the market with our latest two strategic acquisitions with our own R&D and with an aggressive product release schedule. All of this puts us in the driver's seat as the leader in the customer experience industry and gives us great confidence in achieving our financial targets as well as in enhancing our future capabilities.

I will now turn the time over Greg for more Q1 financial details.

Gregory Ayers:

Thank you, Paul. We achieved strong results in the first quarter. Now I will provide more details about the financial performance. The financial results I will discuss are presented on both a GAAP and non-GAAP basis. However, all revenues figures are GAAP. At this point, I would also like to remind everyone of the Safe Harbor statement made at the beginning of the call.

First, let's look at the Software segment, which includes all revenue related to the delivery of our software applications and associated professional services. For Q1 2016, I am happy to report that Software segment revenue increased to $41.5 million, a 28% increase over last year's $32.5 million. Annualized monthly recurring revenues at the end of the first quarter totaled $156.2 million, a 30% increase over the $120.4 million level for ARR one year ago. Both software revenues and the ARR metric reflected more seasonality in the first quarter than in previous years because we had such a seasonally strong Q4. We continue to add retailers and similar consumer-facing businesses because these companies are attracted to the ease of our omni-channel routing and its flexibility in responding to seasonal demand. As we experienced in Q4 of last year, we expect our quarterly revenues to reflect the strong seasonal demand inherent in retailing activity in Q4.

As Paul noted, new contract activity was robust in the first quarter. We added 106 new logos and 54 upsells to existing accounts in the period. We also exited the quarter with the largest pipeline of prospective customers in the Company's history. On a dollar basis, our pipeline is more than 50% larger than at this time a year ago, reflecting significant new additions from both carriers and PBX partners. Our software revenue retention rate, which is measured on a trailing 12 months weighted average dollar basis remained above 93%.

Now I'd like to turn to Software segment gross margins, focusing on non-GAAP results. Non-GAAP results exclude stock-based compensation and the amortization of acquired intangibles. On a non-GAAP basis, software gross margins were 64% compared to 63% in last year's March quarter. The improvement reflects the leverage we are achieving in direct cost of software revenue, in particular customer service.

Our second segment is Network Connectivity, which includes all communication services provided to our customers. Network Connectivity segment revenue for Q1 2016 was $20.8 million, a 10% increase over the $18.9 million in Q1 of last year. Network Connectivity segment revenues generated by customers that also deploy our contact center software solution now represents over 93% of Network Connectivity segment revenues in the quarter, up from 89% a year earlier.

Gross margin for the Network Connectivity segment was 36% compared to 37% in Q1 a year ago. As we noted in our last earnings call, we anticipated gross margins for the Network Connectivity segment in the 36% to 37% range throughout 2016.

Consolidated revenue for Q1 2016 increased to $62.4 million, a 22% increase from last year's $51.3 million. On a non-GAAP basis, consolidated gross margin was 54.2%, up from 53.4% in Q1 a year ago. Total operating expenses were $35.5 million, equal to 56.9% of revenues in Q1 2016, an improvement of 390 basis points from 60.8% of revenues in Q1 of last year.

As Paul discussed, we are intensifying our efforts to improve our operating efficiencies in 2016 and demonstrate greater and more consistent profitability. Sales and marketing expenses rose 18% and were equal to 29% of total revenues compared to 30% of revenues in last year's first quarter. R&D expenses increased 29% over a year earlier levels, equal to 14% of total revenues versus 13% of revenues in Q1 of last year.

During the quarter, we were assimilating the product development teams from our two recent acquisitions, Attensity and AC2.

General and administrative spending declined by 4% compared to the first quarter a year ago. G&A expenses were 14% of total revenues in Q1 2016 compared to 18% in the first quarter of 2015. Shortly after the quarter, end of the quarter, we moved to our new headquarters building.

On a non-GAAP basis, our operating profit for Q1 2016 was $567,000, a substantial improvement compared to the non-GAAP operating loss of $1.4 million in last year's first quarter. Non-GAAP operating margin was 1% in Q1 compared to a negative 2.7% in last year's first quarter.

Adjusted EBITDA, also a non-GAAP measure, was very strong, exceeding $5.7 million in Q1 2016. This was an increase of 117% on a year-over-year basis. We almost achieved the Adjusted EBITDA level of $5.8 million recorded in Q4 of last year, which is our seasonally strongest quarter of the year. The year-over-year marginal Adjusted EBITDA contribution, that is the percentage of incremental revenues that fell to the Adjusted EBITDA line, was 28%. Additionally, our non-GAAP net loss of $174,000 was very close to breakeven.

Included in this quarter's GAAP cash flow statement is a $5.6 million one-time operating source from deferred rent and a one-time investing use of purchases of property and equipment related to the leasehold incentives, which were provide by the landlord of our new corporate headquarters. Even after excluding this one-time benefit, cash flow from operations for the quarter was $10.1 million, which is equivalent to the cash flow from operations for 2015 and 2014 combined.

Also included in purchases of property and equipment is a $2.1 million one-time investment facility made concurrent with our moving to our new corporate headquarters. After deducting these non-recurring items, the normalized investment in property and equipment for the quarter was $1.7 million. At the end of the first quarter, we had $16.3 million in cash and cash equivalents, $70 million in short-term investments and access to $15 million under our line of credit.

Now, let's turn to our updated guidance for 2016. I would like to remind everyone of the Safe Harbor language of the beginning of today's call. Also remind you that this guidance fully incorporates expected revenues and expenses from the two acquisitions completed earlier this year. Based on the strong start to 2016 we've achieved, we now anticipate consolidated revenues to be between $259 million and $265 million. We expect total software revenues to be between $178 million and $184 million, representing a growth rate of between 24% and 28% for the year.

We expect the increasing shift of WFO revenues from perpetual license to a subscription model will have the effect of reducing our software revenue growth by approximately two points in 2016. We expect to achieve operating income of $2 million to $2.5 million on a non-GAAP basis for the full year. We anticipate Adjusted EBITDA to be between $20.5 million and $21.5 million for the year, which would represent a growth rate of 48% to 55%.

For EPS on a GAAP basis, we anticipate a net loss of $0.24 to $0.27 a share in 2016. On a non-GAAP basis—net basis, we expect income of $0.01 to a loss of $0.01 per share for the full year. The EPS amounts are based on an estimated 62.4 million weighted average shares outstanding.

Operator, we are now ready for questions.

Operator:

At this time, if you would like to ask a question, please press the star and one on your touchtone phone. You may withdraw your question at any time by pressing the pound key. Once again, to ask a question, please star and one on your touchtone phone. We will just pause for a moment to allow questions to enter the queue.

We will take our first question from John DiFucci from Jefferies. Please go ahead.

John Difucci:

Thank you. Paul, sort of a high level question, you put up strong results again here, you have got industry analysts recognition pretty much across the board of your product offering and we all certainly appreciate your desire to move to sustained profitability and you are really close to that too. But I am also curious how you balance that with the opportunity because it really looks like we've sort of seen an infection point in this market, it looks like we are past that, and when you couple that with the increased recognition that you've gotten—inContact has gotten within that opportunity, you can't help but sort of wonder and I know the market is not looking for people to invest a lot more right now, but it almost pegs the question, should you actually invest more or perhaps may be redistribute your investment to distribution and to capture as much of that opportunity right now because it looks like that opportunity is sort of accelerating.

Paul Jarman:

John, a great question and that's something we work with seemingly a weekly basis is to measure those. We have three goals, one is growth, two is achieving financial leverage and three is market leadership and in a way they all work together, and you've seen us add additional partners. You've seen us add some width in—through acquisitions for market leadership because that helps in that process. So I would just tell you this, is that we'll remain flexible to take advantage of the opportunity as we can responsibly do so with the cash and the revenues that we have, and so as we see opportunities, we'll take them. But we will also be very cognizant of the fact that we need to create leverage and we want to keep having the market leadership position. So I think the answer to that is we'll take it a day at a time, as we see the opportunities, we won't miss them.

John Difucci:

Okay, fair enough, Paul. I appreciate the word responsibly go after that and if I might just follow-up because I think that Attensity acquisition is really interesting and it gives you sort of the ability to mine voice data. It sounds like there is significant incremental value in that and I just wanted to just make sure I understood, is it something that is live now or will it take time to integrate it into your platform, and was the acquisition something that you saw would be a good idea or was it something really driven by customer demand?

Paul Jarman:

So actually both, so let me start. The product is live today. We will be launching in the middle of the summer the current product integrated inside of inContact. So we have a working natural language processing engine now and it's a wonderful product. We are incorporating that right now into our different user interfaces and different contact center engines that we have in our products. So we will be launching about mid-summer a combined solution that takes advantage of that analytics engine and also how it interfaces with our different solutions and different interfaces.

Secondly, both, we have customers that would love to have a better analytical approach. In essence, in the contact center, we really are the place where all of the unstructured data comes into a Company because you get all the e-mail, the chat, the travel tickets, the voice calls, all of that valuable data, they can't sort or understand without an analytics engine and because all of those words and voice conversations come through our products, we're the natural place for that to be analyzed and to be given the insight back to the company. So we see this as an opportunity and we've also been asked by our customers to somehow make that easier than what's currently in the market today.

John Difucci:

Okay, great. Thanks, Paul. Nice job guys.

Paul Jarman:

Yeah, great, thank you.

Operator:

We'll take our next question from Brian Schwartz from Oppenheimer. Please go ahead.

Brian Schwartz:

Yes, hi, thanks for taking my question this afternoon. Paul, you highlighted in your earnings commentary here about the very strong deal activity. I think Greg highlighted it too in his comments. So, just wondering if we could dive in a little deeper into that deal activity in the quarter; was there a particular strength in any one of your core verticals that you noticed or a specific product that's driving this good new demand for the business or is there anything else that you can call out there?

Paul Jarman:

I would say this. I'd say, first of all, some of these leadership accolades we've been getting has helped because people find us more easily than they might have in the past. I'd say secondly, I wouldn't say there is a tremendous change or vertical has been harder than the other. We have seen success really across the different verticals, but what I will say is helping us is that our current channels, which I would call a referral channel, our direct channel, and our carrier channel is getting help now with new channels such as the PBXs and the VARs and as those start to augment our current channels, that's helping us drive up those new logos and deal count.

Brian Schwartz:

Thank you and then a follow-up question that I had, again on the business activity here in the quarter, just a linearity that you guys saw here in Q1; typically Q1 is seasonally worst here for software sales in the industry, yet your deal activity was remarkably strong right here and you're raising your guidance. So, I am just wondering if there was anything that you guys saw in terms of the cadence of the deal activity or maybe anything else that you're tracking internally in terms of the long-term indicators for the business, maybe seat sizes or multi-product opportunities that really allowed you to deliver what I would say is a very unseasonably strong first quarter for (inaudible)?

Paul Jarman:

You bet, so, first of all, Brian, I would say this is that when you look at the first quarter for us, as I said before, first of all, adding channels has been really helpful. Typically first quarter is a lower channel for us, but we obviously did very well in it from a bookings perspective, and I would just say that from the industry to the additional products to having a lot of great references, all those things are just adding up for us. One thing that we're also excited about is with some of these new products, later through the year, we're going to be able to add additional products to our existing customers that we wouldn't have easily been able to do on the past, which will help us to rise our actual dollars per seat or per agent in our model. So we also, as we look in the second quarter, you heard Greg say that our pipeline growth year-over-year was about 50%. So, it wasn't like for us, it was just one quarter where we had great deal count, we actually see a nice pipeline going into second.

Brian Schwartz:

Last question for me, just one for Greg, may be you can just help me with the explanation. I think you were alluding to this in your introductory comments, just the sequential growth in the ARR; it actually had a decline here from Q4. We're not usually used to seeing something like that and just curious, my guess is that's more of the smaller servicers and maintenance piece in that number and just anything that you could help us in terms of the sequential move in the ARR. Thanks for taking my questions today.

Gregory Ayers:

Sure. So, I would say this, Brian. We have never experienced a level of positive seasonal usage that we did experience in Q4 of last year. So as you can imagine, as the Q4 grew beyond what was normally expected relative to our historical trends, we experienced a decrease in Q1 that we had not normally decreased to—experienced to that magnitude. So, again, it's really a function of the heavy seasonal usage around the holidays and insurance carriers with regard to open enrollment etc. So it's just a higher level of seasonal activity going up in Q4 that naturally comes back down in Q1.

Paul Jarman:

I would just add to that, Brian, and also a good news to that is that with some of those retailers and others, that should really help us in the next Q4 because we'll some of that similar seasonal behavior.

Operator:

We'll take our next question from Jeff Van Rhee from Craig-Hallum. Please go head.

Jeff Van Rhee:

Great, a couple of them here, sir. So, thanks for the snapshot in terms of the pipeline growth of 50%. Just wondering if you have a comparison when you look at last quarter, I mean obviously we're focused on MRR, the recurring side, ARR going forward, but given the 50 this quarter, do you have any benchmark what that looked like last quarter when you're looking at the pipe?

Paul Jarman:

Yes, go head, Greg.

Gregory Ayers:

Yes, so, I'd say that coming into Q1, it was around 20%. So we've significantly upped the amount of qualified seats coming into Q2.

Jeff Van Rhee:

Okay, all right, that's great and then the two, I wonder if you might spend a minute on the two big Fortune 500 customers and just expand a bit more on the initial size and scope of the opportunities, but clearly there is a lot of landscape inside of each of those and your visibility to much larger things, what you have to displace to get there if there are certain promises, expectations already in place, any color there?

Paul Jarman:

Yes, in both of these opportunities, the first one came, as I mentioned, through a carrier and so, we'll work with that carrier obviously to win different divisions and other pieces and that one is around 200 plus seats. The other one we brought in from our direct sales team starts at about 175, it's four locations, one division and as usual, when we get into these really kind of Fortune 100 type accounts, you win your first piece, you help them see the benefit and the ROI of the product, and then you start going division by division across the different pieces. So, I think that in both of these, they've got a decent start and they have a lot of room to grow over the next year and two years.

Jeff Van Rhee:

Great and then just back to high level, if I could, the overall growth, obviously as you get larger numbers takes place here and you certainly have a pretty good pipe here, so far (inaudible) suggests your sort of growth rate rolls over. I mean how sustainable—how do you think about next three years, currently speaking, what would be a real success in terms of a CAGR for software growth on a high end or low end, however specific you are willing to be?

Paul Jarman:

Yes, Jeff, we haven't really created guidance for a multi-year, but I would just say this, we've continuously spent around 28% to 30% in sales and marketing as a percent and we'd like to believe that we can continue to grow at that kind of growth rate or better and we plan on spending that much to help achieve that. Then I would just say, obviously the market penetration is less than 10%. So there is a lot of market to penetrate and the other thing we see is, I look at this quarter and of the 106 new logos, we were only fighting our primary cloud competitors may be 35% of the time, and so there is just a lot of market out there that we can get ourselves, we can get into.

Jeff Van Rhee:

Great, okay and last one for me then just briefly, in terms of win rates, any commentary on overall win rates changes or changes in win rates versus particular players in the quarter, anything of note?

Paul Jarman:

No real changes, probably the biggest thing we saw was that we didn't fight them that often. As I said, about 30% of all the new logos that we hit one, but I would say consistent with previous quarters.

Jeff Van Rhee:

Okay, great. Leverage looks great. Real nice quarter, guys, thanks.

Paul Jarman:

Yes, thank you.

Operator:

We'll take our next question from Mike Latimore from Northland Capital. Please go ahead.

Mike Latimore:

Hi, thanks, yes, yes, a great quarter there. So I guess, Paul, you touched on sort of seasonal patterns around first quarters and fourth. What's your kind of general view on second and third quarters as it relates to ARR season only?

Paul Jarman:

So, first of all, fourth quarter could be as high as 28% to 30% of our revenue for the year. So it's going to be a couple percentage points above the others. Typically, seasonally our slowest quarter is second and then it picks up in third and it's quite high in fourth. So kind of similar to what we've seen in previous years, Mike. Other than just we had a really high quarter in fourth, so it lowered that down in first and then it will stay lower in second and start moving back up towards the end of the year.

Mike Latimore:

Got it and then how much is deal size, any sort of a general color on the average deal size in this first quarter versus last year's first quarter?

Paul Jarman:

I don't have that right in front of me, Mike, but I would just say I would say deal size was probably a little smaller because in some of the bigger deals we have that first P share (phon) and not the entire account, but as you look at what those deals can turn into, they're quite sizable.

Mike Latimore:

Yes, that make sense, and then any sort of ACV number of your cloud phone system channel, either for the quarter or the last 12 months in terms of bookings?

Paul Jarman:

We haven't given them out as far as ACV by channel. We did give you, though, it was about 25 new logos and we did mention for the PBX channel, we saw deals that were as big as 175 seats.

Mike Latimore:

Okay, got it and then I think this was first time when you've been sort of maybe positive on the VAR channel, maybe I am wrong there, but, I mean, any color I guess one, if that's true, there is a picking up the VAR channel and then kind of what are you seeing in that channel?

Paul Jarman:

So we felt like we had a nice first quarter with VARs and it's been a multi-year process because VARs have just turned into the cloud frankly, but I do like the relationships we have and I think that they're starting to having to adapt to the market more because frankly, more deals are going to the cloud and they need a product to sell instead of what they might have sold in the past. So I actually think the VARs will contribute nicely in '16 for us as it relates to bookings.

Mike Latimore:

Thanks a lot.

Operator:

We'll take our next question from Mark Schappel from Benchmark. Please go ahead.

Mark Schappel:

Hi, good evening and nice job in the quarter, guys. Greg, just starting off you with you, the comparative win rate, I assume it tracked with historical norms.

Gregory Ayers:

That's correct.

Mark Schappel:

Okay, great, thanks, and then, Paul, on past earnings calls, you've talked about sort of vertical industries like financial services or healthcare that were initially reluctant to embrace the cloud, but we are starting to move in your direction. I was wondering if you can maybe just give a little bit of update on what you saw this quarter along those lines.

Paul Jarman:

Well, Mark, we're certainly seeing that more and more of the more sensitive channels are more willing to move to the cloud. So we've seen some nice wins in retail, in finance, in healthcare and those would typically be the more careful ones in the past. So you've also seen us put good work into how we manage our security, how we manage our reliability and as we talked about in the previous quarter, all the work around fed ramp and additional certifications that give these larger companies and those verticals more comfort in our security, reliability and scalability. So, I'd say just each, each, each every six months or each year, it seems to get easier and easier to show them that we can do what they need and they are more willing to take the products to the cloud. So, I would feel that just like I said, every six months, it seem just to get easier based on the additional competency that we provide and their additional emotion that the cloud is where they can go.

Mark Schappel:

Great and then one final question here, Paul, you've made a couple of small acquisitions of late and you expressed the willingness to do more. Just wondering if you could just give us an idea about some of the areas you might be interested in moving into?

Paul Jarman:

Well, first thing I would say is this that we're very prudent in that area and so we're not out trying to buy the world and we partnered with the CRMs, we partnered with the PBXs. So those aren't spaces that we're looking at all to be a part of. It's mostly where we find small technology companies that have great products, limited distribution and really one plus one can be three as far as what those products can do within our channels to give us competitive advantage and additional revenue per seat and additional basically differentiation, and so we look at that—we are busy with the two we just have done and we'll focus on those primarily right now.

Mark Schappel:

Thank you.

Operator:

We'll take our final question from Jonathan Kees from WR Hambrecht/Summit Research. Please go ahead.

Jonathan Kees:

Great, thanks a lot for taking my questions and I'll add to the kudos regarding the strength of the quarter. I wanted to ask you, you talked about that you only saw your product peers in about 30% of the new logos. How would you characterize pricing then? Was it not as bad, was it just in relative to the expectations, relative to historical norms?

Paul Jarman:

I don't think pricing changed between fourth and first really. I think basically you have basically three types of contact centers. You have the SMB, which is kind of 0 to 50 seats. You've got the mid, which is 50 to about a 150, then you have the enterprise, which is that kind of 150-plus, and as I look at those three areas quarter-over-quarter, we did not see a significant change in pricing.

Jonathan Kees:

So, if you only encountered your cloud peers for about 30% of the new logos, that was—for that you encountered the premise peers for the remainder. It's interesting that you talked about your new channel, the PBX, a lot of them have a cloud—excuse me, a contact center solution, most likely premise based. How is that working out in terms of your dynamics with them? Are they working with you in terms of targeting new customers and more small location, more like branch offices to current or are you actually working with them in terms of their embedded base and adding cloud to their current base of customers?

Paul Jarman:

No, first of all remember one additional thing from the last question, about 50% of our deals come through partners and about 50% come through our direct sales teams. So when we sell through a partner, it's really the same rate each time and then they sell into the market, so just on that first. Secondly, as you look at the next question, we've got different partners that cover different parts of the market. Traditionally, the carrier partners are going to be more enterprise-focused and more state, local, federal-focused. You look at the PBX partners, they're going to be more focused in the mid-market or SMB. As you look at the VARs, they're going to be mid to upper mid and sometimes enterprise and then our referral partners can bring in all the way from small, mid to enterprise. So, we see different partners bringing us different parts of the business and one thing we like about our partner model is this that we can cover the different areas that we can easily cover with the direct sales force with these partners.

Jonathan Kees:

Okay, great. That's provided some color there. So appreciate it. Thanks, good luck.

Paul Jarman:

Yes, thank you.

Operator:

There are no further questions. At this time, I'd like to turn the call back over to the speakers for any closing comments.

Paul Jarman:

Yes, we would just like to thank everyone on the call today. We are excited about our opportunity in the market and our opportunity to achieve each of those three goals I've talked about: growth, financial leverage and leadership and thank you for your time today.

Operator:

This does conclude your teleconference for today. Thank you for your participation. You may disconnect at any time.